# Bahir Dar University Journal of Law
# የባሕር ዳር ዩኒቨርሲቲ የሕግ መጽሔት

**ISSN (e): 2709-5827 ISSN (P): 2306-224X**

| ቅጽ ፲፫ ቁጥር ፩ | ታህሳስ ፳፻፲፩ |
|---|---|
| **Vol. 13 No. 1** | **December 2022** |


**In This Issue** **በዚህ ዕትም**

Articles ጥናታዊ ጽሁፎች

A Biannual Law Journal published by Bahir Dar University, School of Law
Established in 2010
*በባሕር ዳር ዩኒቨርሲቲ ሕግ ትምህርት በዓመት ሁለት ጊዜ የሚታተም የሕግ መጽሔት*
*በ፳፻፪ ዓ.ም. ተመሠረተ*

## MESSAGE FROM THE EDITORIAL BOARD

The Editorial Board is delighted to bring Vol. 13. No. 1 of Bahir Dar University Journal of Law. Bahir Dar University Journal of Law is meant to serve as a forum for the scholarly analysis of Ethiopian law and contemporary legal issues. It is dedicated to engender a culture of knowledge creation, acquisition and dissemination in the field of law and in the justice system of our country in general.

The Editorial Board appeals to all members of the legal profession, both in academia and practitioners, to contribute scholarly manuscripts. It is commendable to conduct a close scrutiny of the legal and institutional reforms that are still underway across the country. The Editorial Board extends its gratitude to manuscript contributors, reviewers, and others who participated in different capacities.

# Bahir Dar University Journal of Law
## የባሕር ዳር ዩኒቨርሲቲ የሕግ መጽሔት


| ቅጽ ፲፫ ቁጥር ፩ | | ታህሳስ ፳፻፲፫ |
|---|---|---|
| Vol.13 No. 1 | | December 2022 |

## List of External and Internal Reviewers in this Issue

- Alekaw Dargie (BA, LL.B, LL.M), Assistant Professor of Law, Haramaya University, College of Law)
- Alemu Balcha (LL. B, LL.M), Assistant professor of Law, Madda Walabu University
- Aschalew Ashagrie (LLB, LLM, PhD), Assistant Professor of Law, Addis Ababa University.
- Behailu Eshetu ( LL.B, LL.M) Lecturer of Law, School of Law, Hawassa University
- Beki Haile, LL.B, LL.M, Lecturer of Law, School of Law, Jimma University
- Belete Addis (LL.B, LL.M), Lecturer of Law, School of Law, University of Gondar
- Brightman G/Michael (LLB, LLM, PhD) Assistant Professor of Law, Bahir Dar University
- Delil Workicho (LL.B, LL.M), Lecturer of Law, , Haramaya University, College of Law
- Eyader Teshome (LL.B, LL.M), Lecturer of Law, Dire Dawa University, College of Law.
- Misganaw Gashaw (LL. B, LL.M), Assistant Professor of Law, Bahir Dar University
- Muhammed Dawud (LL. B, LL.M), Assistant Professor of Law, Bahir Dar University
- Natae Ebba (LL.B, LL.M) Tax & Corporate Lawyer at Mehrteab & Getu Advocates LLP.
- Serkalem Eshetie (LL.B, LL.M), Public Prosecutor, Ethiopian Ministry of Justice
- Temesgen Sisay (LL.B, LL.M), Assistant Professor of Law, Bahir Dar University
- Tihitina Ayalew (LLB, LLM, LLM, PhD), Assistant Professor, School of Law, Ethiopian Civil Service University).
- Yibekal Tadesse (LL. B, LL.M), Assistant Professor of Law, School of Law, Bahir Dar University
- Zemere Yeshitila (LLB, LLM, Lecturer of Law, School of Law, Dire Dawa University)

**Law School Academic Full Time Staff**

| | |
|---|---|
| Abraham Mamo | LLB (Asst. Lecturer) |
| Adam Denekew | LLB, LLM (Lecturer) |
| Alebachew Birhanu | LLB, LLM (Assoc. Professor) |
| Addisu Genet | LLB, LLM (Lecturer) |
| Asirar Adem | LLB, LLM (Lecturer) |
| Asnakech Getnet | LLB, LLM, PhD Candidate |
| Essubalew Molla | LLB (Asst. Lecturer) |
| Belayneh Admassu | LLB, LLM (Assoc. Professor) |
| Mamenie Endale | LLB, LLM (Asst. Professor) |
| | |
| Dessalegn Tigabu | LLB, LLM (Lecturer) |
| Eden Fiseha | LLB, LLM (Asst. Professor) |
| Enterkristos Mesetet | LLB, LLM (Lecturer) |
| Fikreabinet Fekadu | LLB, LLM (Asst. Professor) |
| Gizachew Silesh | LLB, LLM (Asst. Professor) |
| Gojjam Abebe | LLB, LLM (Lecturer) |
| Yenew Bitew | LLB, LLM (Lecturer) |
| Tewachew Molla | LLB, LLM (Lecturer) |
| | |
| Mekashaw Chanie | LLB (Asst. Lecturer) |
| Jhon Kebere | LLB (Asst. Lecturer) |
| Tigist Derib | LLB (Asst. Lecturer) |
| Gelila Eyob | LLB (Asst. Lecturer) |
| Mihret Alemayehu | LLB, LLM (Asst. Professor) |
| Mohammode Doude | LLB, LLM (Asst. Professor) |
| Mulugeta Akalu | LLB, LLM (Asst. Professor) |
| Tajebe Getaneh | LLB, LLM (Lecturer) |
| Tegegne Zergaw | LLB, LLM (Asst. Professor) |
| Temesgen Sisay | LLB, LLM (Asst. Professor) |
| Tessema Simachew | PhD (Asst. Professor) |
| Worku Yazie | LLB, LLM (Asst. Professor) |
| Yihun Zeleke | LLB, LLM (Asst. Professor) |
| Zewdu Mengesha | LLB, LLM (Asst. Professor) |
| Tikikil Kumlachew | LLB, LLM (Lecturer) |

**Law School Academic Staff on Study Leave**

| | |
|---|---|
| Addisu Gulilat | LLB, LLM (Lecturer) |
| Endryas Getachew | LLB (Assistant Lecturer) |
| Gedion Ali | LLB, LLM (Lecturer) |
| Misganaw Gashaw | LLB, LLM (Asst. Professor) |
| Nega Ewunetie | LLB, LLM (Assoc. Professor) |
| Tefera Degu | LLB, LLM (Lecturer) |
| Yohannes Enyew | LLB, LLM (Lecturer) |
| Tilahun Yazie | LLB, LLM, PhD Candidate (Lecturer) |
| Belay Worku | LLB, LLM, PhD Candidate (Lecturer) |
| Solomon Shumetu | LLB (Asst. Lecturer) |
| Yabisra Alemeneh | LLB (Asst. Lecturer) |
| Yibekal Tadesse | LLB, LLM (Asst. Professor) |

**Part-time Staff**

| | |
|---|---|
| Biniyam Yohannes | LLB, LLM (ANRS Supreme Court Judge) |
| Geremew G/Tsadik | LLB, LLM (ANRS General Attorney) |
| Tsegaye Workayehu | LLB, LLM (ANRS Supreme Court Judge) |

# Bahir Dar University Journal of Law
## የባሕር ዳር ዩኒቨርሲቲ የሕግ መጽሔት


| | | |
|---|---|---|
| ቅጽ ፲፫ ቁጥር ፩ | | ታህሳስ ፳፻፲፫ |
| Vol. 13 No. 1 | | Decembr 2022 |


***Contents***

***Articles***

**Address**

Bahir Dar University Journal of Law
School of Law, Bahir Dar University
P. O. Box- 5001
Tel- +251588209851
E-mail- bdujol@yahoo.com
Bahir Dar, Ethiopia

Websites:
https://journals.bdu.edu.et/index.php/bdujl
http://ejol.ethernet.edu.et/index.php/BDUJOL

# The 2016-Income Tax Reforms of Ethiopia: Drivers, Major Legislative Changes, and Constraints[⇓]

**Belete Addis,[∂] Misganaw Gashaw[ϒ], Mulugeta Akalu[Ψ] & Zerihun Asegid[θ]**

## Abstract

*This article investigated Ethiopia's 2016 income tax reform in terms of its drivers, actors involved in the process, major legislative changes and constraints that may impede its intended goals. It employed a qualitative research methodology, by which it gathered relevant data from key informant interviews, and document review. Legal analysis and description of issues are used as methods of analysis and discussion of the findings. The article identified the drivers of the reforms as addressing changes in the economy, enhancing revenue mobilization, improving efficiency and equity, and addressing gaps in previous income tax legislations. In the reform process, the Ministry of Finance had the upper hand position, though; practically the International Monetary Fund had a significant stump in the course of the process. However, the participation of other key national actors, including the*

[⇓]This article is the result of a research-project funded by USAID's Feteh (Justice) Activity in Ethiopia. However, the content and opinions expressed in the article are the views of the authors, and not necessarily the views of USAID.

[∂] LL.B, LL.M, Lecturer of Law, School of Law, University of Gondar. The author can be

[∂] LL.B, LL.M, Lecturer of Law, School of Law, University of Gondar. The author can be reached via: beleadd82@gmail.com.

[ϒ] LL.B, LL.M, PhD Candidate, Assistant Professor of Law, School of Law, Bahir Dar University. The author can be reached via: misgepower@gmail.com

[Ψ] LL.B, LL.M, Assistant Professor of Law, School of Law, Bahir Dar University. The author can be reached via: mulugeta.akalu@yahoo.com.

[θ]LL.B, LL.M, Lecturer of Law, School of Law, Debre Berhan University. The author can be reached via: zerihun78@gmail.com.

.

*Ministry of Revenues and the Ethiopian Chamber of Commerce was minimal. The reform has introduced major legislative changes, including the introduction of Schedule 'E' and new tax bases; taxation of residual income; and consolidation of tax administration laws. The article also discussed constraints that may impede the goals of the reforms, including the absence of impact assessment of the 2016 reforms; inflation; poor tax administration; lack of meaningful stakeholder participation; and low tax-to-GDP ratio. Finally, suggestions are made for undertaking impact assessment of the 2016 income tax reforms; redesigning the income tax system to be responsive to inflation; modernizing the tax administration; and enhancing meaningful stakeholders' participation.*

**Keywords:** *Income tax; reforms; legislative changes; tax administration; MoF; IMF.*

## Introduction

Tax reform, as the name suggests, is the process of changing the tax system of a nation including the way taxes are levied, collected and managed in a defined jurisdiction.[1] The reform may be manifested through a redefinition of taxable units, or revision of tax rates, tax bases, and assessment or collection methods.[2] The most important policy objectives of tax reforms are to boost government revenue, restore efficiency, maintain fairness, improve compliance and simplify the tax system.[3] The need to modernize the tax administration is also another reason for taking the reforms.[4] Nevertheless,

[1] Sumedh Rao, *Tax Reform: Topic Guide*, University of Birmingham, (2014), p. 6.
[2] *Id*.
[3] Organization for Economic Cooperation and Development (OECD), *Fundamental Reform of Personal Income Tax*, OECD Policy Studies, (2006), p. 31.
[4] Wilson E. Herbert et al., Tax Reforms and Nigeria's Economic Stability, *International Journal of Applied Economics, Finance and Accounting*, Vol. 3: No. 2, (2018), p. 75.

achieving these objectives has never been easy because of the trade-off among two or more of these objectives. For instance, the trade-off between efficiency and equity has been the prevailing challenge facing tax policy makers every time they consider reforming the tax system.[5]

In relation to tax reforms, the influence of international financial institutions such as the International Monetary Fund (IMF) and the World Bank (WB) cannot also be underestimated. For instance, most African countries undergone in sweeping tax reforms in the 1980s due to the Structural Adjustment Programs introduced, mainly by the IMF and the WB.[6] The objectives that were set by these countries with the recommendation of IMF were improving the tax-to GDP ratio and economic efficiency; broadening the tax base; enhancing equity of the tax system; encouraging self-assessment; boosting administrative efficiency; and encouraging saving and investment.[7] Unlike most African countries, Ethiopia was not part of this trend. This was attributable to the tense relation the country had with the west due to its anti-capitalist ideology that it was following during that time.

In fact, the landmark tax reform of Ethiopia took place from 1942-1944, five decades prior to the African sweeping tax reforms of the 1980s. The pre-1941 era was mainly characterized by traditional system of taxation although a few modern taxes had already begun to be introduced a little bit earlier.[8] The

[5] Jorge Martinez-Vazquez, *Successful Tax Reforms in the Recent International Experience: Lessons in Political Economy and the Nuts and Bolts of Increasing Country Tax Revenue Effort*, Revised in 2022, Asian Development Bank (ADB), (2022), p. 26.

[6] Odd-Helge Fjeldstad and Lise Rakner, Taxation and Tax Reforms in Developing Countries: Illustrations from Sub-Saharan Africa, Chr. Michelson Institute, (2003), p.1.

[7] Jean K. Thisen, Tax Reforms in Selected African Countries, Economic Commission for Africa, 2003.

[8] Taddese Lencho, Towards Legislative History of Modern Taxes in Ethiopia (1941-2008), Journal of Ethiopian Law, Vol. 25, No. 2, 2012, P. 104-108.

introduction of "excise and consumption" taxes in 1931, the "entertainment tax" in 1932 and the income tax in 1934 were some examples.[9] However, it was only after 1942 that extensive introduction of various tax laws were observed.[10] The 1942 tax reform was transformative for it introduced a cash-based payment system replacing the in-kind system and published tax laws avoiding arbitrary tax impositions.[11] The major taxes introduced during this time include land tax, income tax, excise tax, wholesaler's sales tax, customs duties, education tax and health tax. After the comprehensive reform of 1941-44, fragmented reforms were common until the *Dergue* regime took power following the 1974 Revolution. The Revolution had a big impact on the country's income tax regime, including the removal of tax on income from agricultural activities and rental of lands and buildings from the income tax schedules.[12]

However, it was in 2002 that Ethiopia undertook the most sweeping tax reforms which were part of a larger liberalization policy of the Ethiopian People's Revolutionary Democratic Front (EPRDF) - led government.[13] The reform was comprehensive not only because it completely changed the existing income tax, and excise tax and somehow customs duties; but it also introduced new taxes such as the value-added tax and turnover tax.[14]

Despite bringing a lot of improvements, the 2002 income tax reform could not be free of limitations. Some of the shortcomings were the fragmentation

[9] *Id*.
[10] *Id*.
[11] *Id*.
[12] *Id.*, p. 120.
[13] Alemayehu Geda and Abebe Shimeles., Taxes and Tax Reform in Ethiopia; 1990-2003, Research Paper, UNU-WIDER, United Nations University (UNU), (2005).
[14] Misganaw Gasahw, Ethiopian Tax System, in Misganaw Gasahw (ed.), Ethiopian Tax Law: A Text Book, Ethiopian Law School's Association (ELSA), Addis Ababa, June 2022

of the tax rules; complexity of the tax laws; prevalence of delegation rules; absence of adequate administrative rules, including assessment rules and valuation rules for fringe benefits; narrow tax base; etc.[15] In addition to these gaps, there appears to be a growing need to make the tax provisions conform to the changing circumstances such as the need to conform tax brackets to the increasing inflation, and socio-economic needs of the country.[16] As the economy grew up, the old rules also could not enable to collect sufficient revenue. Moreover, there was a need to improve the tax administration towards making it more efficient and effective.[17] Derived by such factors, the government undertaken income tax and tax administration reforms in 2016.

Though six years have passed since the 2016 reforms, no study has made an examination of this reform. While the real impact is yet to be empirically studied, this research aims to play its part by investigating the drivers, process and actors of the reforms; major legislative changes it introduced; and some of the notable constraints that may impede its intended goals.[18] To this end, the research employed a qualitative research methodology, by which it used key informant interviews (KII), and document review as data collection tools.

[15] Taddese Lencho, The Ethiopian Tax System: Excesses and Gaps, *Michigan State Journal of International Law*, Issue: 20, No. 2, (2012), pp. 365-369.

[16] *ገቢ ለልማት መጽሄት፣ ስለተሻሻሉት የገቢ ግብር እና ታክስ አስተዳደር አዋጆች፣ ልዩ እትም፣መስከረም 2009 ዓ.ም።*

[17] *Id*.

[18] Though, Ethiopia's current form of government grants both the federal and regional governments with their own power of income taxation, practically, the federal government takes the lead in initiating and enforcing income tax reforms. The regional governments usually play a passive role as they simply adopt the reforms enforced by the federal government, and copy paste and rename the federal tax laws as regional laws to exercise their taxing powers. As a result, the regional income tax laws are almost similar, in content and form, to federal income tax laws. Thus, to avoid redundancy in discussing the 2016 income tax reforms, this paper limits its discussion to the federal income tax reforms and legislations. However, its discussions and findings are relevant to understand the contexts of regional income tax laws too.

Accordingly, KIIs were held with top officials of the Ministry of Finance (MoF), Ministry of Revenues (MoR), Ministry of Mines, and the Ethiopian Chamber of Commerce and Sectoral Association, and selected tax officers at the MoR. The relevant existing bodies of literature on income tax reforms in Ethiopia and income tax legislations were also reviewed to analyze the core issues of the research. Finally, the research used legal analysis and description of issues as method of analysis and presentation of findings.

The article discusses the findings of the research in five sections. The first section is dedicated to make a general overview of the income tax reform of Ethiopia in historical contexts of pre-2016 trends. Section two discussed the drivers that pushed the government to undertake the 2016 income tax reforms, together with hinting the goals intended to be achieved through the reforms. As a follow-up, section three discussed the process and major actors involved in the initiation and design of the reforms. Section four discussed the major legislative changes resulted from the 2016 income tax reforms. Section five is dedicated to point out and discuss some of the notable constraints against the realization of the intended goals of the reforms. Finally, the article winds up with concluding remarks.

## 1. Income Tax Reforms in Ethiopia: An Overview

Tax collection is rooted in the long history of Ethiopia though land and its production value had long been the primary focus and taxes were dealt with in traditional forms. With the introduction of new economic plan and increasing revenue needs in the post-liberation period, Ethiopia introduced modern tax system that transform the tax system into cash-based payment system and published tax laws avoiding arbitrary tax impositions.[19] The country enacted its first modern income tax law in 1944 through the Personal and Business

[19] Taddese, *supra* note 8, p. 104-108.

Income Tax Proclamation No. 60/1944.[20] This law has a distinctive place in the history of income tax system for it established a schedular system, which has remained as the basic structure of income taxation to this day.[21] The Proclamation defined income as 'every income earned or unearned, accruing from or received' and came up with three Schedules: Schedule 'A' for taxing personal incomes derived from employment and other sources in non-business context, while Schedules 'B' and 'C' for business incomes on the basis of fixed and presumptive taxes.

The 1944 income tax law was replaced by Proclamation No. 107/1949 which defined income more broadly as 'every sort of income earned or unearned, whether in the form of gains, profits or rents, salaries, wages or compensation for personal services of whatever kind'.[22] This Proclamation was again replaced by the Income Tax Decree of 1956, which kept Schedule 'A' unchanged, but narrowed down the scope of Schedule 'B' to the taxation of income derived from 'rent of lands and buildings used other than for agricultural produce, cattle breeding purposes.[23] It also brought the taxation of businesses to Schedule 'C' and classified the taxpayers into two groups: business and small business. [24]

The 1956 income tax decree was replaced in 1961 by Income Tax Proclamation No. 173/1961.[25] Some consider this legislation as a better known income tax law in modern income tax history of Ethiopia as it

[20] Personal and Business Income Tax Proclamation No. 60/1944, *Negarit Gazeta*, (1944).
[21] Taddese, *supra* note 8, p. 115.
[22] Proclamation to Provide for the Payment of Tax by All Individuals and Businesses No. 107/ 1949, *Negarit Gazeta*, (1949).
[23]Income Tax Decree No. 19/1956, *Negarit Gazeta*, (1956).
[24] *Id.*, Arts. 40, 41, 43, 44, and 69.
[25] Income Tax Proclamation No. 173/1961, *Negarit Gazeta*, (1961).

remained in force, fully or partly, for more than 40 years (i.e. until 2002).[26] In 1962, a regulation was issued to supplement this proclamation, and the regulation among other things classified business income taxpayers into Category 'A', 'B' and 'C', for the first time.[27] Moreover, the Proclamation underwent many amendments, which also contributed to its long survival.[28] One of these was the Income Tax Proclamation No 255/1967,[29] which introduced Schedule 'D' to bring agricultural income into the main income tax system for the first time.[30] In the late 1970s, Schedule 'D' has been used to levy tax on different incomes, other than agricultural income, such as royalty, income from technical services, income from games of chance winnings, and dividend.[31]

Following the 1974 Revolution, which overthrown Emperor Haile Selassie's government, the *Dergue* regime assumed power. The latter nationalized all means of production (including land, housing, farms and industry) adopting Socialism as its ideology. The *Dergue*, although introduced no new legal framework or income tax structure, changed two of the income tax Schedules of the 1961 Income Tax Proclamation. Accordingly, Schedule 'B' (income from rental of lands and buildings) and Schedule 'D' (tax on income from agricultural activities) were removed and the rates for Schedules 'A' and 'C' were changed.[32] In addition, taxes on agricultural income and rural land were

[26] Taddese, *supra* note 8, P. 119.
[27] Income Tax Legal Notice No. 258/1962, *Negarit Gazeta*, (1962).
[28] Taddese, *supra* note 8, P. 119.
[29] Income Tax Proclamation No. 255/1967, *Negarit Gazeta*, (1967).
[30] Taddese, *supra* note 8, P. 119.
[31] *Id.*, P. 121.
[32] *Id.*, P. 120-121.

replaced with a rural land-use fee and a new tax on income from agricultural activities was enacted in 1976.[33]

The piecemeal revision of the 1961 income tax law had continued in the 1990s even after EPRDF assumed power and made shifts of economic policy. We can mention the Income Tax (Amendment) Proclamation No. 62/ 1993,[34] and Income Tax Amendment Proclamation No. 107/1994. [35] The most notable developments of the 1990s in the area of income taxation were the reintroduction of 'income taxes on rental of buildings' and the reduction of tax rates both for individuals and companies as part of encouraging the private sector.[36]

The repetitive piecemeal revision of the 1961 income tax laws (from 1960s to late 1990s) has resulted in complex system of rate structures and income brackets.[37] This became one of the major reasons why the Ethiopian Government undertook what might justifiably be called 'comprehensive' income tax reforms culminating with the passing of income tax laws in 2002.[38] The Income Tax Proclamation No. 286/2002 put an end to the incremental approach to revision of income tax laws and repealed all previous income tax laws in force up to that time, except the autonomous income tax regimes in the agriculture, mining and petroleum operation sector.[39] This Proclamation brought many fundamental changes to the then income tax system, including bringing the scattered pieces of income tax legislations in a

[33] Rural Land Use Fee and Agricultural Activities Income Tax Proclamation No. 77/ 1976, *Negarit Gazeta*, (1976).
[34] Income Tax (Amendment) Proclamation No. 62/ 1993, *Negarit Gazeta*, (1993).
[35] Income Tax Amendment Proclamation No. 107/1994, *Negarit Gazeta*, (1994).
[36] Taddese, *supra* note 8, P. 122.
[37] *Id.*, P. 123.
[38] *Id.*, P. 124.
[39] Income Tax Proclamation No. 286/2002, Federal *Negarit Gazeta*, (2002), Arts. 118-119.

single body of law; adoption of 'residence rule' to assume income tax jurisdiction; created uniform income tax rates and brackets for Schedules 'A', 'B' and 'C'; and introduced tax avoidance and modern income tax accounting rules to the tax system.[40] The income tax laws resulted from the 2002 reforms served for about 14 years until they got replaced with income tax laws resulted from the latest income tax reforms of Ethiopia, the 2016 income tax reforms.

To sum up this section, it is true that Ethiopia's income tax system underwent several reforms since the 1940s. The reforms from 1940's to 2002 were largely fragmented, while the 2002 reform was the country's first comprehensive and inclusive income tax reform.[41] If we see these reforms from the perspective of their goals; the income tax reforms of the imperial period were aimed at enhancing revenue and encouraging productivity, while the *Dergue* era reforms were undertaken to demote private investment and empower the government in the economy.[42] The post-*Dergue* period coincided with a free economic policy, and the main tax reform goals of this period were broadening the tax base, strengthening the enforcement capacity of the tax and customs authorities and promoting equity in the tax system.[43] However, through all these changes the effectiveness and productivity of Ethiopia's income tax reforms remain questionable due to lack of institutionalized practices, limited role of professionals, lack of adequate

[40] Taddese, *supra* note 8, PP. 123-124.
[41] Of course, a fragmented and gradual income tax reform has also continued from 2002 to 2016. See *supra* note p 50.
[42] *Id*.
[43] Misganaw Gashaw, Tax Reform Discourse and Its Implication on Development: Evidence from the VAT Introduction in Ethiopia, *Mekelle University Law Journal*, Vol: 3 No. 1, (2015), pp. 23-24.

studies and consultation with stakeholders and prominent role of international actors.[44]

## 2. The 2016-Income Tax Reforms of Ethiopia: Drivers

Public policy reforms are designed to achieve defined goals and present solutions to defined problems.[45] In this regard, tax reforms are no exception. Tax reforms can be motivated by several concerns, most commonly, the desire to generate adequate revenue with a minimum of economic distortion, build up an efficient and fair tax system and improve the feasibility and administrability of the tax system.[46] Tax reforms are also used to advance a wide range of policy objectives such as adjusting macroeconomic problems, structural disparities, fiscal imbalances, and balance of payments disequilibria.[47] Moreover, the influence of developed countries, intergovernmental organizations, and international tax experts has been a common driver of post-World War II tax reforms in developing countries.[48]

Ethiopia's post-*Dergue* tax reforms are no exception to the above pattern and tax has been associated with external factors especially the influence of the IMF and the World Bank.[49] The complex and out-dated tax laws, failure of

[44] *Id*.

[45] Christoph Knill and Jale Tosun, Policy Making, In Daniele Caramani (ed.), *Comparative Politics*, Oxford University Press, (2008), pp. 495-519.

[46] Theresa Stattel and Anton Kamenov, Tax Policy Reform Primer, research report produced for review by the United States Agency for International Development (USAID), (2022), p. 4.

[47] Victor Barros *et al*, Drivers of the Tax Effort: Evidence from a Large Panel, REM – Research in Economics and Mathematics, (2021).

[48] Leyla Ates, Domestic Political Legitimacy of Tax Reform in Developing Countries: A Case Study of Turkey, *Wisconsin International Law Journal*, Vol. 30, No. 3, (2013).

[49] Misganaw, *supra* note 43; Feleku Ayenachew, Challenges of Tax Reform In Ethiopia Revenue And Custom Authority (ERCA), Msc Thesis, St.Mary's University College, (2012).

the tax system to generate adequate revenue and weak tax administration are also the common and major factors that necessitated tax reforms.[50] Building on this, this section discussed the drivers of the 2016-Income Tax Reforms of Ethiopia. Examining government documents and interviewing higher officials at the MoF and MoR, the authors have been able to grasp that the 2016 reforms had four major drivers, which are discussed one by one as follows.

### 2.1. Changes in the Economy

Tax policy is a major component of any country's economic governance framework, and fiscal instruments are important to manage economic growth.[51] Thus, reforms on direct taxes (such as income taxes) can be used as essential instruments to influence the micro and macro aspects of the economy.[52] As such, in Ethiopia too, tax reforms have long been considered along with economic changes. For instance, the change of the economic policy from a centrally planned economy to a semi-market oriented economic system is one of the major internal driving factors for the post-1991 tax reforms.[53] Among other things, the increasing public spending and recurring

[50] Ethiopian Economic Association (EEA), Proceeding of the Second International Conference on theEthiopian Economy, Volume III, (2005).

[51] Jason Lakin, The Politics of Tax Reform in Low- and Middle-income Countries A literature Review, International Budget Partnership, (2020).

[52] Ian Preston, Political Economy of Taxation: Needs And Drivers For Tax Reforms, In Savina Princen (ed), *Political Economy of Tax Reforms*, European Commission Workshop Proceedings, (2016).

[53] Belayneh Asmare, Economy wide Impact of Direct Tax Reform in Ethiopia: A Recursive Dynamic Computable General Equilibrium Analysis, MSc Thesis, Addis Ababa University, (2018).

budget deficit have necessitated the country's comprehensive tax reforms of 2002.[54]

After the enactment of the Income Tax Proclamation No. 979/2016,[55] and Tax Administration Proclamation No. 983/2016,[56] *Gebi le-Limat*, a magazine published by the Ministry of Revenues, held an extensive interview with Ato Wassihun Abate, the then Director of the Legal Service Directorate of the Ministry of Finance and Economic Cooperation (MoFEC), now, Ministry of Finance,[57] where he thoroughly discussed the drivers and goals of the 2016 tax reforms, and the main changes it introduced. Part of this interview, as quoted below, is telling that changes in the economy were also the main driver of the 2016 income tax reforms.

"... *በነዚህ ዓመታት ውስጥ የአገራችን ኢኮኖሚ በአማካይ 11 በመቶ እያደገ ነው። ስለዚህ ይህ የገቢ ግብር አዋጅ በወቅቱ የነበረው ኢኮኖሚ መምራት በሚያስችል መልኩ ቢሆንም አሁን ባለበት ደረጃ ግን ከኢኮኖሚው ጋር የተጣጣመና ኢኮኖሚውን መምራትና መደገፍ የሚያስችል አይደለም። ስለዚህ አዋጁ የአገራችን ኢኮኖሚ እድገት ከደረሰበት ደረጃ ጋር የተጣጣመ እንዲሆን ለማድረግ ነው። ... የዛሬ 14 ዓመት የነበረው የገንዘብ የመግዛት አቅም ዛሬ ካለው አቅም ጋር ሲወዳደር በከፍተኛ ደረጃ የተለያየ ነው። ስለዚህ በአዋጁ ውስጥ በገንዘብ መልክ የተቀመጡ የማስከፈያ*

[54] Demirew Getachew, Tax Reform in Ethiopia and Progress to Date, Ethiopian Economic Association Sound International Conference on the Ethiopian Economy, Addis Ababa, (2004).

[55] Federal Income Tax Proclamation No. 979/2016, Federal *Negarit Gazzeta*, (2016) [hereinafter Income Tax Proclamation No. 979/2016].

[56] Federal Tax Administration Proclamation No. 983/2016, Federal *Negarit Gazeta*, (2016) [hereinafter Tax Administration Proclamation No. 983/2016].

[57] *ገቢ ለልማት መድሄት፣ "ስለተሻሻሉት የገቢ ግብር እና ታክስ አስተዳደር አዋጆች ልዩ ቃለ-ምልልስ ከገንዘብና ኢኮኖሚ ትብብር ሚኒስቴር የሕግ አገልግሎት ዳይሬክተር አቶ ዋሲሁን አባተ ጋር"፣ ልዩ እትም፣ መስከረም 2009 ዓ.ም* [here in after *Gebi le-Limat*]. The authors are highly indebted to this interview.

*ምጣኔዎችና የገቢ መጠኖች አሁን ካለው የገንዘብ የመግዛት አቅም ጋር ተጣጥሞ እንድሄድ ለማድረግ ነው።*"[58]

This shows government's continuing use of tax and fiscal policy to influence and manage the economy. In other words, tax reform is needed because the existing tax laws could not capture developments including the 11% economic growth and changes in purchasing power, among others.

In an interview with the authors, Mesfin Gulilat, a Director of the Research and Development Directorate at MoR, also shares this economic justification. According to him, the 2016 income tax reform was required to bring an income tax legislation keeping pace with the economic growth, attracting foreign direct investment, and encouraging the private sector.[59]

## 2.2. Enhancing Revenue Mobilization

Many agreed that adequate domestic revenue mobilization is critical for the healthy financing of public expenditure and fiscal crisis is the mother of tax reforms in most developing countries.[60] Thus, most African countries, including Ethiopia, undertaken tax reforms to mobilize revenues, particularly, with declining external assistance, capital inflows, and trade following the global financial and economic crisis. According to Tadele, who assessed the percentage change in tax revenue due to the percentage change in the base (usually GDP) in Ethiopia from 1974 to 2010, the ability of the Ethiopian tax structure to generate revenues during economic growth has been low and non-

[58] *Id*.
[59] Interview with Mesfin Gulilat, Director, Research and Development Directorate of Ministry of Revenues, (June 23, 2022).
[60] Richard M. Bird, Improving Tax Administration in Developing Countries, *Journal of Tax Administration*, Vol:1, No. 1, (2015).

buoyant.[61] Scholars in the field and donor organizations have long recommended the country to mobilize domestic revenue by broadening the tax base, bringing new taxpayers into the tax net, reducing tax exemptions, and improving the tax administration.[62]

Since the 1940s, governments in Ethiopia have made numerous efforts to reform and modernize the tax system with the primary goal of raising sufficient revenue.[63] However, despite a nominal increase in tax collection, efforts could not bring the required result. According to the National Bank of Ethiopia (NBE) report of 2015/16, the tax to GDP ratio in Ethiopia was 13.5%, which was far less than the average value of sub-Saharan countries (16%).[64] It had become apparent that the government cannot achieve its plan to increase revenue from taxation to 17 % of GDP by 2020 (the end of GTP II). The IMF's 2016-Country Report also calls for additional tax reform if the country has to improve its tax performance and collect corresponding to the underlying economic conditions.[65] As a result, the country's persistent fiscal imbalance and budget deficits was one of the factors that made the 2016 income tax reform necessary.[66]

### 2.3. Improving Efficiency and Equity in the Income Tax System

[61] Tadele Bayu, Analysis of Tax Buoyancy and Its Determinants in Ethiopia: Cointegration Approach, *Journal of Economics and Sustainable Development*, Vol:.6, No.3, (2015).
[62] Alemayehu and Abebe, *supra* note 13.
[63] Takele Abdisa, Macroeconomic Impact of Tax Reform in Ethiopia, *Journal of Economics and Sustainable Development*, Vol: 9, No.19, (2018).
[64] *Id*.
[65] Belayneh, *supra* note 53.
[66] Gebi le-Limat, *supra* note 57.

Enhancing the efficiency and equitability of the income tax system was also the driver of the 2016 income tax reforms of Ethiopia.[67] This goes in agreement with the general goal to ensure that the tax system is fair and efficient, which are used as the two most important criteria to build a good tax system.

In order to attain efficiency in the tax system, tax reforms are aimed at minimizing the cost of complying with the tax laws (by taxpayers and tax authorities) and distortions in the economy caused by the tax. For example, tax reforms introduce legislation that promotes compliance, criminalizes evasion, limits loopholes that invite tax planning, simplifies requirements and procedures, etc. Another often stated reform objective is that tax laws are designed in a way not to inhibit people from deciding to do something because of the tax. When it comes to equity, although there are several criteria, reforms attempt to ensure that taxes are imposed based on the taxpayers' ability to pay and the benefits they receive from government services. As the latter requirement is more practical than legal, tax laws try to ensure that people with equal income pay equal taxes and people with higher income pay tax on a greater percentage of their income. Beyond ensuring efficiency and equity in the system, tax reforms are expected to resolve the possible trade-off between the two competing considerations.[68]

There are empirical evidences showing how the Ethiopian tax system is severely starving both efficiency and equity criteria, as well as how the tax system is performing in managing the two competing concerns is far from

[67] *Id*.

[68] This trade-off is central to income tax policy, where the key issue is whether the distortionary impact of raising taxes off the benefits of having more resources to redistribute.

clear.[69] From an efficiency perspective, slow structural transformation (dominance of subsistence agriculture), poverty (low per capita income), low savings rates, the large size of the informal sector (40% of GDP), low level of monetization of the economy, and macro-economic problems (such as inflation, unemployment, low volume of exports, low FDI share), poor tax culture and low compliance are commonly mentioned as constraints.[70] There are also concerns about equity, where studies indicated that income tax practices have a negligible role on the overall income distribution and poverty reduction.[71] This is because income taxes, though designed progressive may easily turn regressive if the tax brackets are not regularly adjusted to keep up with inflation.

In this regard, the thresholds set for personal income tax under the 2002 income tax laws were not been updated for 14 years and were dramatically eroded by inflation. Most strikingly, the exempt threshold (1,800 Birr annual income) was well below the poverty line (3,781 Birr in 2010/11) and the lowest government wage (5040 Birr until 2022).[72] This means that the poor were still liable to pay income taxes. Evidences show that 1 in 4 households in

[69]See for instance, Wollela Abehodie and Odd-Helge Fjeldstad, Business People's Views of Paying Taxes in Ethiopia, ICTD Working Paper 43 January 2016; Workineh Ayenew, Determinants of Tax Revenue in Ethiopia: Johansen Co-Integration Approach, *International Journal of Business, Economics and Management*, Vol: 3, No. 6, pp. 69-84.

[70] See for instance, Minyichel Baye and Degefe Duressa, Factors Affecting Tax Revenue In Ethiopia, Volume 8, Issue 4, 2020; Daniel Bayera, Tax revenue Determinants and Tax Efforts in Ethiopia from 2000-2019: ARDL Approach, *International Journal of Public Administration and Management Research*, Vol: 7, No. 2, (2021), pp. 1-18; Tahir Desta *et al*, Factors Affecting Tax Revenue in Ethiopia: Autoregressive Distributed Lag Approach, Research Square, 04 Apr. 2022.

[71]Kalle Hirvonen *et al*, Linking Taxation and Social Protection: Evidence on Redistribution and Poverty Reduction in Ethiopia, UNU-WIDER Working Paper 2016/111, (2016), P. 3.

[72] *Id.*, P. 8.

Ethiopia were made poorer by the tax system, which is known as fiscal impoverishment.[73] Thus, it is not surprising to see that responding to the increasing concerns about the equity and appropriateness of the income tax structure is mentioned as one of the driving factors for the 2016 income tax reforms.[74]

### 2.4. Gaps in the Existed Income Tax Laws

Legal reforms are generally recommended as old laws become obsolete to capture changes as a society and the economy evolves. Tax laws in general and income tax laws, in particular, are the most complex and dynamic areas of law that deals with domestic and international persons and transactions. There is thus a need to be flexible so as to permit the adequate handling of new situations when they arise without compromising the certainty and predictability of the system.[75] This is made possible through *de novo* tax design and/or the reform of existing tax laws.

Compatible with this notion, the legislative gaps under the 2002 enacted income tax laws was one of the driving factors to initiate Ethiopia's 2016 income tax reforms.[76] In an interview with the authors, Ato Boshe, a Legal Advisor to the Minster in MoF, further explained that the 14 years old income tax laws had caused serious implementation problems and came to be obsolete to support new developments in the national and global economy.[77] For instance, the laws failed to tax some income sources, which not only

[73] World Bank Group, Ethiopia Poverty Assessment, Washington DC, (2015).
[74] Gebi le-Limat interview with Wassihun, *supra* note 57.
[75] Alexander V. Demin, Certainty and Uncertainty in Tax Law: Do Opposites Attract? *Laws*, Vol: 9, No. 30, (2020).
[76] *Gebi le-Limat* interview with Wassihun, *supra* note 57.
[77] Interview with Boshe, Legal Advisor, Ministry of Finance, (June 17, 2022).

narrowed the tax base but also become a source of inequity.[78] Tax rates and tax brackets were also needed to be updated in light of the economic development of the country.[79] Moreover, as the income tax laws were found scattered in the different legislations, the system was open to inconsistencies and contradictions making them difficult to enforce.[80] This is why, one of the purposes of the 2016 reform was to consolidate and fill gaps of the pre-existing tax laws.

### 3. The Process and Actors Involved in the 2016-Income Tax Reforms

The process and the actors involved in decision-making are crucial agendas in tax reform projects. As far as its nature is concerned, it is apparent that the 2016 tax reform is part of the post 2002 incremental tax reform practice in the country. Given the absence of changes for almost 15 years in response to socioeconomic developments in the country, the government had faced several questions from taxpayers and pressures from the IMF and other international organizations. Thus, the Council of Ministers decided to amend the Income Tax Proclamation No 286/2002 and organized a committee for draft preparation. The Committee was headed by the Ministry of Finance and comprised people from Ministry of Revenue, Ministry of Justice, Ministry of Trade and Industry, and Ministry of Labour and Social Affairs. It was closely supported by independent consultants and technical assistants from IMF. It was the draft by the committee that went through the normal legislative process in the country and finally ratified by the parliament.

[78] *Id*.
[79] *Id*.
[80] Interview with Mesfin, *supra* note 59.

The first question that one can logically raise is what were the roles of the MoF and other concerned government departments in the initiation and formulation of the 2016 income tax reforms. The same question can be raised with respect to the different private and professional associations such as the Ethiopian Chamber of Commerce and Sectoral Associations, the Ethiopian Workers Association, the Ethiopian Employers Federation, the Ethiopian Bankers Association, the Ethiopian Economic Association, the Ethiopian Lawyers Association, etc.

Various state and non-state actors participate and played a role in the 2016 tax reform.[81] In Ethiopia, the MoF is the key institution with the power to formulate fiscal policy, initiate reform, and follow up the proper implementation of the same.[82] Thus, it is expected to take the leading role in the initiation and design of the 2016 income tax reforms, and in fact it played a pivotal role. However, the international actors, particularly, the IMF had a big impact in shaping the course of the reforms. The IMF and international experts were ostensible in developing and implementing tax reforms in developing countries including Ethiopia.[83] Ethiopia has been under the Extended Credit Facility (ECF) and Extended Fund Facility (EFF), which provide financial assistance to countries with protracted balance of payment and revenue mobilization problems.[84] In response to Ethiopia's request for technical assistance to restructure the tax system and increase revenue in 2010, IMF has strongly recommended government authorities to, among others, reduce corporate tax rates (from the current 30% to 25%) and drop the

[81] Interview with Boshe, *supra* note 77.
[82] Definition of Powers and Duties of the Executive Organs Proclamation No.1263/2021, Federal *Negarit Gazzeta*, (2021), Art 26.
[83] Misganaw, *supra* note 43.
[84] IMF Communications Department, *IMF Executive Board Approves US$2.9 Billion ECF and EFF Arrangements for Ethiopia*, Press Release No. 19/486, December 20, 2019.

10% dividend tax.[85] Although such specific recommendations cannot be directly counted in the 2016 income tax reform, the general income tax reform is motivated by the IMF's recommendation. This is later made clear under the 2016 IMF country report on Ethiopia, which underlined the need for tax reform is necessary to overcome the problem of revenue mobilization and support the development agenda in the country.[86] And of course, the government of Ethiopia adopts IMF recommendations in its recent tax reform on income tax and tax administration at the same time.[87] The main features of income tax reform such as adjusting tax bracket, increasing the schedules (from four to five), elevating exempted threshold (to Birr 600 monthly and Birr 7200 annual income) and simplifying tax laws are the aftermaths of the IMF recommendations.[88]

Regarding the role and involvement of experts, the IMF, as part of its technical support, sent Professor Lee Burns of the University of Sydney to draft the income tax law in Ethiopia.[89] Professor Lee has worked on tax reforms in over 30 developing countries for decades as part of the technical assistance programs of international organizations, particularly the IMF and World Bank.[90] He has provided assistance on the design and drafting of the recent income tax and tax administration laws in Ethiopia with the same assignment from the IMF. The influence of IMF and the broad involvement of foreign scholars demonstrate external significances to undertake the reform. This can be more problematic when tax reforms are carried out before

[85] Bruh Yihunbelay, Ethiopia: IMF Recommends Tax Cuts for Ethiopia, *Addis Fortune*, (Mar. 30, 2010).
[86] IMF, Federal Democratic Republic of Ethiopia (FDRE), Article IV Consultation: IMF Country Report No. 16/322, (2016).
[87] Belayneh, *supra* note 53.
[88] *Id.*
[89] *Id.*
[90] *Id.*

home-works remained up in the air. This goes to the institutional framework, where organizational problems and lack of human, material, technological and financial resources are commonly raised.[91]

Thus, although there is a claim that MoF is the one initiating the reforms,[92] the interviews and the evidences produced above say otherwise. The informant from the MoR, on this point, further stated that from the very outset, MoF was and is not in a position to undertake a nationwide tax reforms; it lacks organizational structure and manpower necessary to lead the country's tax system and undertake reforms when necessary.[93] Most of the tax reforms are project-based and run on the technical and financial support of the IMF and WB. The MoF had controlled the monitoring of the whole process of initiation and study, legal drafting, presented to the Council of Ministers for discussion and to the HoPR for approval. Thus, what is clear is that a committee composed of experts and officials from the MoF, and MoR, was established to facilitate the process and to provide comments, if any.[94]

At the final point, the bill was commented on by tax practitioners, scholars, and representatives of the business community.[95] However, stakeholders (government departments, private and professional associations and the general tax-paying public) were not adequately engaged in the development of both the income tax proclamation and regulation. The absence of adequate representation (for example, of the employees and the business community) and expert opinion would frustrate the implementation of the income tax reforms. For instance, when the 2017 reassessment results of the average

[91] Misganaw *supra* note 43.
[92] *Id.*
[93] Interview with Mesfin, *supra* note 59.
[94] *Id;* Interview with Boshe, *supra* note 77.
[95] *Id.*

daily sale of category 'C' were announced, they produced a tremendous uproar from taxpayers, and lack of advance consultation with the taxpayers or their representatives about the process was one of the main contributing factors.[96] In an interview with the authors, the Senior Policy Analyst at the Ethiopian Chamber of Commerce and Sectoral Associations, Teklewengel Kasaye, explained that although the chamber of commerce was invited to the discussion on the draft income tax laws, many of the comments the chamber suggested are not included in the final bill.[97] Of course, one of the lacunas in this regard is that there is no national law or policy that defines the stakeholders and their roles and responsibilities in tax reform projects. So, at least on article, it is possible to understand that the MoF assumes a disproportionately greatest responsibility in the initiation, design and legislating tax reforms.

## 4. Major Legislative Changes of the 2016 Income Tax Reforms

The 2016 tax reforms have resulted in Income Tax Proclamation No. 979/2016,[98] Income Tax Regulation No. 410/2017,[99] Tax Administration Proclamation No. 983/2016,[100] and Tax Administration Regulation No. 407/2017.[101] Though this reform has brought several legislative changes, this section is dedicated to pointing out only the major ones. In addition, even if

[96] Amanuel Mekonnen *et al*., Where the Gap Lay: Presumptive Income Tax Assessment for Small and Micro Enterprises in Addis Ababa City Administration, ICTD Working Paper 94, 2019.

[97] Interview with Teklewengel Kasaye, Senior Research and Policy Analyst, Ethiopian Chamber of Commerce and Sectoral Association, (June 29, 2022).

[98] Income Tax Proclamation No. 979/2016, *supra* note 55.

[99] Federal Income Tax Regulation No. 410/2017, Federal *NegaritGazeta*, (2017) [here in after Income Tax Regulation No. 410/2017], as amended by the Federal Income Tax Regulation (Amendment) No. 485/2021, Federal *Negarit Gazeta*, (2021).

[100] Tax Administration Proclamation No. 983/2016, *supra* note 56.

[101] Federal Tax Administration Regulation No. 407/2017, Federal *Negarit Gazeta*, (2017).

several directives are issued by the MoF following the reform, the discussion focused at changes made at the Proclamation and Regulation level. The discussions are structured into three sub-sections: new introductions; the changes and improvements made on the pre-existed prescriptions; and the changes in the income tax administration.

### 4.1. New Introductions to the Income Tax System

The repealed income tax proclamation was criticized for failing to capture income sources that are not explicitly or implicitly mentioned in the individual income tax schedules.[102] No provision focused on the taxation of residual income. To curb this limitation, the new income tax proclamation, under Art 63 obliges any person who derives any income that is not taxable under Schedules 'A', 'B', 'C', or other provisions of Schedule 'D' to pay income tax at the rate of 15% on the gross amount of the income.[103]

The new income tax proclamation also introduced a tax on new income sources thereby widening the tax base. Income from international air transportation business of non-residents; Ethiopian source dividend, interest, royalty, management fee, technical fee, or insurance premium derived by non-residents; income received by non-resident entertainers; repatriated profit; undistributed profit;[104] and foreign currency exchange gains[105] are among the new tax bases.

The introduction of Schedule 'E' is another new development that increases the number of existing schedules to five. This Schedule is dedicated to list

[102] Taddese Lencho, *The Ethiopian Income Tax System: Policy, Design and Practice*, PhD dissertation, University of Alabama, (2014), p. 265.
[103] Income tax Proclamation No. 976/2016, *supra* note 55, Art 63.
[104] See *id.*, Arts 50-53 and 60-63.
[105] Income Tax Regulation No. 410/2017, *supra* note 99, Art 44.

down incomes that are exempted from taxation under Schedules 'A', 'B', 'C', and 'D'.[106] The incomes listed in the Schedule or those treated as exempted, do not make the tax base of any schedule, hence, not part of the gross income.[107] Thus, an income that neither falls in the exemption list nor satisfies the conditions for exemption under Schedule 'E' should be regarded as part of gross income. For instance, when it states "a contribution made by an employer to employee's pension not exceeding 15% of the monthly employment income of the employee is exempted", it is also saying that a contribution beyond this threshold is a taxable income.

It is not common to design a separate income tax schedule just to list down exempt income sources. The official at the MoR explained to the authors that Schedule 'E' is introduced with the premise that the consolidation of exempted income sources under a single schedule will enable taxpayers to easily understand the tax laws/ensuring simplicity.[108] However, one may argue that stating the applicable exemptions under each schedule rather is more easily understandable than collecting the exemptions of all income tax schedules in a single basket.

The other new introduction is the treatment of micro-enterprises as individual taxpayers, to determine the applicable tax rate and duty to keep books of accounts.[109] Accordingly, even if micro enterprises are by definition 'body' under Schedule 'C', in assessing their income tax liability, the applicable rate is not the 30% flat rate applicable to 'body' taxpayers, but the progressive rate applicable to individual taxpayers. The new law intends to encourage the

[106]Income Tax Proclamation No. 979/2016, *supra* note 55, Art 65; See also *id*., Art. 54.
[107] See *id*., Arts 12 (2), 15 (4), 21 (2) and 64 (1) (b).
[108]Interview with Mesfin, *supra* note 59.
[109]Income Tax Proclamation No. 979/2016, *supra* note 55, Art. 19 (3); Income Tax Regulation No. 410/2017, *supra* note 99, Art 48

enterprises' business growth by exempting them from the 30 % flat rate. Since the enterprises are regarded as individual taxpayers, the type of books of accounts that shall be kept by them varies depending on their annual turnover. Such positive and differential treatment of the micro-enterprises is a good move as it helps these enterprises reduce their compliance cost by allowing them to use simplified bookkeeping and also encourages their business growth by exempting them from the 30 % flat rate.[110]

### 4.2. Major Amendments on the Previous Income Tax Provisions

Both the repealed and current income tax proclamations provided seven tax brackets for taxpayers of Schedule 'A' and individual taxpayers of Schedules 'B' and 'C'. The first bracket being the floor exemption, the remaining six brackets constitute taxable amounts to be charged with tax rates ranging from 10% to 35%. What is changed under the current Proclamation is that it came up with increased thresholds of exempted amounts. Accordingly, the floor exemption of employment income tax increased from birr 150 to 600; and for individual taxpayers of Schedules 'B' and 'C' from birr 1,800 to 7,200.[111] When it comes to the remaining six brackets, the current income tax Proclamation showed a substantial increase in the amounts in the brackets compared to its predecessor. For example, under Schedule 'A', the 10% tax bracket increased from birr 151-650 to birr 601-1,650; the 15% tax bracket increased from birr 651-1400 to birr 1,651-3,200.[112] For individual taxpayers of Schedules 'B' and 'C', the 10% tax bracket increased from birr 1,801-

[110] Belete Addis, Characterization of Taxable Units and Tax Bases under the Income Tax Schedule 'C' of the Federal Income Tax Proclamation of Ethiopia: A Commentary, *Bahir Dar University Journal of Law*, Vol: 10, No. 1, (2019), pp. 93-94.

[111] Compare Income Tax Proclamation No. 286/2002, *supra* note 39, Arts 11, 15 (b) and 19 (2) (b) with the Income Tax Proclamation No. 979/2016, *supra* note 55, Arts 11, 14 (2) and 19 (2).

[112] Compare the repealed Proclamation, Art 11 with the current Proclamation, Art 11.

7,801 to birr 7,201-19,800; the 15% tax bracket increased from birr 7,801-16,800 to birr 19,801-38,400.[113]The increase in amounts in the tax brackets could be taken as progress made by the income tax reform of 2016. The amounts in the tax brackets on which tax rates are applied are increased from the previous ones.

The current income tax laws made no significant change when it comes to tax rates. However, Schedules 'C' and 'D' have introduced some noticeable changes. Under the repealed income tax system, mining and petroleum operations were taxed at a harsh flat rate of 35%.[114] Now, this rate is reduced to 25%,[115] which is intentionally made to encourage investors to engage in the sectors.[116] Previously, income from interest was a subject of taxation under three distinct situations.[117] Now, the new proclamation defines the term 'interest',[118] which was not the case previously, and broadens its reach by imposing a tax on interest from any source, even on loans between individuals. It also imposes a lower rate on income from deposits to encourage deposits and it favors deposits made in resident financial

[113] Compare the repealed Proclamation, Arts 15 (b) and 19 (2) (b) with the current Proclamation, Arts 14 (2) and 19 (2).

[114] The Petroleum Operations Income Tax Proclamation No. 296/1986, *Negarit Gazeta*, (1986); the Mining Income Tax Proclamation No. 53/1993, *Negarit Gazeta*, (1993); and the Mining Income Tax (Amendment) Proclamation No. 23/1996, Federal *Negarit Gazeta*, (1996).

[115] Income Tax Proclamation No. 979/2016, *supra* note 55, Art 37 (3).

[116] Interview with a Senior Tax Expert, Ministry of Mining, (June 22, 2022).

[117] Interest accruing from deposit accounts taxable at the rate of 5% under Schedule 'D'; interest paid to non-resident financial institutions recognized by the National Bank of Ethiopia as lending institutions taxable at the rate of 10%; and interest received by a Schedule 'C' taxpayer, such as banks and other financial institutions, from loans to others as part of its business taxable under Schedule 'C' as business income. See Income Tax Proclamation No. 286/2002, *supra* note 39, Art. 36; Income Tax Regulation No. 78/2002, Federal *Negarit Gazeta*, (2002), Art 10.

[118] Income Tax Proclamation No. 979/2016, *supra* note 55, Art.2 (16).

institutions. Interest from saving deposits is taxable at 5% (if deposited with a resident financial institution), Schedule 'C' taxpayers pay business income tax from their interest income while for other forms of interest the rate is 10%.[119]

Fringe or in-kind benefits are among the types of income sources that have been included both in the repealed and the existing income tax proclamations. However, they were not taxed during the enforcement period of the repealed proclamation of 2002 due to a lack of valuation rules and administrative limitations. The Council of Ministers failed to provide valuation mechanisms in the income tax regulation of that time although the income tax proclamation of 2002 mandated it to do so. The new change that the income tax reform of 2016 brought regarding fringe benefits is that the income tax regulation incorporated valuation rules for fringe benefits.[120] Thus, the introduction of detailed valuation rules for fringe benefits is one big step to broaden the tax base, raise more tax revenues, and ensure tax equity.

Another change under the current income tax proclamation is that it expands the scope of Schedule 'C' to include income from mining and petroleum operations. Though these operations were subjected to separate income tax regimes for a long time, the current income tax proclamation merges them with the other business income sources under Schedule 'C'. It is important to note that though they share the provisions of Schedule 'C' with other business activities subject to Schedule 'C', there are also special rules concerning definitions, deductions, and tax rates applicable only to mining and petroleum operations.[121] The repealed independent mining and petroleum income taxes proclamation was criticized for its separate existence and high tax rate. Now,

[119] *Id.*, Art. 56.
[120] Income Tax Regulation No. 410/2017, *supra* note 99, Arts 7-19.
[121] Income Tax Proclamation No. 979/2016, *supra* note 55, Arts 36 – 44.

these problems are solved by the consolidation of the separate regime with and reduction of the tax rate by the new income tax proclamation.

The repealed income tax laws were containing inconsistent provisions, contradictory versions between the Amharic version and the English Version, highly complex even for an academician, and lacking clarity on many parts. If we compare the current income tax laws with these, it is fair to say simplicity and clarity are one of the milestone accomplishments of the laws resulted from the 2016 income tax reforms. The new income tax proclamation has substantially reduced the problem by providing clearer, simple, and less complex legal provisions. For instance, compared with its predecessor, the new income tax proclamation came up with clear and detailed definitional provisions for income sources subject to Schedule 'D', which ease the characterization of taxable units and tax bases. For instance, the repealed income tax laws had no definition of 'dividend', hence, it was mandatory to cross-refer to the commercial code which in turn created several challenges.[122] The current Proclamation avoided this problem by providing a comprehensive definition of 'dividend', under Art 2 (6), which provides illustrative lists of distributions that will be considered as 'dividends' and also enable capturing 'fictitious dividends'. In addition, regarding taxation of 'royalty', the current Proclamation under Art 2 (20) came up with a relatively comprehensive list of assets whose exploitation results in the payment of royalties. For instance, it adds assets that were not included under Art 31 of the repealed income tax proclamation[123] but are widely used owing to the advancement of technology such as visual images or sounds or both transmitted by satellite, cable, optic fiber, or similar technology in connection with television, radio, or internet broadcasting. In addition, the new definition

[122] Taddese, *supra* note 110.
[123] Income Tax Proclamation No. 286/2002, *supra* note 39, Art 31(5).

of royalty includes the supply of services rendered as per Article 2(20) (F) of the current proclamation. The current Proclamation also attempts to define 'games of chance'[124] for the purpose of taxation of income from games of chance, which was not the case under the repealed income tax laws.

Changes are also made concerning taxation of 'capital gains'. The current income tax proclamation classifies assets subject to capital gains taxation into two classes: Class 'A' comprising immovable assets and Class 'B' refereeing to shares and bonds and any interest in these.[125] By doing so, it widens the scope of assets subject to capital gains tax by adding bonds and any interest in shares or bonds, as well immovable assets other than building. Previously, buildings and shares of companies were the only assets subjected to this tax.[126] The income tax regulation also introduces inflation adjustment in computing the costs of the taxable assets, namely immovable assets, shares, and bonds.[127]

In terms of non-residents taxation, both the repealed and the current income tax Proclamation are inclusive of non-residents with respect to their Ethiopian source income.[128] However, the repealed proclamation had only one prescription about while the current proclamation came up with far clearer and expanded prescriptions. It has emerged with separate provisions regarding taxation of non-residents; Arts 51-53 and 62 of the Proclamation are exclusively dedicated to taxing non-residents. In addition to these provisions exclusively precluded for non-residents taxation, it is clear that non-residents derived 'Ethiopian source' employment income, rental income

[124] Income Tax Proclamation No. 979/2016, *supra* note 55, Art 57 (4).
[125] *Id*., Art. 59 (2) & (7); Income Tax Regulation No. 410/2017, *supra* note 99, Art 3.
[126] Proclamation No. 286/2002, *supra* note 39, Art. 37 (1).
[127] Income Tax Regulation No. 410/2017, *supra* note 99, Art. 56.
[128] Income Tax Proclamation No. 979/2016, *supra* note 55, Art 7 (2); Income Tax Proclamation No. 286/2002, *supra* note 39, Art 3 (2).

from buildings, business income, income from games of chance, income from the casual rental of asset, gains on disposal of certain investment asset, and other income are subject to taxation in Ethiopia.[129]

Regarding the rules of permanent establishment, the current proclamation has an improved and more detailed definition than its predecessor. For instance, while the repealed proclamation used the whole idea of permanent establishment as a definitional element of a resident taxpayer, the new proclamation considered the place of effective management as one alternative criterion to define a resident taxpayer of Ethiopia.[130] New business conducting manners that were not recognized as constituting permanent establishment by the repealed proclamation, such as furnishing of services, are introduced by the new proclamation.[131] This is an indication that the Ethiopian income tax proclamation has shifted from the OECD model to the UN model. The UN model tax treaty is known for favouring the source country principle. But, unlike the repealed proclamation, the OECD and UN model conventions, the new proclamation fails to mention those activities that do not constitute a permanent establishment.

The other major changes introduced by the income tax proclamation are the explicit inclusion and definition of important tax (accounting) concepts. These are acquisition of an asset, cost of an asset, consideration of an asset and net-book value of an asset, and disposal of an asset.[132] These concepts were not defined and explained in the former tax rules despite their relevance to calculate the taxpayer's taxable business income. The new proclamation, however, has provided detailed definitions and explanations for these

[129] See *id.*, Arts 10 (1), 13 (1), 18 (1), 57 (1), 58 (1), 59 (1), and 63.
[130] *Id.*, Art 5(5); Income Tax Proclamation No. 286/2002, *supra* note 39, Art 5(4).
[131] *Id.*, Art 4(1) (2) and (3).
[132] *Id.*, Art 66-71.

concepts, thus making tax assessment less difficult than the previous one.[133] Stipulating what kinds of transactions constitute disposal, what kind of expenses are considered as a cost, and which payments are treated as consideration (income derived from the disposal of an asset) has important significance, including understanding the tax to be imposed on a gain derived from the disposal of business assets.

One important deviation of the new proclamation from the repealed one is the rules of deduction of taxable assets and business assets. The new proclamation unlike the repealed one differentiates assets as business assets and taxable assets and applies differing rules on how to deduct the loss incurred while disposing of the two things.[134] Concerning depreciation deduction, the new income tax regulation has modified the categories of depreciable assets and the existing straight line depreciation rates, introduced new diminishing value depreciation rates, and a 100% accelerated depreciation rate for category "B" taxpayers.[135]

Regarding the deductibility of interest expense, the new proclamation differs from the repealed one in the following aspects:[136] First, it allows a deduction only if the taxpayer has used the loan that gave rise to interest to earn the business income. Second, it denies a deduction for an interest that is paid to a related person. Third, it allows a deduction for interest beyond 2% of the rate between the National Bank of Ethiopia (NBE) and commercial Banks if the

[133] *Gebi le-Limat* , *supra* note 57.
[134] Income Tax Proclamation No. 979/2016, *supra* note 55, Arts 21(3), (4) ((A and B)) and 59 (3).
[135] Income Tax Regulation No. 410/2017, *supra* note 99, Arts 39-41.
[136] Compare Income Tax Proclamation No. 286/2002, *supra* note, Art 21(1)(e); Income Tax Regulation No. 78/2002, Art 10 with the Income Tax Proclamation No. 979/2016, *supra* note 55, Art 23.

lenders are financial institutions recognized by NBE and foreign Banks allowed to lend in Ethiopia.

### 4.3. Changes in the Income Tax Administration

One of the most important changes introduced by the income tax reform of 2016 is the enactment, for the first time, of a tax administration proclamation dealing exclusively with administrative matters. A lot of changes are introduced due to the adoption of this proclamation. The most important change that came up with it is the consolidation/refinement of duplicated procedural provisions that were scattered among the numerous tax laws into a single document. Previously, similar procedural provisions were included in various tax proclamations and regulations. Now, they are merged into a single accessible legal document. The new tax administration proclamation, besides avoiding the scattered and duplicated procedural rules, has brought a lot of changes to the previous procedural rules.

It has also improved the ambiguity of former laws by including provisions for advance rulings, their legal status, their effect, and the procedure of making them.[137] The new income tax proclamation has solved the complexity and unclear nature of the former tax proclamation and regulation by defining important words and concepts which were previously unknown making the tax assessment process very tiresome and vague.

Institutionalization of the dispute settlement process was another achievement brought about by the new laws. The tax complaint committee which was formed as a simple ad-hoc committee is now upgraded into a permanent department within the tax authority composing professional dispute

[137] Tax Administration Proclamation No. 983/2016, *supra* note 56, Arts 68-76.

settlers.[138] Appeal right to the higher courts is also made clear and undisputed process.[139] Unlike the previous laws, the new income tax law has made it clear to which level of court appeal can be lodged, and provided detailed rules on the appeal procedures, on organs responsible for entertaining the appeals, the time span to give decisions on appeals, the composition of the tax complaint hearing department. The law has made a great reform on the organization and working procedures of the Tax Appeal Commission and it has enabled it to be constituted by qualified personnel. The changes the reforms have brought regarding tax dispute settlement are among the most welcomed by the business community.[140]

The income tax reform of 2016 has also brought more taxpayer rights than the repealed ones as it introduced some taxpayer rights such as the right to get tax amnesty for calamities, the right to get an administrative ruling, etc. The advance payment mechanism is also another system that is introduced by the new income tax laws. Previously, there was no mechanism or procedure to make an advance payment. The new income tax proclamation, however, has provided the right to make advance payments and detailed procedures on how to effect the payment.

The new income tax proclamation has also introduced more general anti-tax avoidance rules that were absent in the previous income tax legislation. The only general rule available in the repealed proclamation was the transfer pricing rule. Even this rule was not detailed to prevent or at least reduce transfer mispricing activities. The new proclamation has provided more

[138] *Id.*, Arts 51-60.
[139] *Id.*
[140] Interview with Teklewengel, *supra* note 97.

detailed and elaborate rules on transfer pricing and included two more provisions known as "income splitting" and "tax-avoidance schemes".[141]

## 5. Constraints to the Success of the 2016 Income Tax Reforms

In the preceding sections, discussions made regarding the drivers of the 2016 income tax reforms, and the main legislative changes, largely improvements it introduced. In this section, a discussion is made on selected constraints that may impede the reforms from meeting its intended goals. It is crucial to note that in no way the authors are saying these are the only constraints, but a highlight of some notable ones requiring serious attention. Most of the constraints discussed below are not new to Ethiopia's income tax system or resulted from the 2016 income tax reforms, but continuing impediments.

First, though it has been over six years since the 2016 reforms have touched the ground, its impact is not yet studied. Have a scientific assessment of the pros and cons of the reforms as well as the real impacts it created, positive or negative, is a big milestone to decide what to do in the tax system. Doing so was specially expected from the MoF, as it is the principal responsible organ when it comes to tax reforms. But, so far, it has done nothing in this regard and it appears that it has no plan to do so.[142] The Ministry has also no guiding framework to assess the effectiveness and impacts of such reforms. Not only the MoF, but also the MoR has made no assessment of the reforms, except some piece meal studies about certain issues/aspects of tax.[143] Without studying the real impact, it is hard to tell the practical success stories of the reforms and the shortcomings to heal.

[141] Income Tax Proclamation No. 979/2016, *supra* note 55, Arts 78-80.
[142] Interview with Boshe, *supra* note 77.
[143] Interview with Mesfin, *supra* note 59.

The other related problem related with the MoF is its structural lacuna for income tax reforms [tax reforms for that matter]. Despite the fact that the MoF is at the top tier for the design of the country's income tax system and its reform, its organizational structure is short of resembling it. The Ministry has no separate department and experts for tax research. It is also not active enough in updating/reforming the tax system/laws when the circumstances demand.[144] Thus, when planning for making positive changes in the tax system of the country, the utmost attention should be given to reforming the MoF itself. Specially, it should have a separate department for tax reforms and tax research, staffed with best minds who are allowed to have the expertise autonomy.

Thirdly, inflation is one of the main constraints that have been posing a big challenge to the tax system of the country. For instance, one of the drivers of the 2016 income tax reforms was to make the tax brackets responsive to the changes in the purchasing power of Birr, and the progress in the economy.[145] And in fact changes are introduced by increasing the thresholds for floor exemption and tax brackets.[146] However, the changes resulted from the reform are too insignificant compared to the existing cost of living, which is also a position the MoR shares.[147]

One of the mitigating solutions in this regard is to make timely update of the threshold of floor exemptions and tax brackets considering significant changes in cost of living. To do so, further reform of the whole income tax system may be proposed, but, making such reforms every five years is costly for a least developed country, like Ethiopia. Also making frequent reforms

[144] *Id*.; Interview with Boshe, *supra* note 77.
[145] *Gebi le-Limat* interview with Wassihun, *supra* note 57.
[146] See discussion *supra* section 4.2, first paragraph.
[147] Interview with Mesfin, *supra* note 59.

can go against the basic canons of taxation, certainty. However, the authors believe that making adjustments of floor exemptions and tax brackets should not require a holistic reform of the income tax system, nor the income tax proclamation. Making a timely amendment of few relevant provisions of the income tax schedules can be sufficient. The tax laws as they currently appear have no indications for the possibility of making such changes and this need to be rectified. In answering when to update, two big considerations should be taken into account; a significant change of cost of living and the principle of certainty, the determination of which falls outside the expertise of the authors. But, for instance, in fixing the frequency of the update, we can start from related prescriptions of the income tax laws. For example, the Income Tax Proclamation prescribed a change of the annual gross income thresholds to categorize income taxpayers as category 'A', 'B' and 'C', at least within five years.[148] In addition, the daily sales estimation that used to determine the tax liability of category 'C' taxpayers is required to be revised/updated, at least every three years.[149] These stipulations are made to make the thresholds reflect the changes in the economy, and a change of these thresholds do not require amendment of the entire income tax laws or system. It is important to have similar stipulation for periodical update of floor exemption, tax brackets and tax rates considering the change in the economy. Tax laws should be dynamic or responsive to economic changes, of course, without forgetting other basic economic polices/tools that can better fight inflation.

The fourth main constraint that is impeding the realization of the intended goals of the 2016 income tax reforms is the problems with the tax administration. Despite a lot of improvements have made on the tax

[148] Income Tax Proclamation No. 979/2016, *supra* note 55, Art 3 (3).
[149] Income Tax Regulation No. 410/2017, *supra* note 99, Art 49 (3).

administration laws,[150] the tax administration institution is still one is weak. In the context of Ethiopia, this concerns the MoR [and the revenue authorities at various level], as it is the principal organ to administer the tax laws of the country.[151] The Ministry is strangled with serious challenges such as poor [tax] information collection system, absence of efficient system to follow-up the activities and revenues of the taxpayers (due to which taxpayers are paying less than what they should have), and not well equipped to tax e-commerce.[152] This is also impacting the tax compliance rate. To the extent there is poor tax administration and weak data recording, the level of tax compliance will be also low.[153]

For Teklewengel, a senior policy analyst at the Ethiopian Chamber of Commerce and Sectoral Associations, as long as the tax administration continues to be bureaucratic, dependent on manual operation which require physical meeting of the taxpayer and the administration and not replaced with e-tax, the reform is far from being complete for the business community.[154] He also raised the problem with tax audit where the revenues authorities at various levels have poor culture of timely/immediate auditing of the books of accounts of taxpayers when they are provided with.[155] The authorities collect the tax based on what is stated in the books of accounts, and then after years they will audit the books and require taxpayers to pay accumulated tax. According to him, tax auditing should be undertaken timely, when the books are presented and related to this there is a need to ensure the country-wide application of the already started accounting system of IFRS (as it will

[150] See discussion *supra*, section 4.3.
[151] Tax Administration Proclamation No. 983/2016, *supra* note 56, Art 5.
[152]Interview with Mesfin, *supra* note 59.
[153]*Id*.
[154] Interview with Teklewengel, *supra* note 97.
[155] *Id.*

contribute to alleviate the problems associated with the books of account record).[156] The way the average daily revenue estimation is being administered is also too manual, unfair, and highly susceptible for corruption/abuse which is negatively affecting the small businesses/category 'C' taxpayers.[157]

The tax administration lacuna is also reflected with taxation of fringe benefits. Though the reform has come up with detailed prescriptions of taxation of fringe benefits, these benefits are not taxed as prescribed. The MoR Research and Development Director raised two basic reasons for this.[158] The first relates with lack of administrative capacity and established system to trace fringe benefits employers provided for employees, as well as to make valuation of the benefits in monetary terms. The second relates to fringe benefits provided to higher government officials. If the benefits are valuated in monetary terms, they will highly exceed their monthly salary in that if asked to pay taxes on the fringe benefits, their salary will not be enough.[159] The authors found the second reason not convincing not to tax the fringe benefits payable to higher government officials, as they are easily traceable. What is rather more worrisome is that gaining such excessive fringe benefits, these officials are not taxed enough as the amount of tax liability from fringe benefits is capped at 10% of the monthly salary of the employee.[160] Thus, what should be in order is the need to revisit this prescription for the sake of vertical equity.

[156] *Id.*
[157] *Id.*
[158] Interview with Mesfin, *supra* note 59.
[159] *Id.*
[160] Income Tax Regulation No. 410/2017, *supra* note 99, Art 19.

Moreover, due to weak tax administration, taxation of 'other income' under Article 63 of the Income Tax Proclamation is a rare practice, if not absent. Though bringing residual income sources to the income tax net and thereby widening the tax base was one of the drivers of the reform, the implementation seems not to meet this objective. Officials and tax officers at the MoR revealed that no source has collected as 'other income' since the reform, at least to their knowledge, and they also believe that the low level revenue authorities may not have even the know-how about it.[161] The MoR may take this as an indication in that there is a need for intensive awareness creation about Art 63 of the Proclamation to its officers at various levels.

In conclusion, unless there is a strong institution to implement the substantive prescriptions, making income tax reforms now and then would make no meaningful impact. The problems in the tax administration, among other things, necessities for digitalizing the tax administration, staffing the tax administration institutions with officers equipped with the knowledge and skill required for efficient tax administration.

The fifth problem is lack of meaningful stakeholder representation/participation during tax reforms and/or enactment of tax laws. Though the representative of chamber of commerce and sectorial associations were invited to take part in the 2016 reform process by providing their comments on the draft income tax laws, the recommendations/opinions were not incorporated.[162] This makes the participation merely symbolic. Unless the voices of the business community are given place or reflected in the final

[161] Interview with Mesfin, *supra* note 59. Interview with Thsegaye Bitew, Tax Education Officer, Ministry of Revenues, Bahir Dar Branch (July 2, 2022); Interview with Getaneh Dagnaw, Tax Assessment Officer, Ministry of Revenues, Bahir Dar Branch (July 2, 2022); and Interview with Yilkal Garde, Legal Officer, Ministry of Revenues, Bahir Dar Branch (July 2, 2022).

[162] Interview with Teklewengel, *supra* note 97.

legislations, it is hard to say they are represented, and the potential consequence is continuing non-compliance and confrontational relation between the taxpayers and the revenue authority.

Finally, we may raise the low tax-to GDP ratio as another continuing concern of Ethiopia's income tax system. Even if the amount of revenue from income tax increases from year to year, it is very low compared to the amount of revenue the economy generates, as the tax-GDP ratio of the country is below 10% which is low even in the standards of the sub-Saharan African countries.[163] This is tempting to conclude that the reform has failed in one of its objective, i.e., enhancing the income taxation so as to improve the status of the revenue from income tax to support the economy, as its contribution to the economy of the country was seen as minimal at the time.[164] This is the reflection of the tax administration's failure to collect all taxes as prescribed. Thus, solving the tax administration challenges discussed above is the key to make a positive change in this regard.

## Concluding Remarks

This research article tried to examine the 2016 income tax reforms of Ethiopia, in terms of its drivers, actors' involved in the process, major legislative changes it introduced and some constraints that may shadow the reforms intended successes. In this regard, the main drivers the reforms are identified as changes in the economy, enhancing revenue mobilization efforts, building up efficient and equitable tax reform, and addressing gaps in previous income tax legislations. In the reform process, several actors have

[163] World Bank, Tax revenue (% of GDP): Ethiopia, (2020), https://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS?locations=ET (accessed Nov. 22. 2021).

[164] *Gebi le-Limat* interview with Wassihun, *supra* note 57.

taken part, tough; the role of MoF and IMF is very noticeable, while other relevant national actors had a negligible involvement.

The tax laws resulting from the reforms have introduced many legislative changes, including the introduction of Schedule 'E' (to list exempt incomes); detailed regulation of non-residents and fringe benefits taxation; addition of new income tax bases; explicit taxation of residual income sources; increment of the thresholds for floor exemption and tax brackets; and several improvements of in procedural matters that includes consolidation of the administration laws, introduction of advance ruling, institutionalization tax complaint hearing committee, and detailed prescription for the Tax Appeal Commission.

However, there are also several constraints that need serious attention and solution if we wish to see the realization of the goals of the reforms. In this regard, the article highlighted the absence of impact assessment of the 2016 income tax reforms; the institutional lacunas at MoF to handle issues of tax reforms; lack of prescription under the tax laws to make the tax system responsive to inflation; the much troubled, bureaucratic, and weak revenue authority; lack of meaningful stakeholder participation; and low tax-to GDP ratio.

Based on the findings, the authors forwarded the following recommendations:

- The MoF should undertake scientific impact assessment of the 2016 income tax reforms, as soon as possible. The Ministry should also establish a separate department for tax research and reforms, and staffed with the best minds on the subject matter;

- The tax laws should be devised to have a system of periodical update of the floor exemption, tax brackets and tax rates considering the change in the economy [without a need to wait another income tax reform];

- The government should take action to improve the tax administration system and capacity of the MoR [and its subordinate revenue authorities], including digitalizing the administration, staffing with qualified officers, employing objective criteria for average daily revenue assessment, timely tax auditing, and design effective system of data management/recording or tax information.

- The government should opt for meaningful participation of stakeholders in reforming the tax system or enactment of tax laws than the accustomed symbolic forums; and

- Exploiting the abundant inputs forwarded by previous studies and qualified experts, the government should devise tenable tools so as to improve the tax-GDP ratio of the country.

# The Need to Revisit Ability-to-Pay Principle in the Ethiopian Employment Income Tax System[→]

**Endryas Tekalegn[Σ] & Fassil Wodwossen[π]**

## Abstract

*The application of the ability-to-pay principle in a given country supports the realization of a fair tax system and the protection of the basic rights of taxpayers. However, the application of the principle remains unclear in the Ethiopian employment income tax system. This article, through qualitative, comparative, and doctrinal research tools, tried to assess the application of the ability-to-pay principle under the income tax legal regime and its role in contributing to poverty reduction efforts in Ethiopia and to the protection of human rights. The result reveals that the Ethiopian employment income tax structure neglects the personal and family status of the taxpayer, the number of dependents and disability, thereby causing employees to pay the highest price as a result of the ever-increasing cost of living. This raises the need to reconsider the tax policy and amendment of the income tax laws in such a way it ensures tax payment based on the ability-to-pay and assist employees fulfil their basic needs.*

**Keywords:** Ability-to-pay; Employment Income Tax; Poverty Reduction.

## Introduction

[→] This article is the result of a research-project funded by USAID's Feteh (Justice) Activity in Ethiopia. However, the content and opinions expressed in the article are the views of the authors, and not necessarily the views of USAID.

[Σ] LL.B, LL.M, PhD Candidate, Lecturer of law, Dire Dawa University, Advocate and Attorney at-Law in all Federal Courts.

[π] LL.B, LL.M, Lecturer of law, Dire Dawa University, Advocate and Attorney at-Law in all Federal Courts.

Ethiopia is one of the fastest-growing economies today, registering an annual economic growth rate of 9.5 % over the past 15 years.[1] Despite this, a number of key economic challenges remain unsolved including the high cost of living, inflation, and inequality. The tax policy is one of the key tools to manage economic challenges including fair wealth redistribution and poverty reduction.[2] If policymakers are committed to ending poverty and improving the lives of their poorest citizens, they need to explore ways to redesign taxation and transfers so that the poor-especially the extremely poor-do not end up paying more than their fair share without reaping the benefits.[3]

The government of Ethiopia introduced 'Home-grown Economic Reform' in 2019 which aims to address these issues by implementing a new set of comprehensive reforms.[4] In June 2020, the government has also introduced a new 10-year development plan under the theme of 'Ethiopia: An African Beacon of Prosperity' for the years 2020/21 to 2030/31.[5] The Plan aims to reduce the poverty rate from 19% in 2020 to 7% by 2030.[6] Thus, realizing

[11]World Bank Report (fact sheet), Available at: https://www.worldbank.org/en/country/ethiopia/overview (Last Accessed on April 2, 2022).

[2] Jorge Martinez-Vazque, Violeta Vulovic, and Blanca Moreno Dodson, The impact of Tax and Expenditure Policies on Income Distribution: Evidence from a Large Panel of Countries. Review of Public Economics, Vol. 200, No.1, (2012), p.98.

[3] Gabriela Inchauste and Nora Lusting, How Do Taxes and Transfers Impact Poverty and Inequality in Developing Countries, World Bank Blogs, (September 18, 2017), available at:https://blogs.worldbank.org/developmenttalk/how-do-taxes-and-transfers-impact-poverty-and-inequality-developing-countries (Last Accessed on July 1, 2021).

[4] International Monetary Fund, Six Things to Know About Ethiopia's New Program, ( December 23, 2019 ), Available at: https://www.imf.org/en/News/Articles/2019/12/23/na122319-six-things-to-know-about-ethiopias-new%20program (Last Accessed on July 1, 2021).

[5] Harris Tom and Seid Edris Hussein, 2019/2020 Survey of the Ethiopian Tax System, IFS Report, No. R187, (2021), P. 15, Available at: https://www.econstor.eu/handle/10419/235073 (Last Accessed on July 2, 2021).

[6] Federal Democratic Republic of Ethiopia Planning and Development Commission, Ethiopia 2030: The Path way to Prosperity: Ten Years Perspective Development Plan (2021-2030), P. 27, avilable at: https://europa.eu/capacity4dev/file/109230/download?token=rxippQKh (Last Accessed on July 3, 2021).

this requires sustained improvements in domestic resource mobilization and proper income redistribution to ensure that the poorest and most vulnerable members of the population are also able to enjoy the benefits of continued economic growth.[7]

High inflation and the hike in food price, house rent, fuel price, etc. have always been the news and the moaning of employees. The tax burden effect on the living standard of employees is directly related to human rights which most tax policies shadow.[8] Employees with low-income levels suffer and fight for survival reflecting the direct impact on civil, social, and economic rights.[9] For example, the right to life, the right to property, and new generic rights like the right to sustainable development and such problems for certainty will be alleviated by improving taxation system with practical actions of levying tax on the consideration of ability-to-pay.

Accordingly, the primary goal of the Ethiopian tax law and policy should not only be raising revenue but also attaining equity among taxpayers as part of the move to modernize the tax system.[10] Equity primarily ascertains that taxpayers pay the tax in consideration of their ability-to-pay under different vertical schedules.[11] Thus, the ability-to-pay principle is fetched from the equity principle, which is the paradigm pillar in taxation.[12]The approach is a

[7] Anthony B. Atkinson, Chrysa Leventi, Brian Nolan, Holly Sutherland and Iva Tasseva, Reducing Poverty and Inequality Through Tax-Benefit Reform and the Minimum Wage: The UK as a Case-Study, *Journal of Economic Inequality*, Vol. 15: No.4, (2017), P. 305.

[8] Alejandra Mancilla, The human right to subsistence, University of Oslo, (2019), P. 2, Available at https://onlinelibrary.wiley.com/doi/abs/10.1111/phc3.12618 (Last accessed on July 4, 2021)

[9] Anastasija Jersova and Inta Kotane, The Impact Of the Labour Tax Burden On the Living Standard of the Inhabitants of Latvia, *Journal of Regional Economic and Social Development*, Vol.12: No.1, (2020), P.98.

[10] Harris and Seid, *supra* note 5.

[11] Michael L. Goetz, Tax avoidance, horizontal equity, and tax reform: a proposed synthesis, *Southern Economic Journal*, 798-812, (1978), P.807.

[12] Orhan Sener, Principles of taxation, *Maliye Araştırma Merkezi Konferansları*, Vol.37, (1998), P. 83; See also Chauke K. R, Sebola M. P, and Mathebula N. E, Reflection on

progressive realization and exemption of the minimum threshold from tax and sometimes introducing exemptions or deductions.[13]

This article, therefore, examines the application of the ability-to-pay principle in the employment income tax laws of Ethiopia and its contribution to poverty reduction efforts in the country. Methodologically, it uses doctrinal, qualitative and comparative research methods. As such, it analyses different laws including the FDRE constitution, scholarly commentaries, and other international legal instruments to which Ethiopia is a member. Primary data is collected via interview. It also employs a comparative analysis with the view that the growing interaction of experiences among the legal systems results from plurality which helps to draw lessons from other countries.

The paper is organized into four Parts. Part one explains the conceptual underpinnings of the ability-to-pay principle. It explains the principle of the ability-to-pay, and the justifications underlying it. Also it discusses the nexus between ability-to-pay, taxation, and human rights. Part two explores experiences of other countries such as France, United Kingdom, Ghana, and Kenya. The third section discusses the role of applying the ability-to-pay principle in employment tax laws of Ethiopia in reducing poverty. In this part, the legal and policy framework of Ethiopian income tax laws towards the ability-to-pay principle is examined. Part four, finally, provides a concluding remark and suggests the way forward.

## 1. Taxation, Ability-to-pay Principle and Human Rights

### 1.1. Conceptualizing the Ability-to-pay Principle

The divergent positions on what constitutes ability have given rise to a number of theories. The most widely known and most supported justification

the ability to pay theory of taxation in the context of South African Municipalities. International Conference on Public Administration and Development Alternatives *IPADA*, (2017), P. 403.

[13] Atkinson et al, *supra* Note 7.

for ability-to-pay is founded on grounds of sacrifice.[14] Tax payment is perceived as a deprivation to the taxpayers since it results in a surrender of money that could be used for personal purposes to the government in return of none quid pro quo benefits. It should be noted here that payment of tax is not for rejoicing as taxation is a sacrifice to the taxpayers. Rather, the absence of direct quid pro quo, as in trade, may account for the feeling of deprivation that the taxpayer experiences.[15] Since tax payment instils a direct and immediate feeling of loss on the taxpayer, he/she may strive to avoid it by one means or another. In so doing, for achieving Ability-to-pay, John Stuart Mill points out that the burdens on taxpayers should be designed so that each taxpayer contributes an equal sacrifice.[16]

Thus, a person who is over-taxed relative to others of the same status bears a sacrifice. Poor people who pay tax on the necessities of their existence clearly make a sacrifice to effect this payment. So, in assessing the equity of a tax distribution, what matters is not the sum of money paid by the taxpayer in itself, but his loss of well-being. [17] In other words, the size of the sacrifice depends not just on the amount of tax payments, but also on his income and other circumstances that might influence the impact of the fiscal duties on the well-being of a person, reducing the degree of private satisfaction of needs that he can achieve.[18] Such circumstances include also those related to the

[14] Clara Maria Grassi, Status and Impact of the Ability to Pay Principle in the ECJ's Case Law Concerning Tax Benefits Based on Personal and Family Circumstances, Master's Thesis, *University of Lund*, (2015), P. 16.

[15] Stephen Utz, Ability to Pay, *Whittier Law Review*, Vol.*23*, No.4, (2001), P.867- 950.

[16] Mill, J. S., Principles of political economy. In *The Economics of Population* (pp. 97-104). Routledge. Cited in Pressman Michael, the Ability to Pay in Tax Law: Clarifying the Concept's Egalitarian and Utilitarian Justifications and the Interactions between the Two: *NYUJ Legis. & Pub. Pol'y*, *21*, 141, (2018), P.150; Scott H. Gibson, A Critical Analysis of the Ability to Pay: *Edinburgh Student L. Rev.*, *1*, 1, (2009). P 18

[17] Tapan Mitra and Efe A. Ok, Personal Income Taxation and the Principle of Equal Sacrifice Revisited, *International Economic Review*, Vol. 37: No.4, (1996), P.925.

[18] Henry Sedgwick Quoted in Tapan Mitra and Efe A. Ok, Personal Income Taxation and the Principle of Equal Sacrifice Revisited, *International Economic Review*, Vol. 37: No.4, (1996), P.925.

taxpayer's personal and family situation (as, for instance, the burden to provide for his or her family).[19]

## 1.2. Foundations of the Principle of Ability-to-pay

The justification and legal basis of the principle of ability-to-pay is found in a number of other grand principles. These include equity and fairness, equality, and the right to have a standard of living.

### i. Equity and Fairness

From Greek philosophers such as Aristotle and Plato who initially developed the concept of fairness as justice up to the Universal Declaration of Human Rights (hereinafter UDHR), one can trace continual efforts to claim fairness for each citizen defined in broader and more inclusive terms over time..[20] For instance, the first legal formulation of the ability-to-pay principle came with the Declaration of the Rights of Man approved by the National Assembly of France (August 26, 1789). Article 13 states that all citizens should contribute in proportion to their means.[21] Consequently, equity and fairness then became the most basic set of principles applied to constitutions and laws in the world and become general principles of law.[22] Thus, tax equity is the distribution of burdens among taxpayers in a manner regarded as fair. In that sense, the ability-to-pay is a key factor underlying a system for distributing the costs of government in a way that promotes fairness. This is because when we say a

[19] Id.

[20] César Augusto DOMÍNGUEZ CRESPO, The "Ability to Pay" as a Fundamental Right: Rethinking The Foundations of Tax Law, *Mexican Law Review*, Vol. III, No.1, (2009), PP.49-65.

[21] Burgers I.J. J, and Valderrama I. J, Fairness: A Dire International Tax Standard With No Meaning: *Intertax*, Vol. 45, No.2, (2017), P. 769.

[22] Thomas M. Franck, Fairness in International Law and Institutions, *Clarendon Press*, (1998), P. 46; Michael Akehurst, Equity and general principles of law, *International & Comparative Law Quarterly*, Vol. *25, No.*4, (1976), P. 828.

tax is fair it means a tax that treats equitably individuals who are situated alike.[23]

### ii. Equality

A more stable foundation of the principle of ability-to-pay can also be built considering such principle as a corollary of the equality principle.[24] This is because the ability-to-pay principle is based on equality and places a limit on the state's power of taxation to ensure fair distribution of the burden among taxpayers. Equality requires similar (comparable) situations to be treated the same way and different situations to be treated differently. Accordingly, the ability-to-pay can be seen as a manifestation of the equality principle. This can be justified by looking into Article 13 of the French Declaration on the Rights of Man and the Citizen (1789) which stipulates: "For the maintenance of the public force and for the expenditures of administration, a common contribution is indispensable; it must be equally distributed to all the citizens, according to their ability-to-pay."[25]

### iii. Standard of Living

Another justification for the right to contribute, according to the ability-to-pay, is comprised of certain rights classified as "economic rights"; the right to own property, the right to work, and in general, the right to have a standard of living. According to Article 25(1) of UDHR, 'everyone has the right to a standard of living adequate for the health and well-being of himself and his

[23] C. Eugnen Steuerle, And Equal (Tax) Justice for All?: *Tax Justice: The Ongoing Debate*, (2002) P. 256; J. Clifton Fleming, Robert J. Peroni, and Stephen E. Shay, Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income, *Florida Tax Rev*, Vol.5, No.4, (2001), P. 301.

[24] Crespo, *supra* note 20, p.3.

[25] France National Assembly, Declaration of the Rights of Man and the Citizen Adopted by the National Assembly during its Sessions on August 20,21,25 and 26 and Approved by the King, Paris: Mondharre & Jean 1789 (here in after French Declaration)

family'.[26] The right to an adequate standard of living requires, at a minimum, that everyone shall enjoy the necessary subsistence rights: adequate food and nutrition, clothing, housing, and the necessary conditions of care.[27]Thus, taxing expenses made to satisfy the basic need would go against the ability-to-pay principle as it could affect the minimum subsistence of the taxpayer for which the taxpayer is believed to fulfil basic needs.[28]

### 1.3. Understanding the Nexus between Taxation and Human Rights

The major responsibility of the government is to ensure that each member of society has the right to maintain his or her human dignity. Human dignity is the core of human rights as enshrined under the preamble and Article 1 of the UDHR. Emphasizing this fact, the preamble of UDHR states "[w]hereas recognition of the inherent dignity and of the equal and inalienable rights of all members of the human family is the foundation of freedom, justice, and peace in the world", and Article 1 stresses that "[a]ll human … are born free and equal in dignity and rights". Similarly, Article 21/1/ and Article 24/1/ of the FDRE Constitution also clearly protect the right of everyone to respect his human dignity and honour.[29]

Though taxation is a rarely explored topic on the human rights agenda, it is one of the most important policy instruments governments can deploy to generate the resources needed to realize the full range of human rights.[30] The issue of taxation has become a major subject of policy debate since the 2008

[26] The Universal Declaration of Human Rights (UDHR), United Nations General Assembly, New York, 1948.
[27] Id.
[28] William Glenn Gale, What can America learn from the British tax system?, *National Tax Journal*, Vol. 50, No.4, (1997), P. 758.
[29] The Constitution of Federal Democratic Republic of Ethiopia, Proclamation No.1/1995, Federal Negarit Gazetta, (1995), [hereinafter FDRE Const.].
[30] Era Dabla-Norris, Kalpana Kochhar, Nujin Suphaphiphat, Frantisek Ricka, Evridiki Tsount. *Causes and consequences of income inequality: A global perspective*. International Monetary Fund. (2015). P. 38

global finical crisis, which brings new manifestation of poverty, inequality, and economic dynamics.[31]

The effort to analyse the implications of tax for the respect of human rights and scrutinize the content of tax rules through the lens of human rights law became also a concern.[32]A notable move by the United Nations is the 2014 report on fiscal policy by the UN Special Rapporteur and the appointment of an independent expert on 23 March 2017 by the UN Human Rights Council Resolution No. 34/3. The 2014 report on fiscal policy by the UN Special Rapporteur on extreme poverty and human rights endorses taxation as a key tool for tackling inequality and generating the resources necessary for poverty reduction and the realization of human rights.[33] Similarly, the independent expert was mandated to investigate the impact of illicit financial flows on the enjoyment of human rights from which the independent expert Juan Pablo Bohoslavsky issued a report on how tax policies affect the enjoyment of human rights.[34]

In addition, the nexus between taxation and human right has come into focus through human rights publications such as the International Bar Association's 2013 report on tax abuses, poverty, and human rights,[35] A similar publication

[31] Id.

[32] Manoj Kumar Bharti Creating a Shared Future in Fractured: *International relations, part "Economic sciences", 1* (15), (2018), P. 6

[33] Magdalena Sepúlveda, Report on taxation and human rights (A/HRC/26/28), submitted by the Special Rapporteur on extreme poverty and human rights, (2014) P. 8

[34]UN Human Rights Council, Mandate of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights Resolution No. 34/3, (2017); see also Mr. Juan Pablo Bohoslavsky, End of mission statement of the United Nations Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, to his visit to Switzerland, 4, Oct. 2017, https://www.ohchr.org/en/statements/2017/10/end-mission-statement-united-nations-independent-expert-effects-foreign-debt-and (Last Accessed 2/3/2022)

[35] Thomas Pogge, Tax Abuses, Poverty and Human Rights; A report of the International Bar Association's Human Rights Institute Task Force on Illicit Financial Flows,

has been issued by Christians Fair Taxation as a basic human right[36] and Worster's Publication on Human Rights Law and the Taxation Consequences for Renouncing Citizenship.[37] These publications challenge the inadequacy and inequity of tax policies for the enjoyment of human rights domestically and internationally and strive to treat tax policy as human rights policy.

Accordingly, taxation from a human rights perspective has three roles : its role in generating the 'maximum available resources to finance human rights-related expenditure; its potential role in redistributing resources in order to mitigate and redress social inequalities; and its role in cementing the bonds of accountability between state and citizen.[38] Thus, it can be argued that tax makes resources available whereas tax policy demonstrates tangible action in setting priorities. If carefully implemented, tax is the government's most important policy tool to the realization and protection of human rights.[39] In such cases, the exemption of the minimum for subsistence and redistributive policies could increase equality and growth.[40] Many writers also recognize that a person's vulnerability to tax injustice might be associated with various aspects of his or her situation in life and that the intrusiveness of the government in determining one's susceptibility to taxation should influence the choice of a tax base.[41]

Poverty and Human Rights. *International Bar Association*, (2013) P. 8; see also William Thomas. Human Rights Law and the Taxation Consequences for Renouncing Citizenship. . *Louis ULJ*, *62*, 85. (2017). P. 62

[36] Allison Christians, Fair Taxation as a basic human right: *International Review of Constitutionalism*, (2009), P. 215.

[37] Worster, W. T. Human Rights Law and the Taxation Consequences for Renouncing Citizenship. . *Louis ULJ*, *62*, 85. (2017), Pp. 87-88.

[38] Nolan, A., O'Connell, R., & Harvey, C., *Human rights and public finance: Budgets and the promotion of economic and social rights*. Bloomsbury Publishing, (2013), P.78

[39] Id.

[40] Id., P. 61; See also Goraus-Tanska K.. and Inchauste G, *The distributional impact of taxes and transfers in Poland*, ( World Bank Policy Research Working Paper, WPS7787, 2016), p. 11.

[41] Edwin Robert Anderson Seligman, Progressive Taxation in Theory and Practice, *American Economic Association Quarterly*, Vol.11, No.2, (1894), p.151.

## 1.4. The Role of Tax in Reducing Poverty

Scholars such as Chernick and Reschovsky noted that raising the personal exemption, the standard deduction, and the earned income tax credit, reduced the number of poor families and helped millions below the poverty level.[42]Immervoll et.al., based on a detailed analysis of the targeting efficiency of tax and other cash benefits, also revealed that a number of these benefits are quite successful in targeting the most vulnerable population.[43]

In assessing the effectiveness of earned income tax credit, Hoynes & Patel, in another study, revealed how the sizable contribution of earned income tax credit (EITC) in reducing poverty is significantly understated.[44] In their research, it was found out that that the EITC removes 1.8 million children from poverty.[45]

The same position is held by Higgins & Lustig on the role of transfers, subsidies, and taxes for poverty reduction. They stated that these measures can lead the tax and transfer to a system unambiguously benefiting the poor.[46] Indeed, they observed that out of seventeen developing countries from which they have collected data, fifteen have tax and transfer systems that unambiguously reduce poverty. The same holds true in studies conducted by Atkinson *et. al*. The latter group of scholars have revealed that each of the tax and transfer reform packages has a substantial impact on summary measures

[42] Howard Chernick and Andrew Reschovsky, The taxation of the poor, Journal *of Human Resources*, Vol.25, No.4, (1990), P. 716.

[43] Immervoll Herwig, Levy Horacio, Nogueira José Ricardo, O'Donoghue Cathal, de Siqueira Rozane Bezerra, *The impact of Brazil's tax-benefit system on inequality and poverty*, (IZA Discussion Papers, No. 2114, 2006), P.11 Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=900832 (Last Accessed on March 4, 2022).

[44] Hilary W. Hoynes, and Ankur J. Patel, Effective Policy for Reducing Poverty and Inequality? The Earned Income Tax Credit and the Distribution of Income, *Journal of Human Resources*, Vol. 53, No.4, (2018), P. 865.

[45] Id.

[46] Id.

of inequality and poverty.[47] They further noted that, when more sensitive summary measures are used, the impacts of the tax/transfer reforms are considerably larger thereby justifying the claim that enhanced direct redistribution can be a major element in a broader strategy aimed at tackling inequality.[48]

Turning to another policy practice, the principal policy changes, geared towards reducing poverty since 1997 in the UK, have been the introduction of or increases in the National Minimum Wage, Working Families Tax Credit, and Income Support change targeted at children (replaced and enhanced by Child Tax Credit and Working Tax Credit), Minimum Income Guarantee for Pensioners (replaced and enhanced by the Pension Credit) and Winter Fuel Payments.[49] Changes to income tax and national insurance contributions as well as some benefits not listed above have also affected poverty. This is an evidence to the fact that designing tax policy on the principle of the ability-to-pay does actually reduce poverty.

Research conducted in Ethiopia on the likely implication of government transfer schemes to households reveals that the transfer scheme can be used as a policy to reducing poverty. [50] Supporting this assertion the author could find out evidences showing that the proportion of poor has shown decreases by 3.4% (national), 3.5% (rural), and 2.3% (urban).[51]

Thus, in its direct way, tax has a role to play in the distribution of society's resources and indirectly through its effects on the incentives for the economy.

[47] Atkinson et al, *supra* Note 7, pp. 305-306.
[48] Id.
[49] Holly Sutherland, Tom Sefton and David Piachaud, Poverty in Britain: The impact of government policy since 1997, (2003), pp.8-12 Available at http://www.jrf.org.uk/knowledge/findings/socialpolicy/043.asp (Last accessed on March 2, 2021)
[50] Daniel Abraham Mengistu, The Impact of Fiscal Policy on Poverty in Ethiopia: A Computable General Equilibrium Microsimulation Analysis, *Ethiopian Journal of Economics*, Vol. 22, No. 1, (2013), pp.25-70, P. 56.
[51] Id.

As such, it tries to reduce poverty and the impact of the rise of cost on those who are poor and below the poverty line. One very obvious way in which the tax system is relevant to the reduction of poverty is the impact taxes have on the incomes of households below or close to the poverty line.[52] One example of a tax system that supports a policy for the reduction of poverty would be one that reduces the tax liabilities of households in poverty.[53] This can be effective in various ways including guaranteeing that the tax laws are enacted in such a way they protect the ability-to-pay principle of tax laws.

## 2. Experiences of Other Countries

In the review of the experience of other countries, the income tax system of France and United Kingdom from Europe and Ghana & Kenya from Africa were selected for legal comparison. France and UK are chosen because of their well-developed legal systems in the world from which we can also share good experiences. Most importantly, both countries have good experience on tax credits and deductions that have contributed, despite other factors, to driving their citizens out of poverty and reducing income inequality and which can be best experience for Ethiopia.[54] Ghana and Kenya are also selected on the ground that Ethiopia, Ghana, and Kenya are in the same trend of economic development and Ghana & Kenya have a good experience in the administration of tax exemptions and deductions that helped them reduce

[52] Atkinson et al, *supra* Note 7, P. 308.

[53] Ivaškaitė-Tamošiūnė Viginta, Maestri Virginia, Malzubris Janis, Poissonnier Aurélien and Vandeplas Anneleen, *The Effect of Taxes and Benefits Reforms on Poverty and Inequality in Latvia* (No. 039). Directorate General Economic and Financial Affairs (DG ECFIN), European Commission, (2018), P. 11.

[54] Rafael A. Espinoza and Esther Perez Ruiz, *How Do Fiscal and Labor Policies in France Affect Inequality?*. International Monetary Fund, (2016), P. 56; see also BuRkhause R. V. The minimum wage versus the earned income tax credit for reducing poverty, *IZA World of Labor*, (2021), P. 9; See also Rod Hick & Alba Lanau, Tax credits and in-work poverty in the UK: An analysis of income packages and anti-poverty performance, *Social Policy and Society*, *18*(2), 219-236, (2019), pp.219-236, P. 225.

poverty situation.[55] In that sense, experience of these countries may be feasible in Ethiopia.

### 2.1. The French tax system

France introduced a progressive income tax system in 1911 and family splitting, as opposed to individual system.[56] Since 1948, there has been a move to adapt the fiscal contribution of the household to its financial ability, taking into account the total number of household members, including children.[57] From a pro-nationalist perspective, it was clear from the outset that tax exemptions may promote marriage and population growth.[58] However, it will be unlikely to imagine having children to be benefit from a tax exemption would be tempting to families in France. Thus, the French experience in relation to splitting system shall be cautiously construed taking into account the population policy of Ethiopia. Concerning calculating tax exemption

[55] Clirre Kumar, Africa rising: Inequalities and the essential role of fair taxation, African Forum and Network on Debt and Development (AFRODAD 2014), P.23. see also The Africa initiative, Tax Transparency in Africa 2021 report highlights key role of EOI, (2021), pp, 41-45; see also Nancy Nafula, Denis Kyalo, Boaz Munga, & Roze Wanjiru Ngugi, Poverty and distributional effects of COVID-19 on households in Kenya, (2020), P. 16-20; see also Jacob Novignon, Justice Nonvignon and Richard Mussa, The poverty and inequality nexus in Ghana: a decomposition analysis of household expenditure components, *International Journal of Social Economics*, (2018), P 23.

[56] In an individualised system, the incomes of both spouses are kept separate for tax purposes. In a splitting system, the joint income is divided over both partners before tax is calculated. Income splitting is a tax policy of fictionally attributing earned and passive income of one spouse to the other spouse for the purposes of assessing personal income tax. Countries with a splitting system automatically have, in effect, a progressive income tax system. In a splitting system, it makes no difference for the tax burden who contributes the income. There are various types of splitting systems. Some like UK, Sweden and Austria are directed at spouses, while others such as France focus on families.

[57] Laisney François, Beninger Denis, and Beblo Miriam, Family Tax Splitting: A Micro-simulation of its Potential Labour Supply and Intra-household Welfare Effects in Germany, (ZEW Discussion Papers 03-32, 2003), P. 7

[58] Cicely Watson, Population policy in France: Family allowances and other benefits II, *Population Studies*, Vol. 8, No.1, (1954), pp.46-73, P. 49.

based on the splitting divisor is very much important in considering tax exemption based on the number of dependants in Ethiopia.

Accordingly, the splitting divisor is increased by 0.5 for the first and second child, and by 1 for the third and every subsequent child.[59] In so doing, for a married couple with two children, the factor is 3 and with a family income of € 90,000, the tax burden imposed is calculated over an income of € 30,000 and then multiplied by a factor of 3.[60]. Based on the tax rate of French income tax, this gives a tax liability of € 8,763.[61] Scholars such as Beblo *et. al*, argues that the French family splitting provides certain equity among families with comparable endowments.[62] In addition to these tax benefits for married couples, there is a tax-deductible allowance of 10 percent of salary for work-related expenditure. Also, there is a deduction for maintenance payments[63]and a bonus for working people.[64] Finally, the tax burden changes in line with different forms of cohabitation.

### 2.2. The UK tax system

Income tax in the United Kingdom (UK) is tailored to the taxpayer's ability-to-pay by way of introducing tax credits. Accordingly, Child Tax Credit which was applied in UK is calculated at £ 545 for the family element, £ 2,935 per child element (paid for each child or qualifying young person), £ 3,545 is paid for the disability element, where the child or qualifying young

[59] In France, not only married couples but also spouses or two other people who signed the PACS ('Pacte civil de solidarité') are eligible to income splitting (although not immediately as married couples).

[60] Van Kruiningen, Fair Tax and Families, A comparative study with a view to a more equitable income tax, P. 22, available at https://sallux.eu/Family%20and%20fair%20taxation%20def.pdf (Last Accessed on March 2, 2022).

[61] The tax rate in France is up to the first 10,225 Euros are taxed at 0%. From 10,225 € to 26,070 €, is taxed at of 11%. From 26 070 € to 74545 €, the tax rate is 30% and increased progressively to 41% for those incomes greater than 74545 €.

[62] Beblo et. Al, *supra* Note 57 p. 82.

[63] Van Kruiningen, *supra* note 60, P. 22.

[64] Id.

person is disabled (paid in addition to the child element) and £4,975 for the disability element of Child Tax Credit, where the child or qualifying young person is severely disabled (paid in addition to the child element). [65] In that, Child Tax Credit will be paid directly to the main caregiver for all the children in the family.[66] If they are couples he/she needs to tell tax authorities which one of them (the husband or the wife) is the main caregiver to the child.[67]

Despite this, since 6 April 2017, the individual child element of the Child Tax Credit is no longer awarded for third and subsequent children or qualifying young persons in a household, born on or after 6 April 2017, and is being replaced by Universal Tax Credit. Also, unless a person is currently getting Working Tax Credit, he can no longer make a new claim for Child Tax Credit and must apply for the child element of Universal Credit instead up to a maximum of £646.35 for one child or £1,108.04 for two or more children.[68] A deduction is also available for blind people.

### 2.3. The Ghana's Tax System

Ghana realized significant poverty reduction in line with the first Millennium Development Goal. [69] Ghana's poverty rate was 47.4 percent in 1991 and decreased to 13.3 percent in 2016.[70] Its extreme poverty rate fell from 76 percent to only 45.2 percent between 2005 and 2016.[71]

[65] A guide to Child Tax Credit and Working Tax Credit, Available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1064064/WTC2-2022.pdf (Last Accessed on March 2, 2022)
[66] Id.
[67] Id.
[68] Id.
[69] Vasco Molini and Pierella Paci, *Poverty Reduction in Ghana : Progress and Challenges*, (2015), P3.
[70] Id.
[71] Ali-Nakyea Abdallah, *Taxation in Ghana: Principles, Practice and Planning, 3rd edition, Accra: Black Mask Ltd*, (2008), P. 107; see also Mavis Pobbi, Samuel Gameli Gadzo, Emmanuel Atta Anaman, Philip Yamoah Esse, & Holy Kwabla Kportorgbi,

It should be noted that the reduction of poverty in Ghana is not a surprise but rather a manifestation of different poverty reduction strategies adopted by the government since 1991. One of these strategies is the adoption of personal tax reliefs.[72] The personal reliefs allowed in Ghana are a tax-free threshold of GH¢ 4380, children's education school fee relief of GH¢600 per Child, Marriage/Responsibility Relief of GH¢200, Disability Relief of 25% of that individual's assessable income from business and/or employment, Old Age Relief of GH¢1500, Aged Dependent Relief of GH¢1,000, and Professional, Technical or Vocational Training Relief of GH¢2000 per year.[73] Also, personal income tax, expenses, and limitations are reviewed and updated by the Ghanaian government periodically.[74] This is made to support the economic growth in Ghana or to provide specific tax reliefs in the country. As part of this effort, the tax-free income threshold (worth GH¢ 4,380 per annum) aligned with the current daily minimum wage in Ghana is 12.53 Cedis (375.90 per month).[75]

## 2.4. The Kenya's Tax system

The Kenyan tax systems are expected to honour the principles of ability-to-pay taxes and equitable taxation by various means including the provision of some tax exemptions for incomes needed to obtain the basic necessities of living.

The personal income tax in the country is governed by the Income Tax Act where the tax rates on income increase progressively from ten percent to 30

Utilization of Personal Tax Relief Schemes: An empirical Analysis in the Context of Tax Evasion, *Journal of Accounting and Taxation*, Vol.10, No.8 (2018), P. 102.

[72] Id.

[73] According to a new Act 1071 adopted in 2022 that amends the Income Tax Act 2015 (Act 896) and Act 1007, the tax-free income threshold is increased from GH¢1584 to GH¢ 4,380.

[74] Ghana Business news, National Daily Minimum Wage for 2021, Available at https://www.ghanabusinessnews.com/2021/06/05/national-daily-minimum-wage-for-2021-is-gh%C2%A212-53/ (Last Accessed on March 3, 2022)

[75] id.

percent.[76] The Income Tax Act provides personal relief to taxpayers.[77] Currently in Kenya, every income up to KSh. 24000 is taxable at 10% and every resident individual is entitled to 'personal relief,' of KSh. 2400.[78] In addition to personal relief, interest paid on an amount borrowed from financial institutions up to a maximum of KSh. 300,000 per annum,[79] pension contribution by an employee to a maximum of KSh. 240,000 per annum, insurance premiums paid up to a maximum of KSh 60,000 are deductible.[80] In addition, Articles 13.2 and 35.1 of *the People with Disabilities Act* (PWD Act) 2003 of Kenya provids that an employee with a disability is entitled to a tax exemption on all income derived from his employment who earns below Ksh 150,000 per month or for their first KES 1,800,000 per year.[81] Besides, Kenya has made regular reviews of the income threshold and personal relief as the main instruments of re-distributive taxation.[82] Thus, the equity question and support for the poor have mainly been addressed through various adjustments to the income threshold and the personal relief. Because of this, income tax brackets aimed at cushioning poverty have resulted in about 1.3 million taxpayers being dropped from the tax net since 1981.[83]

[76] Moses Kinyanjui Muriithi and Eliud Dismas Moyi, *Tax Reforms and Revenue Mobilization in Kenya*, (African Economic Research Consortium, Working Paper 131, 2003), P.11.

[77] The Income Tax Act, on 1st January, 1974, (Cap 470) Revised Edition, 2021.

[78] Pay As You Earn (paye) Guide, Kenyan Revue Authority, Available at https://www.kra.go.ke/images/publications/Pay-As-You-Earn-Guide-2022-.pdf (Last Accessed on February3, 2022).

[79] Annah Grace Kemunto, Evaluating Kenya's Tax Law Changes on PAYE, (March 19, 2021), (2021), Available at https://ieakenya.or.ke/blog/evaluating-kenyas-tax-law-changes-on-paye-in-january-2021/ ( Last Accessed on March 2, 2022).

[80] Id.

[81] Id.

[82] Eliud Moyi and Eric Ronge, Taxation and tax modernisation in Kenya: A diagnosis of performance and options for further reform, (Nairobi Kenya : Institute of Economic Affairs, 2006), pP. 3-8. https://www.africaportal.org/documents/12008/Tax-Revenue-Performance-in-Kenya1.pdf (Last Accessed on March 4, 2022).

[83] Stephen Njuguna Karingi, and Bernadette Wanjala, *The tax reform experience of Kenya*, UNU-WIDER, Working Paper 67/2005, 2005) (No. 2005/67), P. 7.

## 3. Ability-to-pay principle and Its Poverty Reduction Role in the Ethiopian income Tax System

### 3.1. The Policy and Legal Framework

The principle of setting tax duties based on the taxpayer's ability-to-pay is accepted in most countries as one of the bases of a socially just tax system in their tax policies or constitution.[84] This move is premised on the ground that tax policy plays a fundamental role in redressing inequalities in society and in shaping accountability mechanisms.[85]

However, looking into the Ethiopian legal framework, we may not find a separate tax policy document issued and publicized by the government. The only document, if at all, with this mission is the national strategic Growth and Transformation Plans (GPTs). In the past few years, the government of Ethiopia has formulated these plans to be executed in three phases: GTP I (2010/11-2014/2015), GTP II (2015/2016- 2019/2020), and now the 10-year development plan under the theme of 'Ethiopia: An African Beacon of Prosperity' for the years 2020/21 to 2030/31. These strategic policy documents have nothing to say about the ability-to-pay principle of taxation. The primary aim or focus of the strategic plans is that of improving the enforcement powers of tax laws and administration to raise revenue adequate to finance development.[86] The plans aim to broaden the tax base and this has

[84] Taddesse Lencho, The Ethiopian income tax structure: Policy, Design and practice, Value', *European Law Journal*, Vol. 19, No. 4, (2014), P.102.

[85] Nasser Abdel Karim, Annad, *Tax justice and sustainable development in the Arab Region: Lessons from four countries,* (Arab Network for NGO Development, April 8, 2019), Available at https://www.annd.org/en/publications/details/tax-justice-and-sustainable-development-in-the-arab-region(Last Accessed on November 4, 2022); see also Jorge Martinez-Vazque, Violeta Vulovic, and Blanca Moreno Dodson, The impact of Tax and Expenditure Policies on Income Distribution: Evidence from a Large Panel of Countries. Review of Public Economics, Vol. 200, No.1, (2012), p.98.

[86] MOFED, Growth and Transformation Plan (GTP) 2010/11-2014/15, the Federal Democratic Republic of Ethiopia, Addis Ababa, (2010), P, 32.

an indirect effect on the equitability of the Ethiopian tax system.[87] Sadly, the government has not issued an official tax policy document either in general or on the ability-to-pay principle of tax in particular.

Moreover, the FDRE Constitution is silent about the principle of ability-to-pay. The Constitution has included a list of rights and freedoms. But there is no clear provision that grants the taxpayer to pay according to his/her ability. Yet, it can be argued that the Constitution is not fully unmindful of the ability-to-pay principle for it recognizes the right to equality as one of the fundamental rights and freedoms of citizens.[88] The principle of equity in taxation expresses the idea that taxes should be fair as one of the principles that guide tax policy.[89] Tax equity is a major policy objective of the government of Ethiopia.[90] It was even one of the major motivations for the comprehensive tax reforms of 2002 and 2016.[91] The FDRE constitution specifies that the government has to ensure that all Ethiopians get equal opportunity to improve their economic condition and to promote equitable distribution of wealth among them.[92] The contrario-reading of this provision suggests that the FDRE constitution impliedly recognizes the principle of ability-to-pay tax. This is even justified from the reading of Article 100 where the constitution requires that taxation shall be determined based on proper consideration.[93] So, we can conclude that the FDRE Constitution has recognized this right implicitly.

Concerning income tax laws, the Ethiopian income tax system is comprised of two separate income tax regimes (the federal and the regional). Although

[87] Id.
[88] The FDRE Constitution Preamble, Article 3/1/, 5/1/, 25, 34, 35, 41/3/ and 42/1/d/.
[89] Michael Akehurst, *supra* note 22, P. 830.
[90] Taddesse Lencho, *supra* note, 85 , P.107-109.
[91] Id.; See also Harris and Seid *supra* note 5, P. 12.
[92] See Arti 89 of FDRE Constitution.
[93] Article 100 of the FDRE Constitution states that;- In exercising their taxing powers, States and the Federal Government shall ensure that any tax is related to the source of revenue taxed and that it is determined following proper considerations.

States have the power to levy and collect taxes on employees of the state and private enterprises according to Article 97/1/ of the FDRE Constitution, the income tax proclamations of regional states is a verbatim copy of the Federal income tax proclamation. Thus, as the scope of this research is to consider the design structure and system of income from employment in line with ability-to-pay principle, it's so important to test whether the employment income taxation system in Ethiopia is designed according to the ability of the taxpayer. In that regard, the Ethiopian income tax system is "schedular" in structure and separate taxes are imposed on different categories of income like income from employment, income from rental of property, and income from a business.[94] As Seligman noted, when indirect taxes exist, they often hit the poor harder than the rich.[95] So, progressivity of income taxes helps to act as an engine of reparation for such poor and respects the payment of taxes based on faculty (ability). In so doing, he recommends that in order to attain equal treatment, the regressive indirect taxes must be counterbalanced by the progressive direct taxes. Thus, the fact that the employment tax system in Ethiopia is schedular, is a step ahead in recognizing individuals' tax duty based on their ability.

The other way of recognizing the ability of the taxpayer in progressive tax systems is introducing the minimum of subsistence as exempted based on the idea of clear-income theory of taxation.[96] Exemption of minimum subsistence based on clear-income theory holds that the laborer's outlay for necessaries are also expenses of production just like production expense is deducted for investment tax.[97] In that sense, the Ethiopian income tax proclamation has provided the minimum subsistence which is one of the keys to assessing

[94] Taddesse Lencho, *supra* note 84, P. 182.

[95] Edwin Robert Anderson Seligman, The theory of progressive taxation. *Political science quarterly*, 220-251, (1893), P.224-226; see also Henry Ordower, Schedularity in US income taxation and its effect on tax distribution, *Nw. UL Rev.*, Vol. 108, No. 905, (2013), P. 915; See also Wolfram F. Richter, From Ability to Pay to Concepts of Equal Sacrifice, *Journal of Public Economics*, Vol. 20, No.2, (1983), P. 92.

[96] Id.

[97] Id.

whether or not the taxation system is based on ability-to-pay. Yet, given the steadily soaring inflation and high cost of living, it is imperative to scrutinize whether or not the minimum subsistence set in the proclamation is sufficient.

In general, it can be argued that the federal income tax proclamation, while it fails to consider the different circumstances of the taxpayer and uses only individual as a taxing unit, appears, at least tacitly, to incorporate some of the ability-to-pay principle determinants and combines the requirements of both horizontal and vertical tax equity by imposing progressive income tax rates on the employment income.

The presence of ability-to-pay principle even with an implicit tone is significant for the taxpayers to defend themselves from excessive tax burden and it has also implications for other fundamental rights and freedoms. It also restrains the government from imposing an excessive tax and violates the socio-economic rights of a taxpayer. This is because the major responsibility of the government is to ensure that each member of society has the right to maintain his or her human dignity. Human dignity is the core of human rights as enshrined under the preamble and Article 1 of UDHR.[98]

### 3.2. The Poverty Reduction Role of Applying the Ability-to-pay Principle

Many writers recognize that a person's vulnerability to tax injustice might be associated with various aspects of his or her situation in life and that the intrusiveness of the government in determining one's susceptibility to taxation should influence the choice of a tax base.[99] Seligman acknowledges that equal amounts of money revenue or the equivalent may not necessarily reflect an equal ability-to-pay, because of differences in "social demands," family needs, and so forth.[100] This is because, taxes, in so far as they took the means

[98] UDHR, *supra* Note 28

[99] Seligman, *supra Note*, 41, P. 151; Wolfram *supra* note 95; Slade Kendrick, The Ability-to-Pay Theory of Taxation, *The American Economic Review*, Vol. 29, No.1, (1939), P. 100

[100] Id.

of satisfying our wants, impose a sacrifice on us. Thus, the sacrifice from tax burden as Ricardo points out will be less if "the power of paying taxes is in proportion to the net, not to the gross, revenue."[101] By net revenue, he means gross income, less expenses of production. That is, the laborer's outlay for necessities is also an expense of production and must be expected from tax to achieve. Thus, the demand for the exemption of the minimum of subsistence comes into the picture and is being applied in most legal systems of the world.[102] This is because the minimum subsistence is a privileged part of all income to attain the ability-to-pay principle of taxation. In so doing, only the surplus above this minimum shall be assigned to the public for the support of government expenditure.[103]

Accordingly, before we begin to tax any income of the poor, Seligman notes, we must, at least, ensure that his gross income is more than the amount required to cover subsistence expenses. Equally, it is unjust and unconstitutional to deduct tax from the income of the poor where that income is the absolute necessaries of life for his family.[104] This scholar further points out, no man shall be bound to give to another what is essential to his subsistence by way of taxation.[105] One example of a tax system that supports a policy for the reduction of poverty would be one that reduces the tax duties of households in poverty.[106] This can be effective in various ways including guaranteeing that the tax laws are enacted in such a way that they protect the ability-to-pay principle of tax laws.[107] In other words, the taxation of an employment income shall be made, at least, taking into account the subjective ability of the taxpayer.[108] In that sense, though the determination of the tax

[101] Seligman, *supra* Note 41, P. 155
[102] Id.
[103] Id.
[104] Id.
[105] Id.
[106] Ivaškaitė-Tamošiūnė, et al, *supra* Note 53.
[107] Id.
[108] The subjective ability to pay is related to the individual's ability to contribute in relation to their personal circumstances, whereas the objective ability to pay refers to

unit is the economic power of the government, it should not tax all the taxpayer's wealth but should exclude the portion required to ensure at least a minimum standard of living. This includes the means required for housing, nutrition, medical insurance and services, and basic education.

Indeed, most income tax systems do not attempt to collect the Personal Income Tax from those with low incomes and realize tax fairness either by defining amounts of income that will be tax-exempt or by offering low-income tax credits to attain the ability-to-pay principle of taxation.[109] Many countries grant different forms of tax relief taking into account the number of children, marital status, or specific expenses linked to the personal needs of the taxpayer (such as medical expenses) using redistributing function tax.[110] Some modern tax systems have grappled with these individual circumstances and attempted to take individual and family circumstances into account in distributing tax burdens.[111]

In Ethiopia, however, it is the poor employees who are still sacrificing in taking the burden of tax and the highest price of increasing cost of living.[112] This is because the federal income tax proclamation has incorporated a list of exemptions for schedule "A" income taxpayers.[113] The major exemptions are common exemptions for those whose salary is less than 600 Birr under Article 11 of the same and employer-paid health insurance benefits, transportation allowance, hardship allowance, per diem, traveling expenses,

the determination of income, or, more exactly, the kind of revenues to be considered as income for tax purposes.

[109] Philip Alston and Nikki Reisch, *Tax, Inequality, and Human rights*, (ed.), Oxford University Press, (2019), P.6

[110] Chiara Bardini 'the ability to Pay in the European Market: An Impossible Sudoku for the ECJ', in Intertax, vol. 38, No.1,( 2010), p. 4.

[111] Atkinson *supra* note 7, P. 310

[112] Interview with Mulay Weldu, Tax Policy Director, Ethiopian Ministry of Finance, and Abere Asefaw, Ethiopian Revenue Authority Legal service Director, (May 14, 2022).

[113] Federal Income Tax Proclamation, (2016), *Federal Negarit Gazette*, Proclamation No 979, 22nd year, No.104, (here in after the income tax proclamation).

and food provided to the employee by the mining employer under Article 65 of the proclamation.[114]

It should be noted here that most of the exemptions provided are not pro-poor. This is because a significant portion of employees' salary is spent on food consumption for their families and themselves. Few employers are willing to cover the costs of meals for their employees fully or partially. However, the interpretation of the tax law by the tax authorities has discouraged employers from partially contributing or fully covering meal costs.

In this regard, a Circular issued by the Ministry of Finance dated Tikimit 5, 2007 E.C. states that except for employees in the manufacturing sector, the cost of provision of a meal by the employer could not be regarded as a deductible expense for the employer and should be added on the employee's salary as taxable income.[115] This was partially revised in 2011 EC.[116] Accordingly, more sectors were covered by the exemption, but a limit on the monthly costs was introduced.

The directive issued by the Ministry of Finance on deductible expenses states food provided by the employer to his employees will be considered as deductible expenses up to 30% of the monthly salary of each employee.[117] This applies only to employers engaged in mining, manufacturing, agriculture, and horticulture. For employers in hotels, restaurants, and others providing food services, the deductible expense is 20% of the monthly salary of the employee.[118]

It is also possible to observe unfair treatment of deductible incomes of the employees under the Directive issued to regulate incomes free from income

[114] Article 11 and 65 of the Income Tax proclamation.
[115] Letter issued by Ministry of Finance dated tikimt 5, 2007.
[116] **ስለ ተቀናሽ ወጪዎች የወጣ መመሪያ ቁጥር** 5; 2011 **ኢትዮጵያ ፌዴራላዊ ሪፐብሊክ ፋይናንስ ሚኒስቴር** (Hereinafter Directive No. 5/2019)
[117] Id., Article 7(1)
[118] Id, Article 7(2)

tax.[119] A directive issued in this respect treats a significant portion of costs of transportation and allowance as non-deductible income. [120]

At a national level, the size of employed population aged ten years and above, in February 2021, is 41,637,071 , while in June 2020 (the result of the Tigray Region excluded), is 39,856,378.[121] Employed persons support not only themselves but also their dependents. From that perspective, the ability-to-pay principles will significantly alleviate the poor living conditions of working people if they are required to pay taxes according to their capacity and income. Underlying all these evidences is the fact that except for the exemption for those employees who earn less than 600 Birr, the rest of the exemptions tend to favor those in higher income brackets, not those who earn a lower income.

Another point worth mentioning is the issue of employees with children and yet earning low income. These segment of people with low salary experience the hardest strain of poverty,[122] which seriously damages the future of children. According to Joseph Stigliz, Children from such families will likely inherit poverty from their parents and remain under the yolk of poverty in the next generation.

While it is clear that the risk of poverty is greatest in a family with a higher number of children and this is a major source of social and economic inequality, the Ethiopian income tax has given no attention to such vulnerable

[119] **ከገቢ ግብር ነጻ የተደረጉ ገቢዎች አፈጻጸም መመሪያ** 1; 2011 **የኢትዮጵያ ፌዴራላዊ ሪፐብሊክ ፋይናንስ ሚኒስቴር**

[120] Id., Article 5/1/

[121] Central Statistics Agency (CSA), Labour Force and Migration Survey Key Findings, (Addis Ababa, Ethiopia] 2021), Available at https://www.statsethiopia.gov.et/wp-content/uploads/2021/08/Final-2021-LABOUR-FORCE-AND-MIGRATION-SURVEY_Key-finding-Report-.17AUG2021.pdf ( Last Accessed on May 15, 2022).

[122] Interview with Selam Endale, public Servant, Federal First Instant Court, (May 15, 2022), Innterview with Tinebeb, public Servant, Ministry of Revenue, ( May 16, 2022), and Interview with Alemneh Bera, Employee in a PLC (May 17, 2022).

groups of society and income tax is not shaped to assist them.[123] In denying due attention to such segment of the society, the government is posing a dangerous threat to social and political stability that would mainly spring from inequality.

Looking retrospectively in the past years, the thresholds for personal income tax were dramatically eroded by inflation, resulting in an effect known as bracket creep.[124] The ultimate payers of the price are those whose earning is low.[125] Most strikingly, the exempt threshold in the Income Tax Proclamation, which is 600 Birr, is below the global poverty line in 2022.[126] The inflation rate was 6.63 at a point when the exempt threshold in the Income Tax Proclamation was adopted as 600 Birr (i.e. 2016). Yet, currently, Ethiopia is experiencing annual inflation rate of 35.1 percent in December which was the highest inflation rate since February 2012.[127]

True that the exempt threshold of 600 Birr is adopted by proclamation No 979/2016 after a salary adjustment for public servants was made and after the

[123] Mulay Weldu, *supra* note 112.

[124] Bracket creep is a situation where inflation pushes income into higher tax brackets. The result is an increase in income taxes but no increase in real purchasing power. This is a problem during periods of high inflation, as income tax codes typically take longer to change than the rate of inflation.

[125] Evangelo Charalampkis, Bruno Fagandini, Lukas Henkel, and Chiara Osbat, *The impact of inflation on low income House Holds*, ( ECB Economic Bulletin issue 7, 2022). Available at: https://www.ecb.europa.eu/pub/economic-bulletin/focus/2022/html/ecb.ebbox202207_04~a89ec1a6fe.en.html ( Last Acceed on March 2, 2022).

[126] R. Andres Castaneda Aguilar, Aleksander Eilertsen, Tony Fujs, Christoph Lanker, Daniel Gerszon Mahler, Minh Cong Nguyen, Marta Schoch, Samuel Kofi Tetteh Baah, Matha Viveros, Haoyu Wu , April 2022 Global Poverty Update, World Bank, (April 08, 2022), Available at https://blogs.worldbank.org/opendata/april-2022-global-poverty-update-world-bank (Last Accessed on 2/4/2022).

[127] Ethiopia inflation rate, Trading economies, Available at https://tradingeconomics.com/ethiopia/inflation-cpi (Last Accessed on April 2, 2022).

minimum wage was increased from 420 Birr to that of 615 Birr.[128] However, the government currently has introduced Job Evaluation and Grading (JEG) where the minimum wage level of public servants has increased from 615 Birr gradually to 1100 Birr despite the minimum threshold stipulated as an exemption being unchanged (i.e. 600 Birr).[129] A key informant from Civil Service Commission responded that there is no clear minimum wage set for public servants but agreed with the fact that the lowest amount of wage paid to guards and janitors in the JEG can be taken as a minimum wage.[130]

Regarding the determination of wages for employees in private organizations, a respondent from the Confederation of Ethiopian Trade Unions revealed that the Confederation has already studied the minimum wage taking into account the country's economic development, labor market, and other considerations by a foreign researcher and is waiting for the formation of Wage Board in accordance with Article 55 of the labor proclamation.[131] Yet the respondent got reserved from revealing the amount of minimum wage studied before the formation of the board since such power is given to the board.[132]

With regard to the formation of the board, a respondent from the Ministry of Labor and skill has also stressed the importance of setting minimum wage and revealed that a draft regulation on the powers and duties of the board is already sent to the Prime Minister's office and the issue of Minimum wage will be settled after the adoption of the regulation by the Council of

[128] Walta News, ለመንግስት ሰራተኞች ከ33 እስከ 46 በመቶ የደመወዝ ጭማሪ ተደረገ, (August 2, 2014 ), Available at https://waltainfo.com/am/25047/ ( Last Accessed on April 2, 2022).

[129] የኢትዮጵያ ፌደራላዊ ዴሞክራሲያዊ ሪፐብሊክ ሲቪሊስ ሰርቪስ ኮምሽን፤ የነጥብ የሥራ ምዘናና ደረጃ አወሳሰን ጥናት የደሞዝ እስኬል አፈጻጸም መመሪያ ቁጥር 1/2012 አባሪ አንድ

[130] Interview with Selam Ayalew, Deputy Manager, Federal Civil Service Commission, ( May 13, 2022).

[131] Labour Proclamation, Proclamation No.1156/2019., Federal Negarit Gazette No. 89, 5th September, 2019.

[132] Interview Kassahun Follo, president of Confederation of Ethiopian Trade Unions, ( May 16, 2022).

Ministers.[133] The respondent also believes that the minimum wage coupled with the tax measures, based on the ability-to-pay, could help the employees cope with the effects of poverty and inflation.[134]

Here, a state has an obligation to provide its citizen with a minimum standard of living as a core obligation. As pointed out above, Article 25 of UDHR provides that everyone has the right to an adequate standard of living. However, although some consider it as a gradual obligation, a state has to refrain from any act that violates this right to a minimum standard of living including imposing excessive tax that could lead to the violation of such human rights obligations. Excessive tax burden has apparently an adverse effect on individual taxpayers and the welfare of a family thereby endangering the right to an adequate standard of living as enshrined under the UDHR to which Ethiopia is also a member. For that reason, the minimum threshold shall be designed to protect the family from a low standard of living and help the family to fulfil all necessary things for their existence, i.e. food, shelter, clothes, water, etc. In that, most countries grant exemptions or some tax relief taking into account the existence of children, marital status, or specific expenses linked to the personal needs of the taxpayer (such as medical expenses).[135]

In Ethiopia, however, poor employees are still taxed heavily, paying the highest price resulting from the rise of inflation which increases from 6.63% at the time of the adoption of the income tax proclamation to 35% in 2022 endangering the full realization of the basic human right of the employees such as food, shelter, health, etc.[136] Accordingly, if a person has no means or is unable to provide his/her basic needs because of the effect of high cost of

[133] Interview with Hana Maru, Lawyer, Minister of Labor and skill, (May 9, 2022).
[134] Id.
[135] Dabla-Norris, M. E., Kochhar, M. K., Suphaphiphat, M. N., Ricka, M. F., & Tsounta, M. E. *Causes and consequences of income inequality: A global perspective*, International Monetary Fund, (2015), p.4.
[136] Ethiopian Inflation Rate, *supra* Note 127.

living and the lower income he has obtained as a result of improper taxation without considering his ability, he will be unable to feed himself or of his family thereby endangering the full realization of basic human rights.

Moreover, the respondents in the key informant interviews criticized the Income Tax Proclamation schedule for not incorporating an exception to deductible expenditures for employees.[137] Employees who have high number of dependents with low wages are really in absolute poverty and their right to a dignified standard of living in the FDRE Constitution and human rights instruments is endangered. Accordingly, they noted that the number of dependents should be considered while determining the tax on individual employee taxpayers.[138] Additionally, interviews with disabled persons and associations with disabilities revealed that disabled persons incur extra expenses than normal persons merely because they are disabled.[139] For example, if a blind wants to drink coffee, he has to pay also for his assistant.[140] The respondent from the Ethiopian Ministry of Finance replied that *"a study is underway on the income tax laws of the country and this new study might come with these special considerations"*.[141]

Thus, as noted in the review, the relationship between tax deductions, allowances, and benefits show the percentage reduction in poverty rates and the proportional reduction in poverty severity in different counties. There are clear positive relationships between tax policy and poverty reduction. And it

[137] Interview with Abedu Ruhuf Mohammed, Legal Expert on drafting and consulting, Ministry of Revenue, May 2, 2022), Interview with Tayo Maseresha, Income tax administration Directorate Director, Addis Ababa Revenue Authority, ( May 3, 2022), Interview with Belachew Asefa, Oromiya Regional State Adama City Revenue Bureau Director, ( May 4, 2022) and Interview with Tesema Abere, Head of Amhara Regional State Revenue investigation Directorate, ( May 16, 2022).

[138] Id.

[139] Interview with Mohamed Abiye, A Blind Tax payer and General Attorney at ministry of Justice, ( May 3, 2022), Interview with *Wesen Alemu*, President of the Ethiopian National Association of the Blind (ENAB), (May 6, 2022).

[140] Id.

[141] Mulay Weldu, *supra* note 112.

is argued that tax measures and transfer systems have many goals and poverty reduction is just among them. Thus, tax measures especially revisiting the minimum subsistence and the taxing unit to include, at least, family as a base or providing different tax incentives and reliefs, at least, for those who have low income and disabled is something imperative for the effective realization of ability-to-pay principle and fair and equitable tax system in Ethiopia.

Most respondents in the key informant interview also do not doubt the idea that tax benefits which can include tax deductions, exemptions, or transfers for poor people, employees with a higher number of dependents, and disabled persons can help to tackle the high cost of living.[142] This also can help achieve the poverty reduction policy of the country. Because tax benefits during inflation have a direct relationship with poverty reduction.[143]This shows that the tax measures have an impact on poverty reduction and alleviating the high cost of living. Yet, when it comes to effecting these measures, respondents believe that the constraints on tax administration are major roadblocks.[144]

## 4. Concluding Remark and the way forward

As can be noted from the review of the literatures and other discussions above, the relationship between tax deductions, allowances, and benefits show the percentage reduction in poverty rates and the proportional reduction in severity of poverty in different countries. The literature consulted also shows that there are clear positive relationships between tax policy, poverty reduction, protection of human rights, and ability-to-pay. However, Ability-to-pay principle is almost an overlooked concept in the Ethiopian tax system in general and employment tax in particular. In so doing, the Ethiopian employment tax system demands reform to close down the legal gaps and practical problems created due to less attention given to the concept of ability-

[142] Mohammed, *supra* Note 139.
[143] Id.
[144] Id.

to-pay principle. Thus, the writers argue that, it is high time for tax measures especially revisiting the minimum subsistence threshold of 600 Birr provided in the Federal Income Tax Proclamation. In addition, taking into account the available resources, Ethiopian employment income tax system should adopt *family and disability* as a base, or provide tax incentives or reliefs (though the amount and manner is something to be ascertained through future research) for those who have low income and disabled. Finally, more studies need to be carried out on mechanisms for the effective realization of ability-to-pay principle in Ethiopia and the protection of human right accordingly.

# Appraisal of Ethiopian Tax Dispute Resolution System at the Review Department (of the Ministry of Revenue) and at Federal Tax Appeal Commission.⇒

***Gizachew Silesh,[∂] Yibekal Tadesse[ϒ], and Israel Woldekidan[λ]***

## Abstract

*Tax disputes are inherent parts of a tax system, and require resolution mechanisms that effectively regulate and protect the interest of disputing parties. Commonly, countries provide for several layers of dispute resolution schemes. The schemes comprise internal review and external dispute resolution mechanisms that include quasi-judicial tax tribunals, courts and different kinds of Alternative Dispute Resolution methods. Ethiopia has made successive reforms on the laws and institutions pertaining to taxation and tax dispute resolution procedures. Despite successive reforms in the substantive content of tax laws, the dispute resolution system by and large remained the same. The 2016 reform, one of the latest reform moves, maintained much of*

⇒ This article is the result of a research-project funded by USAID's Feteh (Justice) Activity in Ethiopia. The authors would like to extend their deepest gratitude to USAID's Feteh (Justice) Activity in Ethiopia for initiating and funding the research. However, the content and opinions expressed in the article are the views of the authors, and not necessarily the views of USAID. The authors also would like to thank the anonymous assessors for their constructive comments on this article.

Acronyms: TAP-Tax Administration Proclamation; TAC-Tax Appeal Commission; FDRE-Federal Democratic Republic of Ethiopia; ADR-Alternative Dispute Resolution Mechanisms.

∂ LL B, LLM (Addis Ababa University), LL M (University of Oslo), Assistant Professor , Bahir Dar University, School of Law. The author can be reached via: gizachewsc@yahoo.com or Gizachew.Silesh@bdu.edu.et

ϒ LL.B, LL.M (Bahir Dar University), Assistant Professor, Bahir Dar University, School of Law. The author can be reached at yibekaltadesse@gmail.com

λ LL.B, LL.M (Bahir Dar University), Lecturer in Law, Debre Berhan University, School of Law. The author can be reached at israkidan@gmail.com.

*the dispute resolution institutions with some changes in the details. The failure or success associated with these reforms and the overall application of tax dispute resolution system in the country has not been sufficiently studied. Using a qualitative research approach, this research thoroughly examined the Ethiopian law and the practice pertaining to the prevailing tax dispute resolutions system at Review Department of the Ministry of Revenue and the Federal Tax Appeal Commission. The research found out several legal and practical limitations regarding geographical accessibility, independence, legal certainty and access to justice. Thus, the existing tax dispute resolution system of Ethiopia needs to be re-visited so that the Country will have a tax dispute resolution system that balances the interest of the public and taxpayers.*

**Keywords:** *Tax dispute; Review department; Tax Appeal Commission; Ethiopia***.**

## Introduction

Tax disputes are inevitable aspect of tax systems. They are said to occur when taxpayers disagree with the decision of tax authority in respect of the taxpayer's liability, entitlements and related issues.[1] Effective and efficient tax dispute settlement mechanism is an important part of a good tax system.[2] The availability of a fair, impartial and independent mechanism for resolving tax disputes between taxpayers and the tax authority is one of the indicators of a well-developed or advanced the tax system.

Commonly, countries grant taxpayers the legal right to challenge alleged errors in tax administration or improper decisions by the tax authority. The mechanisms for that include internal review mechanisms, and external tax

[1] Michael Walpole and Binh Tran-Nam, Access to Tax Justice: How Costs Influence Dispute Resolution Choices, *School of Taxation and Business Law, The University of New South Wales,* p. 17.

[2] Binh Tran-Nam and Michael Walpole, Tax Disputes, Litigation Costs and Access to Tax Justice, *eJournal of Tax Research (2016), Vol 14, No.2*, pp. 319-336.

dispute resolution (involving Administrative Appeals Tribunal), the courts, and different kinds of Alternative Dispute Resolution methods).[3] An internal review can enable the tax authorities to swiftly identify and correct mistakes at a minimal fiscal cost at administrative level while external review mechanisms are necessitated for their neutral adjudication.[4]

As in any other system, tax disputes are common in Ethiopia. Since the 1940s, the Ethiopian tax system has made successive reforms on the laws and institutions pertaining to taxation and tax dispute resolution. The latest significant reform on substantive and administrative aspects of tax laws of Ethiopia was undertaken in 2016. Proclamation No. 983/2016 (TAP)[5], one of the major outcomes of this reform, lays down the rules for tax dispute resolution system at federal level. The system comprises[6] the internal review process at the level of Ministry of Revenue; appeal to the Tax Appeal Commission (quasi-judicial Administrative tribunal for tax); and a last resort to regular courts by way of appeal and cassation.[7]

As such, the new tax administration law came up with major improvements including the establishment of Federal Tax Appeal Commission as an independent dispute settlement organ; changes regarding advance payment calculation requirements to take a case for appeal; the change on the period of limitation to file objection before internal review department, etc. However, there are still concerns over handling of tax grievances and adjudication of tax

[3] See Simon Whitehead (ed.), Tax Disputes and Litigation Review, Law and Business Research, 2018.

[4] World Bank Group, The Administrative Review Process for Tax Disputes: Tax Objections and Appeals in Latin America and the Caribbean; a Toolkit (hereinafter, World Bank), p.18.

[5] Federal Tax Administration Proclamation No. 983/2016, Federal *Negarit Gazette*, Extraordinary Issue, Year 22, No 103. (hereinafter TAP), Art 55.

[6] Id.

[7] Id.; The Constitution of Federal Democratic Republic of Ethiopia, Proclamation No.1/1995, *Federal Negarit Gazetta*, (1995) (hereinafter FDRE Constitution), Article Art 80(3). Pursuant to Art 80(3) of the FDRE constitution, the Federal Supreme Court has a power of cassation over any final court decision containing a basic error of law.

disputes. Particularly, many question the accessibility and independence of tax adjudication institutions (Review Department at the Ministry of Revenue and the Tax Appeal Commission); transparency and fairness of procedural rules (due process), the impartiality and competence of adjudicators. Therefore, it is imperative for this country to examine the law pertaining to handling of tax grievances and adjudication of tax disputes. This article takes a theoretical and practical perspective to look into the legislative contents and practice of tax dispute resolution processes.

The investigation specifically targets tax dispute settlement system at the Review Department of the Ministry of Revenue and the Tax Appeal Commission at federal level. The Tax Appeal Commission is just a single institution located in Addis Ababa while the Review Departments are established at 12 branches of FDRE Ministry of Revenues, five of which are in Addis Ababa and seven in regional branches. Each branch has a review department, a total of 12 Review Departments Nationwide. The Figure below shows the braches/review departments across the Country.

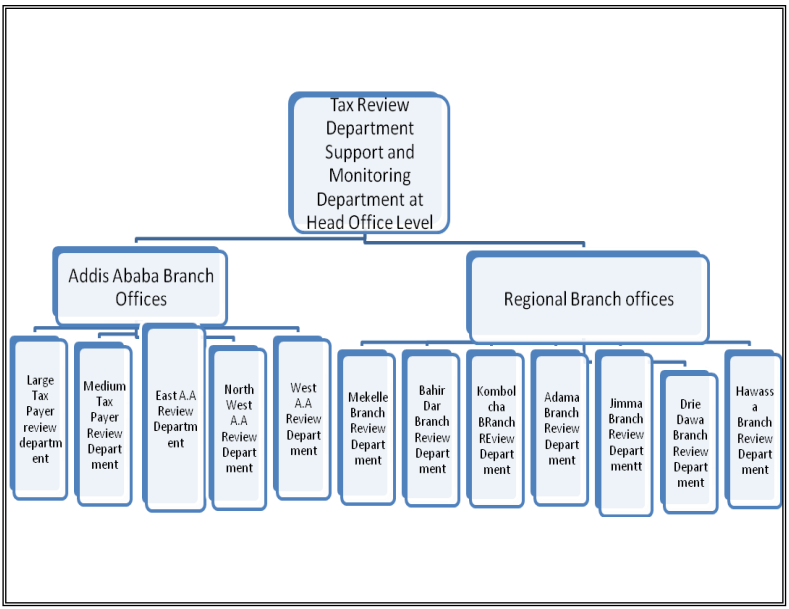


**Figure 1**: **Distribution Review Departments across the Nation and Samples selected**

The study employed qualitative research method, in which both primary and secondary qualitative data are collected and interpreted. Participants experiencing the operation of the institutions were selected as sources of primary data. Notably, experts involved at the stage of internal review, and members of tax appeal commission were primary respondents. Head/officers of these two institutions were involved as key informants. Essential secondary data (in the form of reports, and other documents) has also been generated from secretaries/registrars of these two institutions. Taxpayers and lawyers having pending cases in the institutions (those who appeared during the data collection process) were interviewed as source of primary data. We also held short observation at the Tax Appeal Commission hearings.

Regarding sampling, the Tax Appeal Commission is taken for granted as it is the sole institution of its kind. But from the review departments, we selected

samples purposively. All the branches at the Ministry of Revenue are part of the same institution sharing same working rules and instructional culture. Due to this, and partly induced by time and resource limitation, we are convinced that undertaking the research at some of the branches in Addis Ababa would be representative. Of the five branches in Addis Ababa, we purposively chose to collect data from the three review departments in Addis Ababa: Review Department for Large Taxpayers; the Review Department for Medium Taxpayers; and the East Addis Ababa Small Taxpayers Review Department. We have also collected supplementary data from the review department at Bahir Dar Branch. The table below summarizes data sources and data collection instruments used.

**Table 1 Data Sources and Data Collection Instruments Used:**

| S.N | Participant category | Data collection instrument used |
|---|---|---|
| 1 | Head/Officers of Review Departments | Key Informant Interview Qs. |
| 2 | President of Tax Appeal commission | Key Informant Interview Qs. |
| 3 | Members of Review Departments | Interview/Group Interview-FGD/ |
| 4 | Members of tax appeal commission | Interview |
| 5 | Taxpayers and Lawyers | Interview |
| 6 | Proceeding/hearing at TAC | Non-participant observation |
| 7 | Secretaries/registrar | Forms to be filled/documents collected |

We categorised the primary and secondary data into thematic areas using content analysis techniques. In addition, where possible, any information obtained in the interviews was cross-validated against secondary data in reports of institutions. Finally, the findings were synthesized. The study found out several legal and practical institutional limitations.

The contents are organized in four sections. Section one provides general background on the research issue, the scope, and methodology of the

research. The second section offers a brief overview of tax dispute settlement methods across various jurisdictions. The third section analyses the legal framework and practical realities of the Ethiopian tax dispute resolution mechanisms at the Review Department of the Ministry of Revenue and at the Tax Appeal Commission. Finally, the last section provides the summary of findings and recommendations for institutional actions.

## 3. Tax Dispute Resolution Mechanisms: An Overview

Tax disputes are disagreements between a taxpayer and a tax author regarding the taxpayer's tax liabilities or entitlements or other related issues.[8] It occurs when a taxpayer holds a view that differs from that of the tax administration and decides to take action as a result of this disagreement.[9] It is vital that taxpayers trust the system. They always would like to see a system that is not arbitrary, unfairly harsh, and one with a process in place to review contentious rulings of tax authority.[10] A well-functioning tax regime meets such expectations of taxpayers. While tax dispute resolution mechanisms vary across countries, they all can be categorized into either of the three: administrative review, courts and alternative dispute resolution mechanisms.

### 3.1. Administrative Review

Administrative review of tax grievance is a case in which the taxpayers can request for review of the decisions of the tax authority by itself or agencies other than courts with a special jurisdiction to review tax decisions.[11] The international practice shows that there are differences in the institutional

[8] Tran-Nam and Michael Walpole, "Independent Tax Dispute Resolution and Social Justice in Australia", *UNSWLJ,* Vol.35, No.2, (2012), P. 477.
[9] Id.
[10] Deloitte Consulting LLP, systems Approach Policy Value Chain Analysis: Tax Dispute Resolution (TDR) Reform, (2020), P. 2, (hereinafter Deloitte), available at https://pdf.usaid.gov/pdf_docs/PA00XJ7P.pdf , last accessed on March 16, 2022.
[11] World Bank, *supra* note 4, P.22.

arrangements for administrative review. [12] Yet, the scope of the review covers both matters of fact and matters of law in most countries. The reviewers are public officials who are bound by both the standard civil-service regulations and the specific procedural rules of the agency charged with internal tax reviews. The administrative review can be done by the tax authority itself (internal) or by a separate authority (external).

At the primary level, the taxpayer can file an objection to the tax authority itself to review its own decisions.[13] In most cases, the review can be done by the same official or unit that issued the objected decision or separate official or specialized unit within the tax authority.[14] The tax objection can be reviewed again by another entity independent from the tax authority.[15] The authority may be tax-review agencies or board that are somewhat independent of the main tax authority.[16] For instance, in New Zeeland, it is a division within the tax administration.[17] The cases in Malaysia, Myanmar, and Singapore are also different as the review authorities are found within the Ministry of Finance.[18] In South Korea, the Tax Tribunal is established under the Prime Minister's jurisdiction.[19]

### 1.2. Alternative Dispute Resolution Mechanisms (ADR)

Although there are variations among jurisdictions on the modality of adopting ADR, , there is a wider tendency to use this institution for tax dispute

[12] Id.
[13] Satoru Araki and Iris Claus, 'Comparative Analysis of Tax Administration in Asia and the Pacific', Asian Development Bank, Mandaluyong City, Philippines, (2014), p. 60.
[14] World Bank, *supra* note 4, P.22.
[15] Jamaica, Argentina, Mexico, and Panama are countries which have such type of internal review arrangement.
[16] Araki & Claus, *supra note* 13, P.60
[17] Id.
[18] World Bank, *supra note* 4, P.60.
[19] Id.

resolution purposes.[20] The use of ADR for such ends may take the form of an administrative mediation or independent mediation. Administrative mediation is a type of mediation in which the process involves a mediator who belongs to the tax administration.[21] Independent mediation is different from administrative mediation as it allows recourse to an independent mediator who does not belong to the tax authority.[22]

In some jurisdictions[23] domestic arbitration of tax disputes is allowed. In these countries, arbitration is typically allowed only after exhaustion of all available remedies within the tax authority. Domestic arbitration procedures may be provided by law as a right or may be available through agreements with the tax authority with respect to a specific case if both the taxpayer and the tax authority agreed to do so.[24] In most cases, the domestic arbitration of tax disputes is restricted to questions of fact such as the valuation of an asset.

### 1.3. Courts

The courts, both ordinary and tax courts, may have the first-instance and appellate jurisdiction to adjudicate tax disputes. There are jurisdictions in which, once the remedies at the tax authority are exhausted, review is made by the first-instance ordinary courts. It is done without having other tax dispute-settling organs in between. In this regard, the Russian experience is mentionable.[25] In some others, the complexity of tax law forced countries to

[20] Victor Thuronyi & Isabel Espejo, How Can an Excessive Volume of Tax Disputes Be Dealt With?, IMF, 2013, available at https://www.imf.org/external/np/leg/tlaw/2013/eng/tdisputes.pdf, last accessed June 30, 2022.

[21] United Nations, United Nations Handbook on Dispute Avoidance and Resolution, (New York, United Nations), 2021, (hereinafter United Nations), Dispute Avoidance and Resolution English.pdf (un.org), last accessed on March 16, 2022, p. 93.

[22] Id., P.104.

[23] Id. In this regard, Portugal is the notable one.

[24] United Nations, *supra* note 21, P.105

[25] Yana Proskurina and Maria Mikhaylova, Russia, in Simon Whitehead ed., The Tax Disputes and Litigation Review,7thed, Gideon Roberton Publisher, UK, (2019), P.291.

establish a specialized court or quasi-judicial tribunal whose jurisdiction is limited to the adjudication of tax disputes. Judges of these specialized courts and tribunals are usually well aware of tax issues and are thus in a better position to settle disputes involving these issues.[26] Tax-specialized courts are found in many jurisdictions. For example, in South Africa, there is a specialized tax court called Special Income Tax Court. In Indonesia a tax dispute settlement agency which was affiliated with the Ministry of Finance is replaced by a specialized tax court with a view to provide fairer dispute resolution.[27]

## 4. The Ethiopian Tax Dispute Resolution System at the Review Department and Federal Tax Commission

### 4.1. Brief Historical Account of Tax Dispute Resolution System of Ethiopia.

Ethiopia has undertaken successive reforms on the laws and institutions pertaining to taxation, and a tremendous change has been made on the substantive content of tax laws including the types of taxes, the tax bases, jurisdictional reach etc.[28] However, the dispute resolution system, by and large, remains the same, and consists of internal review (review department) by the tax authority, appeal to tax appeal Commission, and review by regular courts on question of law. For instance, as early as 1961, the Ethiopia income tax law[29] had envisaged a similar tax dispute resolution mechanisms: Tax

[26] United Nations, *supra note* 21, P. 98

[27] Araki &Claus, *supra note* 13, P.65.

[28] For a comprehensive review of history of Ethiopian tax reforms, see Taddese Lencho, Towards Legislative History of Modern Taxes in Ethiopia, (2008), available at https://journals.co.za/doi/pdf/10.10520/AJA00220914_78 Last accessed ….

29 See Ethiopia Income Tax Law, Proclamation No. 173 / 1961, Articles 49-61. Proclamation No. 173 of 1961 had envisaged a Tax Appeal Commissions to be appointed by the government to deal with appeals against tax assessments made by the Income Tax Department of the Ministry of Finance; and Tax Appeal Commissions may be established for Provinces, or, in case of need, for certain local offices. In case the Income Tax Authority or the appellant is dissatisfied with the decision of the Tax

Appeal Commissions (empowered to deal with appeals against tax assessments made by the Income Tax Department of the Ministry of Finance); and the High Court of Appeal (in case the Income Tax Authority or the taxpayer is dissatisfied with the decision of the Tax Appeal Commission).

The subsequent legislation, Proclamation No. 233/2001, that repealed Proclamation No. 173 of 1961, simply reshaped Tax Appeal Commissions into the Federal Tax Appeal Tribunal, whose decision may be appealed to the Federal High Court.[30]

The Income Tax Proclamation No.286/2002[31] and Value Added Tax Proclamation No.285/2002 also maintained similar institutions for tax dispute resolution. These legislations had envisaged tax dispute resolution system that consists of a Review Committee[32], a Tax Appeal Commission, and the appeal

Appeal Commission, either party may appeal, within thirty days, to the High Court of Appeal by sufficiently establishing the grounds for its grievances

30 See generally Federal Tax Appeal Tribunal Establishment Proclamation No. 233/2001. Federal Tax Appeal Tribunal Establishment Proclamation No. 233/2001 repealed the provisions of Proclamation No. 173 of 1961 dealing with dispute resolution. In doing so, it established The Federal Tax Appeal Tribunal as an autonomous public body of the Federal Government with legal personality accountable to the Prime Minister. The institution has its head office in Addis Ababa and possibly branch offices in other places. Among others, it is mandated to examine and decide on appeals lodged by the tax payers against tax assessment made by the Authority, whose decision may be appealed to the federal High Court on grounds of error of law upon payment of 75% disputed tax. Federal Tax Appeal Tribunal Establishment Proclamation No. 233/2001 repealed the provisions of Proclamation No. 173 of 1961 dealing with dispute resolution. In doing so, it established The Federal Tax Appeal Tribunal as an autonomous public body of the Federal Government with legal personality accountable to the Prime Minister. The institution has its head office in Addis Ababa and possibly branch offices in other places. Among others, it is mandated to examine and decide on appeals lodged by the tax payers against tax assessment made by the Authority, whose decision may be appealed to the federal High Court on grounds of error of law upon payment of 75% disputed tax.

31 See Income Tax Proclamation No.286/2002, Articles 104-115; Value Added Tax Proclamation No.285/2002, Article 40-43.

32 Id. Yet, one major departure in these legislations is that they introduced Review Committee, a grievance review committee within the tax authority. The ministry of revenue or appropriate regional authority appoints members of the Review Committee.

to Regular Courts on grounds of error of law. The Review Committee is empowered to provide recommendations to the head of tax authority that may approve or render an alternative verdict. Then, grievances may be taken to the Tax Appeal Commission[33] after payment of 50% of disputed tax, and an appeal from the decision of the Tax appeal commission may taken to the regular courts but only on question of law.

The latest reform, launched in 2016, encompasses substantive and administrative aspect of tax laws. Along with the reforms on the substantive content of the tax laws, a separate legislation, specifically dedicated to administrative and dispute resolution aspects of all federal taxes, has been enacted.[34] This is a major departure from previous approaches where each tax legislation used to provide its own section on tax administration and dispute resolution. It sustained the three dispute resolution institutions in of the legislations it repealed: Review department within the tax authority, a Federal Tax Appeal Commission, and the appeal to Regular Courts. Yet, the new tax administration proclamation purports to be comprehensive and revisited the institutional structure and status of these dispute resolution institutions. Indeed, the new tax administration law came up with changes including the constitution of review department, procedures it follow, the re-establishment of Federal Tax Appeal Commission as an independent dispute settlement organ, changes regarding advance payment requirements to take a case for appeal, etc.

33 Id. Tax Appeal Commission was supposed to be established at Federal, Reginal, Zonal, and Woreda Level. Members of the Tax Appeal Commission were to be appointed by the Minister of Justice or the appropriate city administration, regional, zonal or woreda executive organ. Members serve for a period of 2 years and they are entitled to attendance fees for their service. The review committee and the Tax Appeal Commission were not institution with legal personality status. the status of members of the Review Committee and Tax Appeal Commission were similar to ad hoc committee, as opposed to fulltime employees.

34 See TAP, *supra note* 5.

The reforms brought through this legislation and their practical application regarding the tax dispute resolution system has not been empirically studied. The subsequent sections examine the law and the practice in the current Ethiopian tax dispute resolutions landscape at Review Department and the Federal Tax Appeal Commission.

## 4.2. Tax Dispute Resolution System at the Review Department (Internal Review): Appraisal of the Law and Practice

Following the 2016 reform on tax administration, a Review Department is established within the Tax Authority. It is meant to undertake an independent review of notices of objections filed by the taxpayers. This section explores the success or otherwise of the Review Department in discharging its duties.

### 4.2.1. Organizational Structure and Accessibility of the Review Department

The organizational structure of the Review Department is detailed by a directive.[35] Unlike the previous one, as of 2016, it is reorganized as a permanent office. Further, as per Article 4 (1) of the directive, the Department is required to be established in all branches. Accordingly, there are five Review Departments in Addis Ababa and 7 Review Departments in different regional states.[36] The Review Departments are accountable to their respective Branch General Manager.[37] , and the decision of the Review Department will

[35] The Revised Ministry of Revenue Directive enacted to determine the working procedures of the Review Department, Directive No. 171/2021 (hereinafter Revised Directive).

[36] Interview with Mr. Dereje Bana, Head, Ministry of Revenues Review Departments Support and Monitoring Office, *on the organizational structure of the review department*, Addis Ababa, Ethiopia, 11 December 2022. There used to be a Review Departments at the head office as well but as of December 2020 there is no a Review Departments at the head office level; rather a new office is established whose main function is to support and monitor Review Departments established at branch offices across the country.

[37] Revised Directive No. 171/2021, *supra* note 35, Art. 6(1).

not have effect unless approved by the Branch General Manager who has the power to either fully or partly endorse the recommendation, reject or remand the case for reconsideration by the Review Department.[38]

The organizational structure of the internal review varies from jurisdiction to jurisdiction. In many jurisdictions, it is the head of the tax administration authority that has the power to review tax objections. In this regard, the experience of Nigeria, Kenya and Australia are worth mentioning. In these countries, it is the Commissioner General who has the power to make the first review on the objections of the taxpayers.

In other jurisdictions, the internal review power is given to a department within the tax administration but a department different from the one that makes the assessment. For instance, in Canada the Appeals Branch of the Canada Revenue Authority reviews a taxpayer's objection.[39] The Dispute Review Unit of New Zealand Inland Revenue's National Office is another jurisdiction under this block. The Disputes Review Unit performs the internal review function.[40] It is distinct from the audit/investigation role, and it is concerned with examining the disagreement from a new perspective to render an objective and unbiased judgment on the objections brought by taxpayers. Structurally, the Review Department of Ethiopia can be grouped under this category.

Turning to the Ethiopian practice once again, the Review Department is established at every branch office of FDRE Ministry of Revenues at the selected sites throughout the country. However, in this vast nation, there are only 12 branch offices. For instance, the Jimma Branch Office covers the whole of South West Ethiopia which includes South West and West Oromia,

[38] Id., Art. 11 (4) and 6 (2)

[39] Jacques Bernier and Mark Tonkovich, 'Canada' in Simon Whitehead (eds),*The Tax Disputes and Litigation Review* , Law Business Research Ltd, London, (2015), pp. 73-74.

[40] Geoffrey Clews, 'New Zealand' in Simon Whitehead (eds), The *Tax Disputes and Litigation Review* , Law Business Research Ltd, London, (2019), pp. 223-224.

Southern Ethiopia Regional State, Gambela Regional State and some parts of Benishangul Gumuz Regional State. A taxpayer residing in one of the peripheral areas of either Gambela or Benishangul Gumuz Regional State has to travel hundreds of miles to bring his case to the Review Department at the city of Jimma. This costs the taxpayers much in terms of money and time. Thus, the current geographical distribution of the revenue department has a serious accessibility problem. From the focus group discussions held with members of the Review Department, electronic tax dispute settlement is recommended as a solution to alleviate the problem of accessibility.

### 4.2.2. Institutional Independence of the Review Department

#### 4.2.2.1. Institutional Structure of the Review Department

Independence refers to the administrative distance between the office that made the tax decision and the department in charge of reviewing that decision.[41] Ensuring the independence of the reviewing institution is one of the international good practice principles of internal review mechanism.[42] Yet such endeavour is subject to influence of variables such as structural arrangements within the institutional hierarchy, the rules and procedures of appointment of its members, etc.[43]

In Ethiopia, the Review Department is part of the Ministry of Revenues, which is the tax collection and administration wing of the executive. The audit department makes the assessment and the Review Department review grievances against such assessment. Though the audit department and the Review Department are different departments, still they are under the same supervisor, the Branch General Manager who may reverse or partially accept

[41] World Bank, Toolkit on the Administrative Review Process for Tax Disputes: Tax Objections and Appeals in Latin America and the Caribbean, World Bank Group, p.27. (Hereafter, World Bank, Toolkit on the Administrative Review Process for Tax Disputes)
[42] Id.
[43] Id.

the recommendation or remand the case to the Review Department. Several members of the Review Department voiced their concern over such a stretched discretionary power vested in the office of the branch manager. The Branch Manager's decision may not be free from bias and venality. No mechanism is set in place to contain the counter effects of such bias, for example, if she reverses the recommendation even without reasons. Furthermore, the members of the Review Department stated that dissenting opinion of any member of the review panel is not in practice included in the decision handed to the tax payer. Instead, it is withheld as a file in the Review Department.[44] This is contrary to the common practice of adjudication that allows any dissenting opinion from the decision of the majority to be part of the decision. Such clear lack transparency in the institution is a manifestation the jeopardy happening against the independence of the members of the Review Department.

#### 4.2.2.2. Recruitment, Composition and Tenure Security of Members of the Review Department

The appointment of members of the Review Department is one of the key factors with strong relevance to the independence of the internal review. The Review Departments is structured as having a head, professional staff, a secretary and other administrative staff.[45] In recruiting such personnel for the Department, the branch revenue office should checks and verifies whether the candidate has the required education preparation, skills and work experiences,[46] and candidates will be assigned if these requirements are met.[47]

[44] Interview with members of Review Department of Bahir Dar Branch, Bahir Dar, Ethiopia, June 15, 2022.
[45] Revised Directive No. 171/2021, *supra* note 35, Art. 4(1).
[46] Id., Article 7(1).
[47] Id. Personal independence is another point of contention in this institution. The law permits the department to recruit members from the pool of personnel in the Ministry of revenue who could have worked as auditors, tax officers or legal officers. This would have a direct effect on the personal independence of members of the Review Department. First, as the reviewer previously worked in either the audit or tax

Candidates could be recruited from the audit department or other units involved in tax assessment. There are no rules that limit and regulate conflict of interest after the officers are appointed. For instance, a member of the review department may review a tax objection in which he already knows in his tax assessor or auditor capacity. Some countries have a clear law that regulates such issues. For instance, in Australia and the US, the relationship and interaction of the assessing unit and review unit is seriously regulated.[48]

Still on the composition of personnel, the law requires the Review Department to have at least a lawyer and an accountant.[49] Yet it is silent about the number and composition of the remaining members. Also, there is no career path within the review department. Key informants from the Review Department expressed that they have doubt on their job security.

### 4.2.3. Proceedings at the Review Department

#### 4.2.3.1. Preliminary issues

Where a taxpayer disagrees with the tax assessment of the authority, there shall be held discussion with the tax auditor which is known as the exit

assessment department of the Ministry, he or she is likely to be familiar with the auditor who made the audit and naturally their willingness to challenge their colleague is susceptible. Second, it's unjust to be conscious of the audit and tax assessor mindset that members of the RD have established over the course of their careers as auditor and tax assessor. They carry out the task of review with the mindset of being suspicious of the taxpayer as tax avoiders. Third, the problem related to the tenure of the reviewer will have a direct impact on their personal independence.

[48] World Bank, Toolkit on the Administrative Review Process for Tax Disputes, *supra* note 41, p.33.

[49] Revised Directive No. 171/2021, *supra* note 35, Article 7(4). One of the benches at Large Taxpayer Branch office has only three members. In practice, there is a difference from branch to branch. For instance, in the majority of the branches, the maximum numbers of member are five. Finally, even though Article 7(2) of the Revised Directive allows the application of the appropriate guidelines and organizational studies on the transfer, assignment and promotion of staff of the Ministry to members of the Review Department, there is no career path within the review department. Key informants from the Review Department expressed that they have doubt on their job security.

conference. The TAP under Art. 55 (1) stated that a taxpayer who wishes to dispute a tax decision can file a notice of objection to get the decision reviewed by the Review Department. The law listed the conditions for a notice of objection to be valid including payment of the undisputed amount of tax or evidence that shows his agreement to pay it;[50] objections should be submitted within 21 days after the service of the notice of the tax decision.[51]

With respect to pleading, as stated under the TAP, a notice of objection or pleading shall be instituted to the Review Department in written form.[52] The notice should state precisely the grounds of objection, the amendments required to be made to correct the decision, the reasons for the amendments, and ensure that all relevant documents relating to the objection have been submitted.[53] Where the Review Department believes that the notice of objection has not met the procedural requirements, it should immediately serve written notice on the taxpayer, which contains the reasons why the notice of objection is not validly filed.[54] In practice, largely, Review Department just see whether the objection is submitted within 21 days. Panellists of the Review Departments stated that, although the objection does not clearly put the grounds of objections, the department accepts it and the grounds will be discovered during oral presentation.[55]

After ascertaining the validity of the notice of objection, the RD would send to the tax auditors to appear on the date fixed for defence. Although, the forum is an internal review medium, as we noticed from the practical scenarios, the tax authority (particularly the tax audit department) should be required to produce a statement of defence so that it would be easy for the

[50] The same condition is provided under Art. 8 (4) of the Revised Directive No. 171/2021, *supra* note 35.
[51] TAP, *supra* note 5, Art. 54.
[52] Revised Directive No. 171/2021, *supra* note 35, Art. 54.
[53] Id.
[54] Id., Art 54(4).
[55] Interview with Mr. Fikadu Getachew, Member of Review Departments, at Large taxpayers Branch. Addis Ababa, Ethiopia, April 15, 2022.

Review Department to identify issues. This is particularly important to minimize the contact of parties for longer period of time. In practice, the Review Department hears the parties individually at different time to frame issues.[56] Had the tax authority submitted a statement of defence, the department would have easily framed issues and handle the hearing process within a short period of time.

Under the Ethiopian tax administration system, tax agents can represent taxpayers in their dealings with the Authority, including at the internal review process. The fact that tax agent appear at the internal review is also expressed under the working procedure of Review Department.[57] Hence, they can prepare notices of objection on behalf of taxpayers.[58] The tax authority as a defendant is represented on internal review by tax auditors. In practice, taxpayers may appear through an authorised representative, which is understood, under the law, as anyone who can bring a power of attorney from the concerned justice office. Besides, they can be represented by lawyers. Members of some Review Departments have concerns in relation to who should really appear before the internal review as a principal actor. Since a tax suit concerns individual interest/ right, internal review departments need to make sure that the petitioner is a real party on the action/objection. Practically, the owner of the business, general manager, accountant, lawyer, tax agent even family members appear at the hearing. As the interviewees confirmed, the Review Department would hear such persons even without possessing a power of attorney as long as they come with the manager of the company.[59] Some tax administrations may choose to rely on the rules of representation that apply in other administrative or civil litigation. However, in this regard, the tax procedure law of Ethiopia is not clear.

[56] Interview with Mr. Desalegn Chekol, Chairman of Tax RD of Bahir Dar Branch. Bahir Dar, April 8, 2022.
[57] Revised Directive No. 171/2021, *supra* note 35, Art 15(3)
[58] TAP, *supra* note 5, Art 95.
[59] Interview with Melese Wondimagegn, a member of Review Department, at Medium Taxpayers' Branch, Addis Ababa, Ethiopia, April 14, 2022.

#### 4.2.3.2. The Hearing Process

As an adjudicative body, the Review Department needs to follow certain procedures of the fair trial process. The right to be heard is one of the most important elements of procedural due process of law recognized in various jurisdictions. The TAP, at least tacitly, recognizes the right to be heard for taxpayers in stating the fact that "the Tax Authority is duty-bound to issue a directive specifying the procedures for reviewing an objection including hearings and the basis for making recommendations to the authority and the decision-making procedure."[60] However, the Directive issued is silent with respect to hearing process in the internal review. As a tax procedure law, the Directive as well as TAP should have expressly recognized this right for aggrieved taxpayer. On its face, it seems that this right of the taxpayer has been left as optional or something to be executed on the blessing of the Review Department.

In practice, after the submission of notice of objection, Review Departments hear parties over the tax objection. Accordingly, parties shall attend in person or through their respective agents or pleaders and the suit shall then be heard.[61] As many members of the Review Department stated, the silence of the working procedure rules on the effect of non-appearance has been creating difficulties in the internal adjudication system. Panellist of the Review Department reported that parties frequently failed to appear on the date fixed for hearings,[62] yet they will not lose anything because of their failure of appearance. Commonly, if one of the parties appears, the Review Department hears the party appeared on the date fixed and the other party would be heard on another day separately.[63] In rare cases, some Review Departments

[60] TAP, *supra* note 5, Art 54(2).
[61] Interview with Fikadu Getachew, *supra* note 55.
[62] Id.
[63] Interview with members of Tax Review Department of East Addis Ababa Small Taxpayer's Branch, Medium Taxpayer's Branch and Large Taxpayers Branch, Addis Ababa, April 11, 2022

postpone the hearing for another day if both of the parties failed to appear on the first hearing. But, if either party fails to appear for the second time, the proceeding will be held ex parte.[64] Yet, the party whose case has been heard ex parte can present his/her oral argument at another date even without showing good cause for non-appearance.[65] Besides, if both of the parties failed to appear on the actual hearing time, the Review Department will reschedule it to another day.[66] In effect, cases have been delaying for a long period of time. Although some level of flexibility is required in the quasi-judicial review systems, particularly, the effect of non-appearance should have been regulated.

#### 4.2.3.3. Issues Related to Evidence.

As can be understood from the tax procedure laws, the Review Department may use testimonial evidences and documentary or other kind of evidence provided it is relevant to the matter.[67] However, the procedures of witness examination is neither regulated under the tax procedure laws nor well guided in the review process. As we noticed from the proceedings, largely, the panellists have substantial role in witness examinations. Besides, in practice, witnesses do not take oath before testimony. More importantly, most of the interviewees have a concern in relation to the time limit when certain evidence shall be presented in the internal review proceedings. In practice, because of the absence of time limit under the law, parties can bring any evidence at any time.[68] First, it is not clear as to whether evidence, to be adduced at the trial, should be annexed to the notice of objection under the tax procedure laws of Ethiopia. Second, whether evidence which was not presented at the tax audit department can be adduced at the Internal Review Department is not clear either. As a result, practically, the Review Department

[64] Interview with Mr. Desalegn Chekol, *supra* note 56.
[65] Id.
[66] Id.
[67] Revised Directive No.171/2021, *supra* note 35, Article 12.
[68] Interview with Mr. Mebit Ayehu, Attorney, Addiss Ababa, Ethiopia, April 14, 2022.

accepts any evidence at any stage of the proceeding. However, as we noticed from the views of different lawyers, unrestricted permission of evidence presentation makes the proceeding informal.[69]

#### 4.2.3.4. Burdon of Proof

The tax procedure law of Ethiopia provides that the burden of proof in relation to objection of tax decisions, except in some limited instances, is largely imposed on the taxpayer.[70] In other jurisdictions, generally, the burden of proof lies with the party normally in possession of the relevant evidence. For example, the tax department would have the burden of proof in matters such as comparable gross profits ratios. Therefore, like other states, it is commendable to make the tax payer bear the burden of proof, limiting the exception to circumstances where the tax department has sole access to the necessary evidence.[71] For example, in some countries, in disputes requiring whether the determination of transfer pricing is consistent with the arm's length principle, the government is obligated to prove this fact.[72]

### 4.3. Tax Dispute Resolution System at the Federal Tax Appeal Commission: Appraisal of the Law and Practice

Beyond the administrative remedies, taxpayers have the right to access an independent and impartial adjudication, a power which normally rests with the courts. As noted earlier, tax authority's decision may be neutrally

[69] Id.

[70] TAP, *supra* note 5, Art 59. It states that "in any proceeding under this Part in relation to a tax decision, the burden shall be on the taxpayer to prove that the tax decision is incorrect. "

[71] Richard K. Gordon, Law of Tax Administration and Procedure, Tax Law Design and Drafting (volume 1; International Monetary Fund; Victor Thuronyi (ed.), (1996), p.12.

[72] Eduardo Baistrocchi, Tax Disputes under Institutional Instability: Theory and Implications, The Modern Law Review, July 2012, Vol. 75, No. 4 (July 2012), pp. 547-577

evaluated either by a general court of law or a special court or tribunal empowered to dispose tax disputes.[73]

Specialized tax tribunal reviewing administrative decision of the tax authority has been a hallmark of Ethiopian tax dispute settlement system since the 1940s.[74] The Federal Tax Administration Proclamation (TAP)[75] established the Federal Tax Appeal Commission (TAC)[76] as an autonomous entity with its own responsibility and budget, entrusted with the function of adjudication of tax disputes by way of appeal from decisions of tax authority. The commission has a president and other members for the adjudication function, as well as administrative/secretarial staff including the registrar.

The Commission's function is analogous to judicial function of the court. The FDRE Constitution does not expressly recognize tax appeal tribunals. But the legitimacy of quasi-judicial bodies such as the Tax Appeal Commission is drawn from Articles 37 and 78(4) of the FDRE Constitution that envisages the establishment of institutions legally empowered to exercise judicial functions, along with the regular courts.

### 4.3.1. Scope of Jurisdiction of Commission

Article 2(2) of TAP impliedly defines the jurisdiction of the TAC in what it calls appealable decisions". Appealable decision constitutes what the law described as "objection decision" and "any other decision of the Authority made under a tax law", excluding *tax decisions* and decisions in the course making a tax decision.[77] In other words, the jurisdiction of the commission extends over every decision of tax authority but not on tax decisions and

73 World Bank, *supra* note 4, P.20.
74 Aschalew Ashagrie, The Tax Appeal Proceedings Before The Federal Tax Appeal Commission In Ethiopia, Critical Reflections, *Mizan Law Review*, Vol:14:2, P.203.
75 TAP, *supra* note 5.
76 Id., Art.86 ff.
77 Id., Art.2.

decisions ancillary to it.[78] These excluded decisions are not appealable while any other decision of the tax authority could be appealed.

This conclusion must be read with caution. Particularly, it does not mean that the Commission will never have a chance to review tax decisions; rather the law dictates that such decisions are not yet mature to be reviewed. Tax decisions must pass one more stage to be appealable; that they must be reviewed by the Review Department that provides recommendation to the concerned officer of the tax authority for final decision; or that the authority must have failed to review and decide during the legally specified period.[79] It is only then that tax decisions would take the label "objection decision"[80] instead of tax decision, and then become mature for appeal to TAC.

At this juncture, it is important to observe that the law confined the scope of jurisdiction of the Review Department to tax decisions that would later develop into objection decisions while the scope of jurisdiction of the commission extends to objection decisions plus "any other decision of the Authority made under a tax law". The phrase "any other decision of the Authority made under a tax law" encompasses every decision the taxpayer is

78 The scope of this exclusion hinges on what amounts to tax decision. A tax decision, as per art. 2(34) of TAP, comprises;

- tax assessment decisions[78] of the tax authority;
- decision of the tax authority allowing a request to amend the self-assessment or a refusal thereto;
- Determination on the amount of unpaid tax and the tax that will become payable by the taxpayer whose assets are under the control of the receiver;
- Determination of a secondary liability(such as where a tax representative shall be personally liable) or the amount of tax recovery costs payable;
- Determination of late payment interest payable;
- Decision regarding an application for a refund of overpaid tax(be it about eligibility or amount);
- Determination that renders either the supplier or purchaser liable for the amount of unpaid withholding tax under Article 92 (3) of the Federal Income Tax Proclamation;

[79]Id., Article 55(7).

[80] Id., Article 55(4).

aggrieved of, and tax law is defined, broadly,[81] as inclusive of the whole set of substantive and procedural rules governing direct and indirect taxes within the jurisdiction of the federal government.

Then, what decisions, other than objection decisions, would the tax authority render and then the commission would review? Obviously, there would arise multitude of issues between the taxpayers and the tax authority whereby the latter renders administrative decisions that might displease the former. For instance, there could be instances where the tax Authority revokes a license for an alleged or real failure to use sales register machine as per Regulation No: 139/2007, and so on.

In a nutshell, the commission is empowered to review every decisions of the tax authority that would constitute administrative decisions. Allowing a space of revision for all grievances against the tax authority is the logical extension of the fact that TAC is the institution specialized in tax matters. On the contrary, to encumber TAC with all the routines from tax authority deprives the time and energy to focus on the major issue of objection decisions.

To explore issues related to such concerns, the researchers held interview with legal experts of the tax authority. However, the experts revealed that they have never thought of such extended power of the TAC, and they did not experience grievances other than objection decisions being lodged to TAC so far.[82] One may even wonder whether this broad empowerment is what the legislature intended to. The power of TAC to review every decisions of the tax authority may also be in contradiction with Federal Administrative Procedure Proclamation (FAPP)- Proc. No.1183/2020,[83] which provides that

[81] Id., Art. 2(36).

[82] Interview with Mr. Yilkal and Co, Legal Experts at Ministry of Revenue, Bahir Dar branch, on 25 June, 2022.

[83] Federal Administrative Procedures Proclamation, Proc. No.1183/2020, Federal *Negarit Gazette*, Year 26, No.33. See also Aschalew, *supra* note 74, pp.212-213.

anyone aggrieved with a final administrative decision has the right to appeal to the Federal High Court (FHC)[84] for judicial review.

### 4.3.2. Accessibility of the Commission.

The commission is established as the first hand tribunal to review decisions of the tax authority, on federal tax matters, located in the capital, Addis Ababa. Ethiopia is a federal state. Accordingly, the FDRE Constitution divided power to levy and collect taxes between the two layers of government. The tax jurisdiction of the Federal government spans all over the nation's territory, and its tax subjects are spread as such. As noted earlier, in an attempt to ensure its accessibility and minimize compliance cost, the tax authority has about twelve branches in Addis Ababa and regional states. However, taxpayers aggrieved by the decision of regional branch tax authorities must travel to the capital to get their case reviewed by TAC. Thus, the commission's accessibility is seriously questioned.

The legislature did not envisage possibilities for opening branches for TAC but contemplated delegation of the commission's authority to a Regional Tax Appeal Commission.[85] Members of the commission pointed out regional governments do not have tax appeal commissions and thus delegation proved untenable so far due to the differing institutional arrangements.[86] A lawyer interviewed at the TAC remarked "for instance, my customer is from Somalia region, Jigjiga; He had to travel to the capital to explain the facts and deliver necessary documents to me, and he incurred significant cost in this process"[87].

The centralized nature of the TAC has also negatively affected access to judicial review of the Commission's decision. In principle, state supreme courts can entertain jurisdiction of federal high court via delegation. That

84 .Id., Art. 52; Interview with Mr. Yilkal and Co, *supra* note 82.
[85] TAP, *supra* note 5, Art.90(4).
[86] Interview with Belay Wodisha, presiding Judge at @Tax Appeal Commission, Addis Ababa, Ethiopia. April 13, 2022.
[87] Interview with Taddele Tesfaye, Attorney , Addis Ababa, Ethiopia, April 13 2022.

implies taxpayers within the jurisdiction of federal government but residing in the regions could have lodged their appeal to the state supreme court when they are dissatisfied with decision of the commission. Yet, the taxpayers are less likely to bounce back and restart the litigation at regional supreme courts once the lawyers and other expertise, as well as other logistics have been channeled to/sourced out from Addis Ababa in the course of their submission to the Commission in Addis Ababa. They would rather continue their case at the Federal High Court in Adds Ababa. Thus, the centralized nature of the TAC has also indirectly hampered, or at least made it impractical, the access to judicial review by the nearest Court. Members of the Commission as well as the customers unanimously underlined this drawback. Circuit Tribunal and ICT options are under consideration to ameliorate this limitation, according to key informants. [88]

### 4.3.3. Institutional Independence of the Commission

#### I. Members Appointment: Process and Selection Criteria

Tribunals are established to provide justice, sharing judicial power with courts. International and national legal instruments including the Ethiopian Constitution recognize access to an independent and impartial judiciary as one of the fundamental human rights.[89]Accordingly, tribunals must demonstrate independence and impartiality similar to the courts.[90] While this principle is widely accepted, strict application of the judicial independence to tribunal does not seem feasible.[91] The ideal model could be distancing it, as far as possible, from the executive which is perceived to be the most dangerous

[88] Interview with Mr. Mulugeta Ayalew, President of Federal Tax Appeal Commission, Addis Ababa, Ethiopia. April 13, 2022.
[89] FDRE Constitution, *supra* note 7, Art .37.
[90] Pamela O'Connor, Tribunal Independence, (The Australasian Institute of Judicial Administration Incorporated), 2013, p.12
[91] Peter Cane, *Administrative Tribunals and Adjudication* (Hart Publishing, 2009), as cited in O'Connor, Id., p.7.

threat to judicial and tribunal independence.[92] The executive undertakes key decisions on matters directly affecting the financial and career interests of members of the tribunal including their appointment, reappointment, promotion, term of office, rates of remuneration, suspension and removal from office.[93] Yet, it is inevitable that, as a state institution, tribunals will be accountable to one of the state apparatus. Tribunals do not enjoy absolute independence. [94] As O'Connor noted, "the starting point for tribunal independence is to ask what tribunals require to carry out their functions."[95]

O'Connor, citing Bryden,[96] proposed three parameters as model for measuring tribunal's independence: institutional independence, adjudicative independence, and administrative independence.[97] Institutional independence refers to the tribunal's structural and institutional relationship to the executive; adjudicative independence pertains to the 'individual' aspect of judicial independence−the ability of tribunal members and panels to render decisions "impartially, free from external interference or improper influence from any source"; and administrative independence is concerned with claim by the tribunals to control their governance, finances and personnel.[98] As a measure of institutional independence, best practices require transparency and accountability[99] at the stages of the appointments processes− recruitment, assessment, selection and appointment. The appointment by the executive should not invite political patronage and submissiveness; it should be transparent and based on objective criteria stipulated in advance.

[92] Id.
[93], O'Connor, *supra* note 90, P.17.
[94], Id., P.6.
[95] Id., P.7.
[96] Phillip Bryden, How to Achieve Tribunal Independence: A Canadian Perspective' in Robin Creyke (ed) *Tribunals in the Common Law World* (Federation Press, 2008), as cited in O'Connor, *supra* note 90, p.15. Bryden identified four aspects of independence: adjudicative independence, institutional independence, administrative autonomy and policy independence.
[97] O'Connor, *supra* note 90, pp.15-18
[98] Id.
[99] Id., P. 42

The TAC has been established as a quasi-judicial body to review appeals from the tax authority,[100] and it is accountable to the Prime Minister. The TAP envisages appointment of the president of the TAC and other members of the Commission by the Prime Minister (now Minister of Justice). He would most likely make discrete enquires about potential candidates, and then selection remains at his sole discretion.

This appointment process offers the advantage of being practical and economical. Yet it is criticised for being prone to political patronage and bias in the final appointment. It sustains what O'Connor labelled as "'old boy network' that gave privileged access to certain social groups and perpetuated a narrow membership profile."[101] The closed nature of the recruitment process gives access to narrow class in the network who may not have the required qualification while others more qualified but out of the network may be overlooked.

This shortcoming could be mitigated by advertising for expression of interest and encouraging application from wider section of potential candidates.[102] This need to be accompanied by setting common merit based selection criteria[103] that would in effect circumvent political patronage and bias in the appointment. Art.87(2) of TAP simply invites lawyers with significant experience in tax or commerce, certified accountants, previous tax officers with significant experience, and other with special knowledge and experience relevant to the functions. For instance, Zambian Tax Appeals Tribunal Act of 2015 clearly provides that the Tribunal shall consist of the following members, to be appointed by the Minister of Finance:

[100] TAP, *supra* note 5, Art 86. The reorganization of the executive organs of the federal government in October 2018 shifted the accountability of the Commission from the Prime minister to Made to the Ministry of Justice (the then Attorney general). See Proclamation No.1097/2019, Art. 33(8).
[101] Id., p. 45
[102] Id., pp.44-45.
[103] Id.

(a) three legal practitioners of ten years or more standing recommended by the Judicial Service Commission and who have sufficient knowledge of, and experience in tax matters;
(b) two qualified accountants certified as such by the Zambia Institute of Chartered Accountants; and
(c) two persons from the business community.

Compared to its Zambian counterpart, the Ethiopian law is far vague on selection criteria mainly in using vague terms such as "significant", "relevant". Moreover, the number of members of the commission and the professional matrix also remains unclear.

The data collected from the Commission over the profile of its members shows that it has a total of seven members (4 males and 3females). The professional mix shows that six out of seven of them are trained in law while just one of them is an accountant who joined the Commission few months before. The experience of the members comprises those who begin their carrier within the commission with no previous experience to those who earned more than a decade of experience. Such degree of variation in experience is evidence of the limitations of the selection criteria.

**Table 2: Profile of Members of the Commission**

| Members code | Male | Female | Age | Profession | credential | Years of service in TAC | Years of service elsewhere | Fulltime | Part-time |
|---|---|---|---|---|---|---|---|---|---|
| A | X | | 53 | Law | LLM | 4 | 18 | X | |
| B | X | | 47 | Law | LLM | 3 | - | X | |
| C | X | | 51 | Law | LLB | 3 | - | X | |
| D | X | | 38 | Acctg | BA | 5 mon | 8 | X | |
| E | | X | 32 | Law | LLM | 3 | 6 | X | |
| F | | X | 27 | Law | LLB | 2 | 0 | X | |
| G | | X | 25 | Law | LLB | 2 | 0 | X | |
| Total | 4 | 3 | | | | | | | |

## II. The Tenure Security and Remuneration

Similar to appointment processes, the tenure security and remuneration security of members determines institutional independence of tribunals. Tenure security is considered the hallmark of judicial independence internationally. The questions of whether members of tribunal should be appointed until retirement age, and if not for affixed term or a renewable one remain contested.

It has been held that tenured appointments would impair the ability of tribunals to meet changing needs of users and the function of the office.[104] Unlike judges of regular courts, tenured appointment of members of tribunals generally failed to win acceptance across different jurisdictions. Then, if members of tribunals should not be appointed until retirement age, should it be if for a single affixed term or a renewable is still controversial. Non-renewable term would deprive tribunals the opportunity of retaining skilled and experienced members, and of course discourages potential candidates from the start. On the other hand, members with renewable appointments are likely to be submissive to the political will of the executive. This could happen even without the influence of the executive for members expecting reappointment would be cautious of how their set aside rates would be perceived.[105] Due to this consideration, for instance, the New Zealand Law Commission rejected both tenured and renewable appointments and concluded that "fixed term appointments can be consistent with independence, provided that the term is long enough and that members have sufficient security from removal without cause during the term".[106]

Security of remuneration is also an aspect to institutional independence. It aims to shield the members of the tribunal from the executive for fear of manipulation of their means or from being tempted to supplement their

[104] Id., p.63
[105] Id., P. 62
[106] Id., P.63

livelihood from other sources. There has to be a guarantee that remuneration cannot be reduced during the term.[107]

The Ethiopian law, under Art 87(4) of TAP, lays down the rules on tenure security and remuneration. In the relevant part, it provides that a member of the Commission:

a) may be appointed as either a full-time or part-time member;
b) shall be appointed for a term of 3 years and shall be eligible for re-appointment;
c) shall hold office on such terms and conditions, including in relation to remuneration and attendance fees, as the Prime Minister (Minister of Justice) determines.

We noted in the foregoing discussion that renewable appointments and remunerations that depend on discretion of the executive could be detrimental to institutional independence. Thus, the short term (3 years) renewable appoints and remunerations that totally depends on the discretion of the Prime Minister is detrimental to institutional independence of the Commission, as O'Connor remarked that "independence which depends on the discretion of those who appoint the tribunal is 'illusory'".[108]

Interview evidences from members of the Commission revealed the absence of rules regarding the future destiny of the members after their term of service ends. Rather they capitalized their experience in the Commission is of special value that they will be in demand both in the government and the private sector. It is doubtful how that would work for all of them, and generally uncertainty about their future career would inevitably compromise their independence.

[107] Id., P. 74
[108] Id., p. 22.

### 4.3.4. Personal Independence of Commission Members

Personal independence, also known as adjudicative independence, concerns itself with whether tribunal members will render decisions impartially and whether there are safeguards against external interference or improper influence over the practitioner. Statutes often require judicial review of tribunal's decisions, tribunal codes of conduct, oath of office, and immunity from suit, disclosure of conflict of interests, and disqualifications. Most of the mechanisms are meant to ensure individual accountability which place duties and restrictions on adjudicators to preserve their own impartiality.

The TAP fares well regarding adjudicative independence. Its decisions are appealable to the Federal High Court though limited to issues of law.[109] The courts may decide to affirm the decision of the Commission, to set aside the decision of the Commission, or to dismiss the appeal.[110] To ensure impartiality, Art. 87 of the TAP provides integrity tests for persons to be appointed as Members of the Commission.[111]

A notable limitation of the TAP regarding adjudicative independence is largely associated with tribunal's codes of conduct. Members of the tribunal are duty bound to protect their own impartiality and there must be ways to sanction in case of default. Similar to code of conduct for the judges, there should have been codes of conduct for members of TAC and consequences of breach thereof, and due procedure in dealing with them needs to be put in place.

Be that as it may, experiences proved that formal structural safeguards are essential for independence of tribunals but they are not sufficient to ensure *de facto* independence. It is observed that unless complemented by cultural

[109] TAP, *supra* note 5, Art 57, 58.
[110] Id., Art 57(5).
[111] Id., Art 87.

institutions and societal values, they can be easily ignored or manipulated by the executive.[112]

### 4.3.5. Public Perception about Independence/Impartiality of TAC

Public trust in the neutrality of courts and tribunal is indispensable. Not just the reality but the perception about independence of institutions matters to a great extent. It is a common expectation from the public that "an adjudicator must not only be impartial, but must be seen to be impartial."[113]

The data gather from interviews shows that the perception of customers regarding independence/impartiality of TAC is generally positive. Yet, a significant number of interviewees alleged the institution to be a government adjunct and as such it tends to work in a way it does not offend the executive.[114] An interviewee pointed out that the commission does not dare to strictly apply the law where it thinks the decision's outcome will have wider implication and likely to affect the government revenue substantially.[115]

However, as noted earlier, the perception to be neutral is equally important to show the reality of impartiality. The mechanisms to enhance the perception of impartiality include permitting stakeholder or community organisations to take part in the nomination of Commission member, and to include some of their candidates as members of Commission.[116] In Zambia, for instance, two of the seven tribunal members are required to be from the business community. In the Ethiopian case, although the previous legislation[117] had

[112] O'Connor, *supra* note 90, p.23
[113] Id., P.12
[114] Interview with anonymous Taxpayer, Addis Ababa, Ethiopia, May 3, 2022. "በእኔ እምነት ነፃና ገለልተኛ ነው የሚል እምነት የለኝም፡፡ እንዴት ነው አለቃህ ላይ ክስ ቀርቦ ገለልተኛ ሆነህ የምትወስነው? ደሞዝ ከፍሎ እያሰራህ ራሱ ተቋሙ? በፍፁም ሊሆን አይችልም፡፡" (In my opinion, I don't think it (the commission) is independent and impartial. How can you impartially decide in a case in which your boss who pays your salary is sued? never!)
[115] Interview with Attorney Melese Woldie, *supra* note 59.
[116] O'Connor, *supra* note 90, P.14.
[117] See generally Income Tax (Amendment) Proclamation No. 608/2008.

recognized stakeholders' representation, there is no explicit provision in TAP. Yet, Art.87 (2)(d) of TAP generically provides that individuals having special knowledge, experience, or relevant skills may be appointed as members to the Commission. This provision may be broadly interpreted to accommodate stakeholders such as the business community. Thus, it could be helpful to draw professionals from all sectors including the academia.

### 4.3.6. The Proceedings at the TAC

#### 4.3.6.1. Filing a Notice of Appeal to the Tax Appeal Commission

A dispute resolution system needs to be designed in ways that respects the procedural rights of taxpayers.[118] Also it is important to have a mechanism to determine whether any barriers to procedural justice exist and to identify how these barriers might be reduced or eliminated.[119] Under the Ethiopian law, appeal to the TAC must be filed within 30 days of service of notice of the objection decision. The research examined whether this requirement to file a case to the TAC causes impediments to access to justice. In exceptional cases, this period may be extended for a further 15 days but in such a case the taxpayer must show good cause.

The researchers found the timeline set in Ethiopian law is consistent with the international practice.[120] Further, the overall views of customers/lawyers on the issue was gathered through an in depth interview. The interviewees reported that the time limit is reasonable and practically that is not a problem. They also noted the possibility of extension in exceptional circumstance as a safe exit. They reasoned out that the taxpayer had been with the case

[118] Evgeny Guglyuvatyy, Procedural Justice: Examining Tax Resolution processes in Russia and Singapore, *Journal of Tax Administration*, Vol 7:1 2022, P.23.
[119] Id.
[120] A 2015 OECD survey found that periods of 30-60 days were most common. See OECD, Tax Administration 2015: Comparative Information on OECD And Other Advanced And Emerging Economies, OECD 2015, P. 313.

throughout the auditing process, the exit conference, the review at the tax authority, and thus has got more than 30 days. This is enough for a reasonable diligent person who really needs to exercise his right.[121] The interviewees underlined that taxpayers request more time to mobilize the fund for advance deposit, not really for preparing and submitting their pleadings.

#### 4.3.6.2. The Advance Deposit Requirement

The question of whether the tax, once it is assessed, has to be paid immediately or it should be suspended during the protest/appeal process has drawn divided opinion. The competing interest of the state for timely collection of finance and the possibility of denial of access to justice need a balanced consideration. Thuronyi and Espejo observed differing experiences in common and civil law systems. In the formers case, the taxpayer typically does not have to pay the tax until there is a court decision, while in the Civil law systems the taxpayer is require to pay the tax assessed in principle but most countries provide for the suspension of tax collection under certain circumstances. The scholars described rules that deny the right to proceed for the protest/appeal if the taxpayer does not pay the tax as "a harsh approach and may raise constitutional questions of due process or procedural equality before the law." [122]

The Ethiopia law stipulates that:"a notice of appeal to the Tax Appeal Commission in relation to an objection to a tax assessment shall be treated as validly filed by a taxpayer only if the taxpayer has paid to the Authority 50% of the tax in dispute."[123] This requirement is one of the most contested issues in the Ethiopian tax administration system. Aschalew, commenting on the Ethiopian case, holds that "although the 50% amount of deposit may be tolerable in the interest of the general public, demanding taxpayers to meet

[121] Interview with Tesfaye Yizengaw, Attorney, Addis Ababa, Ethiopia. April 13, 2022; Also Interview with Attorney Mebit Ayehu, *supra* note 68.
[122] Thuronyi & Espejo, *supra* note 20, P.13.
[123] TAP, *supra* note 5, Art.56(2).

this obligation through payment of cash under all circumstances seems to be unjust."[124] The lawyers interviewed opined that the pre-payment rule is a serious impediment to access to justice. At times, according to these interviewees, the audit goes back to several years and the government's claim exceeds the whole assets of the business. A lawyer particularly mentioned, for instance, that his customer is assessed for eight million birr but the business as a whole cannot be sold for that amount.[125] Failing reversal of the decision at the TAC, he remarked, his customer's business would be closed. Another interviewee added that most businesses face liquidity problem to pay the deposit amount. They may not even resort to banks for loan due to the fact that they have to provide tax clearance but the tax authority will not issue the clearance before the payment of that amount.[126] Other interviewees proposed that the taxpayers' duty to pay should be postponed at least until the decision of the TAC as the neutral adjudicator.[127] They underlined that the unchecked decision of the tax authority should not block access to justice.

At this juncture, it is important to enquire into the nature of the advance deposit requirement. Is it not an issue of execution of the tax authority's decision? The tax authority is given ample power to take precautionary measures and enforcement power including seizure, freezing accounts, etc. The deposit requirement is being used as an easy way of execution of the tax authority's decision. In so doing, the system as it stands now takes hostage of the taxpayer's constitutional right to access to independent and impartial adjudicator. Those unable to pay would be denied access to justice. Tran-Nam et al remarked that "if tax dispute resolution is indeed not neutral between the

[124] Aschalew, *supra* note 74, p.219.
[125] Interview with Tesfaye Yizengaw, *supra* note 121.
[126] Interview with Rekebki Tsega, Attorney, Addis Ababa, Ethiopia. April 13, 2022.
[127] Interview with Tesfaye Yizengaw, *supra* note 121; Interview with Taddele Tesfaye, *supra* note 87.

'haves' and the 'have-nots', then this may be regarded as a violation of distributive justice."[128]

Thuronyi and Espejo contends that "a more moderate alternative is to provide that the failure to pay the tax does not affect the taxpayer's right to have the appeal heard, but the taxpayer will be subject to the compulsory collection procedure in the event that no deferral of payment is authorized."[129] The experience of some states such as Brazil shows that the taxpayer can proceed to litigate in court without advance deposit but the tax authority may proceed for execution just after its decision. In exceptional circumstances, the taxpayer may obtain suspension of execution upon provision of guarantees.[130] In South Africa, in principle, tax collection may not be suspended by an objection or appeal or pending the decision of a court of law but a taxpayer may request a senior South African Revenue Service (SARS) official (the Commissioner or his delegates) to suspend the payment of tax or a portion thereof.[131]

Section 164 of the South African Tax Administration Act No.28/2011 provides a number of instances where the suspension of payment or denial of same could be effected depending on circumstances. A senior SARS official may suspend payment of the disputed tax having regard to:

a) the compliance history of the taxpayer;
b) the amount of tax involved;
c) the risk of dissipation of assets by the taxpayer concerned during the period of suspension;
d) whether the taxpayer is able to provide adequate security for the payment of the amount involved;

[128] Tran-Nam and Walpole, *supra* note 8, *p. 326*
[129] Thuronyi and Espejo, *supra* note 20, p.12
[130] Daniella Zagari and Maria Eugênia Doin Vieira, 'Brazil', Whitehead (ed.), *supra* note 83, p.33. In Brazil, the court precedent allows the taxpayer to proceed without depositing the amount.
[131] See South African Tax Administration Act, 2001.

e) whether payment of the amount involved would result in irreparable financial hardship to the taxpayer;
f) whether sequestration or liquidation proceedings are imminent;
g) whether fraud is involved in the origin of the dispute; or
h) whether the taxpayer has failed to furnish information requested for purposes of a decision thereof.

On the other hand, a senior SARS official may deny a request for suspension of payment or may revoke a decision that suspended payment if satisfied that:

a) after the lodging of the objection or appeal, the objection or appeal is frivolous or vexatious;
b) the taxpayer is employing dilatory tactics in conducting the objection or appeal;
c) on further consideration of the factors considered for suspension, the suspension should not have been given; or
d) there is a material change in any of the factors considered for suspension.

Although the discretion to suspend resides with the tax authority, the South African approach offers possibilities to avoid drastic measures against tax payers. The researchers propose that the Ethiopian law should be revisited. Instead of setting pre-payment as precondition, the appellant should be allowed to proceed to appeal, and the tax authority may proceed for enforcement in due course. Depending on circumstances, the tax authority's action for enforcement may be suspended by the TAC upon the application of the appellant showing convincing causes and subject to appropriate guarantee.

#### 4.3.6.3. The Hearing Procedure

The opportunity to be heard is an important element of procedural rule of law. In so far as tribunals share the function of the judiciary, they need to act judicially.Acccordingly, the tax administration legislations, in design, should

address the rules of a formal hearing, including the conditions for calling a hearing, the effect of non-appearance, the obligations and rights of the parties involved, and the institutional requirements for holding a hearing. To this effect, the TAP tacitly recognizes the taxpayers' right to be heard[132] in public.[133]

As a way to substantiate the evidence over such issues, the research team had also attended two sessions of hearing. Though the hearing begins with the appellant's brief statement, the chance to present one's perspective swings frequently between the parties; there is no formal examination of witness by the parties. Instead, the panellists are so active; they inquire the parties turn by turn repeatedly, require the party's witnesses (usually auditors) at any point to explain matters raised on the spot. We observed that the system is more inquisitorial than the Ethiopian judicial practice. The diligence and curiosity for facts and the search for truth by the panellist is so exciting, though our short lived observation is not adequate for an overall generalization.

We gathered the views of customers (lawyers) about the proceeding. By and large, they are content with the overall function of the Commission. According to the interviewees, the Panellists of the commission read the pleadings before the hearing, identify issues and the points in need of clarity. They all concur on the diligence of panellists which they claimed a character judges in regular courts are lacking.

Nonetheless, most of the interviewees remarked that the panellists give limited time to present one's own case, and as such there is a serious restriction on the right to be heard. Interviewees attributed this to the panellists' conviction that they have read it all and they only need clarification. While acknowledging panellists' diligence, interviewees stressed

[132] TAP, *supra* note 5, Art. 90(1).

[133] Id., Article 90(2); See Directive on the Working Procedure of the Tax Appeal Commission, Directive No 02/2011 E.C (issued by the Prime Minister), (hereinafter TAP Directive 02/2011), Art 11.

that it is not uncommon to get issues overlooked during the hearing. One interviewee remarked that panellists, when they, later in writing decision, realise issues that should have been debated but overlooked, often shift the burden to the party and state that the party did say nothing on this issue. The interviewees also underscored that the TAC is the final arbiter on matters of fact; there is no recorder during the trial to recount what real issues were presented. These two factors are resulting in significant repercussion on the right to be heard and judged according to facts.

Interviewees commented also on matters of evidence. The commission flexibly accepts evidence. They remarked that not in a few cases appellants submit to the commission documents that should have been submitted to the tax auditor or, at the latest, to the Review Department. There should be a limit on that, they remarked. The other input from the interviewees is that there are no fixed dates for decision. "The first fixed decision date is usually not workable and next appointments do not have fixed dates; simply they will tell you to follow up via the registrar". Sometimes the parties fail to follow up after a single or two visits. Interviewees alleged that there are uses and abuses of this gap in that the appellant who lost the case seat idle deliberately and later, where the authority moves for enforcement, the appellant initiates further appeal to the High Court alleging that he just knew it is decided while in fact several months have already passed after the decision. On the other hand, a lawyer stated that he had an incident where he honestly did not know it was decided but later, where he checks and tries to appeal, lapse of appeal time was raised as a preliminary objection. Then he had to go to the cassation bench to get it reversed in his favour.[134] So, there should be certainty in this practice as well.

[134] Interview with Girma Merhatsidik, Attorney, Addis Ababa, Ethiopia, April 15, 2022.

### 4.3.7. Efficiency and Competence of the TAC

The TAC as it stands now came into the picture following the enactment of tap in 2016. Data sources indicated there had been case backlogs that the newly structured TAC had to overtake. Here we provided evaluation of efficiency and competence of the TAC with the period of its short lived experience. Only the last three years' case submissions and disposals had been documented. The lack of proper documentation enables only limited trend analysis.

**Table 2: : Summary of Case Disposal Rate between 2016 and 2022**

| Years | No. of objections filed | Cases disposed/decided |
|---|---|---|
| Sept. 2016-August 2019 | 2492 | 1852 |
| Sept. 2019-August 2020 | 385 | 793 |
| Sept. 2020-August 2021 | 832 | 765 |
| Sept. 2021-Feb. 2022 | 576 | 529 |
| Total | 4276 | 3939 (337 left undisposed) |

The data in the table shows what has been accomplished by the commission after it tookover the task in 2016. The figures, therefore, shows the exceeding performance of the commission. Had it not been for the backlogs, the Commission's annual performance, number of cases disposed, exceeded the appeals lodged.

Lawyers, who were all customers, were asked to share their views regarding the speed at which their cases are disposed. They responded that TAC disposes cases in quite reasonable speed at which they aspired to get similar service in regular courts. Regarding competence of commission members, opinions of the customers are positive but few users mentioned that there is a need to work on qualification and professionalism.[135] The profile of members

[135] Anonymous Interviewees, Attorneys , Addis Ababa, Ethiopia, April 15, 2022.

of the commission (see Table 3 above) also suggests that some members need to earn more experience.

The success rate of appellants supposedly measures the screening power and efficiency of the review department. It also indicates how far complaints are well founded. The data collected from the commission's registrar is presented below.

**Table 3: Success Rates of Appellants=Ratio of ((cases reversed+varied+remitted)/total cases disposed)**

| Years | Reversed | varied | Remitted | confirmed | Withdrawn | Dismissed | Total disposed | Success rate |
|---|---|---|---|---|---|---|---|---|
| Sept. 2019-August 2020 | 199 | 112 | 8 | 338 | 67 | 69 | 793 | 319/793=40% |
| Sept. 2020-August 2021 | 147 | 58 | 15 | 361 | 5 | 179 | 765 | 220/765=28.8% |
| Sept. 2021-Feb. 2022 | 83 | 45 | 3 | 316 | 15 | 67 | 529 | 131/529=24.8% |

The data presented above shows that the success rate of the appellants is between 40% to 24%. The implication is that significant number of objection decisions are reversed, varied, or remitted to the tax authority while they should have been screened and settled there. The rate would get higher along the review systems if one surveys cases taken to High Court, Supreme Court and Cassation division. Though three years data may not be conclusive enough to show the real picture of incidents, we take it to be informative to some extent. As such, this is a significant rate compared to some other

jurisdictions such as France[136] where only 12.4% of the decisions of the tax authority are revised/reversed by the administrative courts; Germany[137] where about 20% of decisions of the tax authority are revised/reversed by the specialized tax champers of ordinary courts. The good thing in this trend, again with caution due limited time data, is that the success rate is declining (from 40% to 28%, then to 24%) along the time range. It promises the possibility of learning curve at the tax authority; there shall be more cases settled there, and only few would land at the TAC.

## Conclusion and Recommendations

In the course of an extensive appraisal on the institutional operation and specific practices of the Review Department and TAC, this study has found out arrays of evidences that would inform the institutions themselves, the legislature, and policy makers at large. To this end, it is found out that the current structural set up of the Review Department, and the TAC suffers from serious accessibility problem. In particular, the TAC is solely based in the capital. It is geographically inaccessible, which in effect deprives taxpayers the chance to get legitimate claims reviewed. The feasibility of more branches should be seriously considered. In areas where running costs are not economic, ICT solutions and Circuit tribunals could be employed. In the long run, we would propose harmonization of institutions with the regional governments so as to make delegation a feasible option.

The second problem is related to the mandate of the Review Department. The review department is accountable to the general manager of respective branches, and has no mandate to pronounce final judgment. The general manager has the exclusive mandate to approve or reject recommendations. As confirmed by the data sources, sometimes, the managers reverse legitimate recommendations without acceptable reasons. This renders the whole purpose

[136] Philipe Derouin, 'France', in Whitehead (ed)., *supra* note 3, P.93.
[137] Axel Cordewener and Michael Hendricks, Germany', in Whitehead (ed.), *supra* note 3, p.101.

of constituting the resource intensive review departments less useful. The researchers would recommend that either the branch manager's vote should be reduced to single vote (one among the rest instead of absolute veto), or reversals and amendments by the General Manager should be well reasoned out and must be, once again, reviewable by the next superior authority, whose sole mandate would be to confirm the general manager's or the review department's holding. Without such considerations, the system would be prone to corruption and other forms of misuse.

Third, the tax law does not adequately regulate procedural issues, both at the Review Department and at the TAC, including the qualification of the person who can appear before the Review Department/ TAC; the effect of non-appearance, submission of statement of defence by the tax authority; the hearing procedure; deadline for submission of evidence, etc. As such, it resulted in uncertain and protracted procedures in the determination of issues. There should be clear laws comprehensively regulating procedural aspects of the dispute resolution. In particular, evidence not presented at the exit conference (to the auditor) should be barred except in situation where convincing reasons are presented.

Fourth, the law extended the scope of appellate jurisdiction of TAC unduly, perhaps inadvertently, to every decision the tax authority makes. It is advisable to limit its jurisdiction to review of objection decisions for a focused and effective adjudication of same. Also, the institutional independence of TAC is questionable due to the closed nature of nomination process, short and renewable tenure of the members, etc. To mitigate that limitation, the appointment process should be open enough with a fair space of competition. There needs to be a call for all potential candidates Also, there has to be objective selection criteria such as quantified years of experience and specific skills and competence requirements. It is also advisable to disentangle the person who recruits and the one who finally appoints among the list of eligible.

The tenure and remuneration insecurity of members of the Commission is a serious drawback that subjects the members to the wills and whims of the appointing executives. We recommend fixed but longer term tenures instead of renewable ones. Remunerations should not also be at the sole discretion of the appointing authority.

There should be clear standards of codes of conduct for members of the Commission, and clear accountability mechanism in case of breach. The judicial codes of conduct and disciplining mechanisms could be adapted.

Although the current perception about the TAC regarding independence/impartiality is in good standing, it needs to build on that. One mechanism could be engagement of the business community, professional association, and academics in the recruitment for membership of panellists in the commission.

The requirement of advance payment hampers the right to access to justice. The possibility of closure of businesses due to liquidity problem should not be overlooked. We recommend postponing that requirement until TAC as a neutral adjudicator decides. Or, at least, let the appellant proceed to appeal without payment, and also let the tax authority proceed to enforce at a time of its convenience. Where there are compelling reasons to suspend execution, let the TAC decide on case by case basis. Debarring the right to access to justice should not be used as a means of enforcement.

Finally, regarding the proceeding at the TAC, the diligence of members of TAC to read pleadings in advance, their commitment and inquisitiveness to arrive at the truth are well appreciated by users. But significant numbers of them resented regarding the adequacy of the opportunity to present and to be heard. Given the TAC is the final decision maker on matters of fact, there is a need to reconsider the hearing practice of TAC. In terms of facility, there has to be a record system to cross-check facts presented at the hearing stage.

# The Treatment of Ethiopian Consumer Cooperative Societies under the Ethiopian Income Tax and Value Added Tax Regime: Law and Practice⇓

***Teklemuz Gebreselassie*** ∂ ***& Dawit Redae*** ϒ

***Abstract***

*The economic and social contribution of Cooperative Societies is immense in Ethiopia. In recognition of this, Federal Co-operative Society Proclamation No_985/2016 exempt them from income tax with restrictions on their transaction. Yet, they are obliged to pay all other direct and indirect taxes including VAT. There has been a rampant complaint in many parts of the country over the transactions of these institutions and their income & VAT treatment. The article aims at examining the magnitude and manifestations of the problem of Consumer Cooperative Societies taxation in Addis Ababa city and other three regional states (Amhara, SNNP and Oromiya). To attain this, a qualitative research approach is employed in the course of which pertinent legislations, key informant interviews and literature have been explored, analyzed and synthesized. The FDRE Constitution, Ethiopian Cooperative Laws and other legislations are used as primary sources of data. Key informant interview has also been conducted with authorities in Federal and city administration Cooperative Agencies and Revenue Authorities. Additionally, books, articles, journals, and other relevant materials on the subject are examined as secondary data sources. Finally, the study concludes that the Consumer Cooperatives in the study area are transacting outside members without taking in to consideration the unique feature of 'serving*

⇓This article is the result of a research-project funded by USAID's Feteh (Justice) Activity in Ethiopia. However, the content and opinions expressed in the article are the views of the authors, and not necessarily the views of USAID.

∂ LL.B (Dire Dawa University), LL.M (Mekelle University), Lecturer, College of Law, Dire Dawa University. The author can be reached at teklemuz300@gmail.com.

ϒ LL.B (Dire Dawa University), LL.M (Addis Ababa University), Lecturer, School of Law, Adigrat University. The author can be reached at dandavehope@gmai.com.

*only members' and this income is treated as the income from Cooperative members; and there is no uniform system on levying and collecting of VAT., Therefore, Cooperative Agencies and Revenue Authorities of the country should exercise their mandate of regulating Co-operatives transaction and taxation.*

**Keywords***: Co-operatives taxation; VAT; Income tax; Transaction.*

---

## Introduction

Co-operative is one of the universal phenomena through which a human will come together with others for shared interests. Such moves manifest as business institutions in modern times cooperative societies, as one of such business institutions, take on different characteristics depending on the specific interest it is established. Accordingly, different scholars and institutions define the concept in varying ways. In one of the widely, acclaimed definitions, Cooperative Societies Agency (ICA) defines it as "[a]n autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise."[1] A closely similar definition of the concept has been also given by Cooperative Soceities Proclamation of Ethiopia. From this definition, it is possible to infer the distinguishing features and principles of Co-operative Societies, including 'serving their members most effectively and strengthening the Cooperatives movement. Particularly, Cooperatives pursue the goal of supporting each other and get product/service at lower price by creating a market linkage with other Cooperatives.

From these features and principles, one infers a legal presumption that the establishment of Cooperative Societies is not profit maximization. This

[1]Ethiopia Agricultural and Transformation Plan, *Agricultural Cooperatives Sector Development Strategy*, 2012-2016, ( June 2012), P.8.

presumption in turn arises from the principle of mutuality which portrays 'no one can make profit from oneself'.[2] That is why, Cooperatives are exempt of income tax as profit motive is missing in their transaction. However, the mere exemption of income tax does not preclude the impact of indirect tax as this indirect tax is applied on specific aspect of transaction. Accordingly, there is neither any special benefit nor any additional compliance for a cooperative society on VAT and other indirect taxes.[3]

Similarly, in principle, Cooperative societies in Ethiopia *serve their members* most effectively and strengthen the cooperative movement by working together through local, national, regional and international structures.[4] Also, there are exceptional circumstances where Cooperatives can give service to non-members.[5] However, the income tax treatment of Cooperatives transaction with non-members on the conditions sated in Article 23 is not clear. Moreover, the Ethiopian VAT proclamation No. 285/2002 referred in Article 6(1) states that Co-operatives should pay VAT since indirect taxes are uniformly applicable for any form of business so long as there is a *'taxable transaction*'.[6] Nevertheless, the practical applicability of these laws related with Cooperatives transaction, income tax, and VAT treatment in Ethiopia are

[2] Milind V. Sahasrabudhe, *Indirect Taxes Cooperative Banks / Housing*, (May 2010), p.3.
[3] Id.
[4] Co-operative Society proclamation of Ethiopia, Proclamation No.985/2016, Federal *Negarit* Gazzeta (2016), Article 5(6).
[5] Id., Article 23.
[6] "Taxable transaction" is an activity which is carried on continuously or regularly by any person in Ethiopia or partly in Ethiopia whether or *not* for a pecuniary profit that involves in whole or in part the supply of goods and services to another person for consideration." Currently, Article 2(3) of the VAT amended proclamation No. 609/2008 states "the phrase "any person" also the phrase "activity which is carried on continuously or regularly" in Article 6 of the Proclamation are repealed and replaced by "any registered person" and "activity whether or not carried on continuously or regularly".

not closely examined yet. Thus, this article examines the tax treatment of Ethiopian Consumer Co-operative Societies in Addis Ababa and other three regional cities of the country (Amhara, SNNP and Oromiya).

Qualitative research tools have been employed to explore the operation of the transaction and tax treatment in these institutions across the study cites. Both primary and secondary data were generated to attain the objectives of the investigation. In the secondary source, different books, articles, journals, and laws are reviewed and deeply examined as sources of secondary data. The primary data is collected through structured and unstructured interviews from *key informants* namely, Ethiopia Federal Cooperatives Agency and city Co-operative Societies Agencies. The other *key informants* are Federal Revenue Authority and Revenue Authority from each city of the three regions. Both purposive sampling and Simple Random sampling is employed to understand the grounds of tax exemption in practice on the taxation of co-operative societies in the capital cities of the above regions. In addition, Personal observation is made to scrutinize the transaction of Cooperative Societies with members and non-members. The data generated from these sources were analyzed and synthesized through qualitative method.

The Article is organized under three Sections. The first section deals with the theoretical framework of Cooperative Societies taxation. It highlights the Cooperatives income tax and VAT, specifically focusing on the pro and cons of Cooperatives income taxation. The second section discusses the tax treatment of Cooperative Societies in Ethiopia. This section emphasizes the legal and practical application of Cooperatives taxation in Ethiopia through an analysis of the transaction of Cooperatives and their income tax and VAT treatment. Finally, the last section provides concluding remarks and recommendations of institutional actions.

## 1. Cooperative Societies and Taxation: A Theoretical Framework

Individuals who conduct business have numerous options to determine the most appropriate way to pursue the particular business interest. The choice mainly depends on the desired characteristics of the business, including tax implications.[7] They may take into consideration whether the business is exempted from income tax and other indirect taxes. In some countries, a co-operative society, as a special type of business organization is subject to direct and indirect taxes. Yet, in others, their contribution of easing socio-economic burden dens of communities is recognized. Accordingly, governments provide them with several facilities, concessions and privileges including exemption from taxes.[8] Because of these divergent practices of levying and the varying explanations, Cooperative Societies income taxation and VAT are controversial all over the world. The next section addresses such controversies and the issues underlying the arguments.

### 1.1. Direct Tax Treatment of Co-operative Societies: Income Tax Perspective

The controversy of Cooperatives income taxation arises from the absence of clear business boundary between members or non-members. The 6th ICA Principle and Paragraph 6(d) of the ILO R. 193 emphasize serving members effectively as an ultimate objective of the cooperation among cooperatives. But, the practicalities of these laws are doubtful and several member countries of these instruments allow co-operatives to transact with non-members. That is, a co-operative society may have a number of activities. As a result, the income from some activities may be exempted from income tax; whereas, income from other activities may not be exempted.[9] In general, income tax

[7] James R. Baarda, *Cooperatives and Income Tax Principles*, University of Arkansas, LLM Course, Published, (2007), p.1.
[8] Daniel Ish, Some Aspects of the Taxation of Canadian Co-operatives, *Mc Gill Law Journal*, Vol.21, (1975), p.78.
[9] CA Pramod Shingte Pune, *Taxation of Co-Operative Societies in India*, (2000), P.2.

exemption of co-operatives is a major subject of debate in policy practice and scholarly discourse.

### 1.1.1. Arguments in Favor of Income Tax Exemption of Cooperative Societies

The cooperative enterprise is conventionally held to be a non-profit institution guided by the principle of service for the benefit of patrons.[10] Cooperation among cooperatives has been a feature of cooperatives since the beginning of their modern history in the mid nineteenth century. Now the sixth of the seven ICA principles introduced in 1995 lays down the statement on the cooperative identity. The 2001 UN Guidelines, the other document in related to this issue, creates a supportive environment for the development of cooperatives. Thirdly, the 2002 ILO Recommendation No. 193 concerning the promotion of cooperatives also emphasizes the importance of cooperation among cooperatives. These international instruments do not expressly regulate the way cooperatives should cooperate.

Consistent with the ideals of international documents, most countries in modern times provide several facilities, concessions and privileges, which are peculiar to such societies registered under Co-operative Societies Acts.[11] Among such facilities or concessions are facilities or concessions in respect of payment of income tax liability.[12] The main reason for the exemptions of tax and other privileges for these traditional co-operatives is dependents on the characteristics they owe. A Canadian scholar, Daniel Ish states that Co-operatives have been characterized, in contrast to ordinary business corporations, as lacking the speculative or profit making element.[13] The main objective of the common business corporation is to reap a return to investors based on the amount of capital invested in the corporation by the shareholder,

[10] Helmberger and Hoos, *Taxation of co-operative in USA*, (1962), p.20.
[11] Pune, *supra* note *9*, *P.1*
[12] Id.
[13] Id.

while the co-operative de-emphasizes the role of the member as investor and stresses his role as patrons.[14]

The aims of co-operatives are to socialize the interests of the members by eliminating or minimizing the role of the member qua investor and maximizing the role of the member qua patron, restricting the return on invested capital to a nominal rate. As such, it requires that the surplus of the co-operative be distributed to the members according to their patronage rather than their investment. Accordingly, it substitutes the capitalist principle of "one vote per share" for the co-operative principle of "one vote per member" regardless of the number of shares.[15]

A common view at the time was that a "true co-operative" by its very nature and mode of operation had no income of its own. This view was based on a number of theories. First, the co-operative acts as an agent for its members. Another, not totally distinct from the first, was that a co-operative was intended only to provide goods and services to members at it marginal cost rather than to produce profit.[16] Thus, any surplus resulting from its operations was merely an adjustment in arriving at this fundamental object and was not income as such.

The quality of income test, of course, failed to be tenable as it can be shown that the sums held by the co-operative do not in fact belong to it. If one proves that the co-operative is the agent of the members ("agent" perhaps not always used in its strict legal sense), then the surplus is not taxable because the co-operatives' right to it is not unrestricted.[17] It will be recalled that in

[14] Ish, *supra* note 8, P.43.
[15] Id.
[16] *A* "price adjustment" theory of the operations of co-operatives has also been alluded to in Canadian jurisdictions. This theory is based on the premise that a true co-operative is intended only to provide goods and services to members at cost rather than to produce a profit. Patronage dividends paid out of surplus are deemed to be merely a price adjustment in arriving at this fundamental objective.
[17] Ish, *supra* note 8, p.53.

*Saskatchewan Wheat Pool* case[18] a similar ruling was reached, thereby establishing similar principles. The courts found the relationship between member and co-operative to be one of agency, trust or some contractual relationship less than a legal agency or trust. Thus, the court laid down the principle that a particular co-operative did not possess sufficient ownership in the surplus to be taxable on it.

The agency principle enunciated in *Saskatchewan Wheat Pool* has been followed often in cases involving marketing cooperatives. The Tax Appeal Board in 1952 held that a Manitoba dairy co-operative was exempt from taxation under the *Income War Tax Act* on the ground that the co-operative was acting as a mere "conduit pipe" of the members for the profits from the creamery operations.[19]

In general, the argument in favor of exemption of co-operatives from income tax depends on the ICA principle (serving only members), features of non-profit, and theories of agent-principal relationship between the agent and principal. The proponents hold that cooperatives are tax-exempt because they are not-for-profit. Technically, this is tenable because taxes aren't owed when there is no income.[20] Further, it is argued that the institutions are motivated not to by profit, but by delivery of services to their members at affordable price rate and required level of high quality .[21] Similarly, the grant of this privilege to cooperatives may not literally help the government raise revenue, but it fulfills the mandate of easing the life burdens of people. Further, the tax exemption privilege under the law was made to enable the cooperatives

[18] *M.N.R. v. The Saskatchewan Co-operative Wheat Producers Lt),* S.C.R.,402, (1928-34) (1930), As Cited in Daniel Ish, *supra* note 8, p. 47.

[19] Ish, *supra* note 8, P.48.

[20] Jeffry Pilcher, why Are Credit Unions Tax Exempt, available at: https://thefinancialbrand.com/16153/why-credit-unions-have-a-tax-exemption, (Accessed February 16, 2022).

[21] Dagnachew Asrat & Addissie Shiferaw, *Law of Public Enterprises and Cooperatives*: Teaching Material, Prepared under the Sponsorship of the Justice and Legal System Research Institute, (2009), p. 140.

develop into viable and responsive economic enterprises and thereby fulfill its purpose of serving the need of the members.[22] Thus, removing tax exemptions of cooperatives will deprive poor people the only organization that knows their conditions and which provides them what they need. Hence, it is strongly and unyieldingly opposed.[23]

### 1.1.2. Arguments Against Income Tax Exemption of Cooperative Societies

Co-operatives have traditionally been regarded as non-profit making and only serve the members. Due to this reason, they were exempt of income tax. However, recently most countries co-operatives are not exempt of income tax. Because, co-operatives in several countries deviate from the characteristics of non-profit making purpose and exist as independent profit earning entity.[24]

For example, in Canada the confusion led to the establishment of a Royal Commission[25] on Cooperatives to study the taxation of co-operatives prior to the resolution of the various problems in the courts. The Royal Commission (McDougall Commission) had a broad mandate to determine the most just and equitable means of taxing co-operatives. One important finding of the Commission was that co-operatives could indeed earn income and thus become liable to pay tax on the same. A co-operative was an entity, which of course is the necessary consequence of incorporation, and not merely a "price adjustment" agency. However, it was recognized that dividends which were

[22] Daniel H., Against Repeal of Co-operatives Tax Privilege, available at: http://www.cda.gov.ph/resources/updates/news/741-against-repeal-of-cooperative-tax-privilege, (Accessed on February 16, 2022).

[23] *Id.*

[24] Ish, *supra* note *8*, p.30.

[25] The Royal Commission was established by Order in Council on Nov. 16, 1944. The Honorable Mr. Justice McDougall, Court of King's Bench, Quebec, was named chairman of the Commission.

paid to members by a co-operative could not be treated in the same way as profits of an ordinary business corporation.[26]

The main recommendation of the Commission was that the then existing provision of the *Income War Tax Act*, which ostensibly exempted co-operatives from taxation, be repealed and the Act be amended to provide for the taxation of co-operatives on the same basis as other taxpayers. However, it was further recommended that all taxpayers be allowed to deduct patronage dividends "which are paid or credited to their customers in proportion to the quantity, quality or value of goods acquired, marketed, or sold or services rendered".[27] Then certain provisions were set out in a way they comply with the equitable rules of deducting patronage dividends. It is important to note that no attempt was made to place co-operatives in a privileged position in this respect; the deductions were available to all taxpayers, including partnerships and ordinary business corporations. One clear concession made to co-operatives was that newly formed co-operatives in their first three years of operation would obtain a complete exemption from taxation. The rationale behind this idea was that it was in the public interest to favor fledgling co-operatives, whose mortality rate had been high in the early years of operation because of their inherent inability to attract capital.[28]

Similarly, in Zambia there is a general misconception on cooperatives that they are exempted from income tax. However, that is not the case because there is a limit to which income of a cooperative can be treated as exempt from being taxed. The exemption for cooperatives is conditional upon the cooperative meeting the exemption threshold set out in the Second Schedule to the Income Tax Act.[29]

[26] Ish, *supra* note 8, p. 66.
[27] Id., p.60.
[28] Id.
[29] Zambia Revenue Authority, *Taxation of Co-operatives*, (2016), p.1.

Moreover, in most countries co-operatives are divided in to two categories for income tax treatment purpose Viz, the non-income co-operative and co-operatives with income. In some countries a non-profit or exempt co-operative takes a third category.

The Non-profit (Exempt) co-operatives apply to organizations of a charitable nature or organizations which perform a function which is deemed to be in the public interest.[30] The reason for exempting co-operatives from paying income tax is not because of their co-cooperativeness *per se* but because of the purpose they serve in society. The rationale" of the exemptive provisions lies on the broad base of social policy. But, the taxation status of non-profit organizations has been criticized on the ground that certain entities, although of doubtful public benefit, in effect receive a public subsidy and an unfair competitive advantage by reason of their qualifying for exempt status.[31] That's why; Co-operatives should also be required to meet a "public benefit" test to be exempt.

On the other hand, the non-income co-operative are not exempt of income tax. Co-operatives advance the argument in support of non-payment of taxes based on the premise that they are agents of their patron-members and have no taxable income. From this, it follows that funds received by co-operatives in the course of operation are not deemed to be income of the co-operative at all. There appears to be a legal inconsistency in treating the member-cooperative relationship as one of principal and agent on the one hand, while recognizing the separate legal entity of the cooperative on the other.[32]

Further, there are other institutional features evidencing the absence of a true agency. For example, the co-operative usually conducts business in its own name, and holds title to property and employs its own people. These factors all must be considered in characterizing the agency relationship. Of course,

[30] Bryan A.Garner, *Black's law dictionary*, 8th edition, (2004), p.81.
[31] Ish, *supra* note 8, p.40.
[32] Id.

none of these factors is individually sufficient to determine this relationship. Yet it has been widely held that the cumulative effect is a strong indicator of the absence of an agency relationship.[33]Thus, as there is no true agent-principal relationship, the co-operatives entity should pay income tax.

The last type of cooperatives falling under the third tax category is widely known as income earning co-operatives. This category of institutions operates in many legal systems. Most of them operate not as non-profit organizations or as agents of their members, but as income earning type. It is clear that co-operatives do earn income and thus should be taxed on the same basis through which other intermediaries under the tax system are treated.[34] Co-operatives today are large business ventures permeating virtually all possible markets, and preferential tax treatment in these institutions is an issue. According to several scholars, preferential tax treatment amounts to a public subsidy of co-operatives, allowing them an unfair competitive advantage over non-co-operative taxpayers in similar businesses. Such differential tax treatment of business forms performing similar functions cannot be said to be equitable and neutral and should not subsist.[35]

Historically, such question over equitability of preferential treatment has been a subject of controversy since the beginning of the 20th century in the west. The issue was particularly old and hot in England. In 1922, strong opposition arose among ordinary business men who considered that the cooperatives were sailing under false colors in claiming that cooperative dealings were distinguishable from ordinary business dealings.[36] In 1933, the tax collector and business viewpoint was stated by Mr. Hore-Belisha, Financial Secretary to the Treasury.[37] He pointed out that "as a good tax collector, there should be

[33] M.M.Caplin, *Taxing the Net Margins of Cooperatives,* 58 Geo. Lj (1969), p.74.
[34] Id.
[35] Id., *p.78*.
[36] Israel Packel, *Cooperatives and the Income Tax*, University Of Pennsylvania Law Review,( Dec, 1941), p.139.
[37] Id.

some limit to mutuality; … otherwise the whole country might be covered by cooperatives and the government would receive no income tax." Therefore, there need to be "equality of sacrifice as regards the Revenue which is a foundation of the common wealth and existence of the state."[38]

### 1.1.3. Mutuality Vs Non-Mutuality Principle on Co-operatives Income Taxation

The application of the mutuality principle has been recognized and has continued to evolve over time from legal precedents originating in the UK, where limited legislative enactments have not denied but supported the application of the principle.[39] This principle implies that any income derived from oneself is not taxable for income tax purposes.[40]

The mutuality principle was developed in the late 1800s at a time when individuals had to rely on their ability to self-insure for the provision of sickness and death benefits, as the insurance business had not yet evolved into an economically viable industry. Mutual organizations were created with the explicit purpose of providing insurance to their members whilst not deriving assessable profits or gains for their members.[41]

Modern forms of mutual entity cover a wide range of activities, such as recreation, sports, community services and co-operatives. Over the years, the mutuality principle has also been the subject of substantial legal litigation and a considerable body of legal precedents has been built up, from which the underlying concepts regarding the application of the mutuality principle is established.[42] The most widely applied concepts of mutuality principle derived from the precedents include: the obligation on the part of the

[38] Hore-Belisha, *Co-operatives tax treatment in England*, (1933), p.20.
[39] Love & Natalie, The Relevance of the Mutuality Principle within the Non-profit Sector, *Third Sector Review*, Vol. 13, (2007), p.4.
[40] Id.
[41] Id.
[42] Id., p.6.

members to share a common purpose and the common fund to give effect to the common purpose ; the requirement for the members to have ownership and control of the common fund at all times ; the mandatory rule of complete identity between contributors and participants[43], and the possibility of surplus funds to be distributed to the members as mutual income.

Trading activities undertaken by the entity may be mutual or non-mutual in character: This shows that the mutuality principle does not exclude all profits and gains derived by the mutual entity from being classified as income under ordinary concepts and therefore as assessable income. Receipts from non-mutual sources such as the undertaking of commercial trading activities are assessable income to the entity. The nature and substance of a transaction determines the character of any profits derived as either mutual income (and therefore non-assessable) or non-mutual income (and therefore assessable). Further, the status of the parties to the transaction with the entity (that is, whether there is a membership relationship) is irrelevant. If the transactions are non-mutual in nature, the resultant surplus is taxable whether the transactions are with members or non-members. It depends entirely on whether it is a transaction entered into for commercial purposes.[44]

For many years now it has been accepted that the principle of mutuality prevents certain receipts from forming taxable income in the hands of the recipient.[45] In other words, the general principle applicable to mutual concerns is that the surplus accruing to it cannot be regarded as income, profits or gains for the purpose of the Income Tax law.[46] The basic principle underlying herein is that no one can make profit out of himself. Even if any surplus is generated; it is not subject to tax as it is exempt based on the 'concept of Mutuality'. The cardinal requirement in case of mutual association is that 'all the contributors to the common fund must be entitled to

[43] Pune, *supra* note 9, p.3.
[44] Id.
[45] *British Broadcasting Corporation* V. *John, UK High Court, (June, 1990).*
[46] pune , *supra* note 9, p.2 .

participate in the surplus & all the participators to the surplus must be contributors to the common trade.'[47] In other words there should be complete identity between the contributors and the participators.

Modern form of mutual entity in several countries includes co-operatives but not limited to it. Co-operative is normally considered to be an entity where the members come together to achieve common goals by sharing fruits of common labour.[48] The individual members may come and go, but the members as a class remains the same and hence, so long as group of members or individuals are covered under members, the transactions with them are covered under principle of mutuality and thus, need not be subject to tax.[49]

Therefore, these features suggest a presumption that it is a form of mutual entity where members contribute and work for their own benefits inter-se. Accordingly, taxation of such co-operatives is always perceived to be on different footing relative to other form of pure commercial organizations.[50] This shows when people work between themselves, contribute money within themselves and enjoy the fruits of such efforts within themselves; the entity is considered to be mutual benefit entity. In effect, there is no contribution from outsider and there is no flow of fruits to outsider.

The rational for exemption of co-operatives from income tax is, therefore, derived from the mutuality principle, i.e., mutuality of transactions precludes income tax thereon and recognized, in general law, that a person cannot make a profit from himself. Similarly, if co-operative societies get any profit and income arising from a cooperative society's transactions with its members, it is exempt of income tax. The surplus arising out of contributions from

[47] Id .
[48] Milind V. Sahasrabudhe, *Indirect Taxes Cooperative Banks / Housing*, (May 2010), p.3.
[49] Id.
[50] Id.

members is not a taxable income as the same is governed by the concept of mutuality.[51]

However, any income derived from business dealings with non-members is fully taxable because the contrary reading of mutuality principle proves the fact that the income earned by a person from external source is taxable. As such, transactions with outsiders shall be taxed provided there is taxable surplus from such transactions. Thus, just because entity is formed as cooperative society, it does not mean all its transactions will be covered by mutuality. In sum, Income of co-operative society other than surplus from contributions from members is taxable subject to deductions.[52]

### 1.2. Indirect Tax Treatment of Co-operative Societies: VAT Perspective

Mutuality of transactions precludes income tax thereon. Clearly nobody can make profit out of oneself. Yet, does it essentially preclude impact of indirect taxes? The answer is 'NO'; this is because indirect tax is applied to specific aspect of transactions.[53] A typical case in point is VAT. VAT, as a broad tax regime, is designed to bring within its charge every kind of economic transaction, subject to limited exceptions. This is normally achieved by drafting a broad provision imposing VAT on an extremely wide range of business transactions and then removing, throught a specific exception, any transaction that is not to be liable.[54] On this regard, some countries exempt co-operative societies from VAT tax through such specific exception. The justification for their exemption is that:

[51] Love L., Concept of Mutuality, available at: *http://www.caclubindia.com/article/concept-of-mutuality-a-discussion/* (Accessed March 15,2022).

[52] CA Ramesh S Prabhu, *Taxation of Co-Operative Societies*: 80P of Income Tax Act,( 1961) , P.9.

[53] Milind V. Sahasrabudhe, *supra* note 2, p.7.

[54] Bekure Herouy, *The VAT Regime Under Ethiopian Law with Special Emphasis on Tax Exemption:* The Ethiopian and International Experience, (March 2004), p.20.

"Cooperative societies are not economic operators and as such they are not carrying on economic activities and the services they render are not taxable if such services are rendered to their members free of charge. Therefore, these cooperative societies are entitled to operate on specific conditions which are out of scope of VAT."[55]

On the other hand, the VAT law in most countries includes all legal persons created under the law of the state (or of a foreign country) that are engaged in economic activities of any kind, as well as all physical persons to pay VAT.[56] Governmental bodies at the national, regional, and local levels are to be included as taxable persons, in the same way as any other person, if they get engage in economic activity.[57] These premises suggest that all co-operative societies which can get profit from its transaction with their members should pay VAT.

Finally, it is important to note that transactions are usually stated to be within the scope of VAT if they are "supplies of goods or services." These terms are given extremely wide meanings that go significantly beyond the usual meanings of "supplies," "goods," and "services" in most languages. The aim is to bring within the charge all economic activity.[58] Further, VAT is a tax on supplies made in the course or furtherance of economic activity, or, put another way, as part of a business.[59] It should therefore be confined to activities of this nature and not be imposed on other activities such as the personal hobbies of an individual, gifts made for personal reasons, or

[55] Gunta Kaulina, *Planned amendments to Value Added Law*, KPMG, (2016), P.1.
[56] Id.
[57] Mohammed Abdullah Al Mehrezi, *Value Added Tax (VAT)*, (1998), p.22.
[58] Id., p. 21.
[59] The phrase "economic activity" is based on the EC Sixth VAT Directive, art. 4. This is chosen from the range described in this note because it is felt the term is best fitted to be translated widely. The scope of the term is wider than "business," in the sense that the term tends to imply only profitable activities. Profit is irrelevant to VAT (although the profit motive is not). note, however, there are alternative approaches.

charitable activities with no business or commercial content.[60] However, a co-operative society which furthers the economy of the members is dealing with taxable service and should pay VAT though they are not-for-profit.

Above all, a person is a taxable person (or in some countries a registered person) if he makes taxable sales above a threshold amount and such sales are made in connection with certain economic or taxable activity. A taxable activity for VAT purposes generally is broader than the concept of trade for income tax purposes.[61]

## 2. Tax Treatment of Cooperative Societies under Ethiopian Law & its Applicability

Co-operative societies are established on the basis of freedom of association which is safeguarded under international, regional human right laws and those

[60] David Williams, *Value-Added Tax, Tax Law Design and Drafting; International Monetary Fund*: volume 1, ( 1996), p.32.

[61] The tests include:

- *Continuity*

Supplies should be made regularly and fairly frequently as part of a continuing activity. Isolated or single transactions will not usually be liable to VAT.

- *Value*

The supplies should be for a significant amount; trivial, even if repeated, transactions would not usually count.

- *Profit (in the Accounting Sense)*

Not necessary; after all, large concerns can create substantial value added and pay large sums in wages, yet make no profit (many publicly owned firms do precisely this). Such firms should certainly pay VAT.

- *Active Control*

Control should be in the hands of the supplier. He should be actively engaged in the "control or management of the assets concerned" (including operation through an agent). The proprietor should be independent and, hence, should be excluded from coverage.

- *Intra- Versus Inter-trade*

Supplies should be to members outside the organization and not just between members of the organization.

- *Appearance of Business*

The activities should have the characteristics of a normal commercial undertaking with some acceptable method of record keeping in place.

under the FDRE Constitution. Currently, the Federal government of Ethiopia enacted a law on cooperative society under Proclamation No. 985/2016. The applicability of the law is on all co-operatives established in the country.[62] the next sections examine the contents of the proclamation vis-à-vis the stipulations in international documents and experiences of other countries.

### 2.1. Transaction of Cooperative Societies in Ethiopia

The 6th ICA Principle and Paragraph 6(d) of the ILO R. 193 unequivocally obligate cooperatives to serve the members of the cooperating entities.[63] This obligation apparently suggests that co-operatives are not allowed to provide services and sell goods to non-members. However, the practicability of this legal restriction on co-operatives transaction with non-members in Ethiopia is doubtful and requires rigorous investigation of the practice. The next sections take an examination of the practical application of these laws.

The co-operative proclamation of Ethiopia share common percepts with the ICA over co-operative society: As such, it defines the term as: "autonomous association having legal personality and democratically controlled by persons united voluntarily to meet their common economic, social and cultural needs and other aspirations, which could not addressed individually, through an enterprise jointly owned and operated on the basis of cooperative principles"[64]

Looking closer into this definition, one would notice phrases construing the legislative intents of the lawmakers. To this end, cooperatives are entrusted with the obligation *"…to meet the common economic, social and cultural needs of members".* This feature is also supported by the values of Cooperative societies which include self-help, self-responsibility, democracy,

[62] Co-operative Society Proclamation, *supra* note 4, Article 3.
[63] Hagen Henrÿ, Cooperation, Concentration and Value Chains: Legal and Implications in Terms of Cooperative Principles, ICA 2018 research conference, ( July 2018), P. 40.
[64] Co-operative Society Proclamation, *supra* note 4, Article 2(1).

equality, equity and solidarity.[65] Similarly, Cooperative members are expected to be guided by the ethical values of honesty, openness, participation, social responsibility and caring for others.[66] The foundational principles of cooperatives are the outcomes of these values. In other words, these values underlie the principles cooperation regarded as an essential of the cooperative spirit in this legislative provision.

The other provision worth considering in this respect is Article 5 which lists out the seven principles of Cooperative society. The principles closely reflect the contents of those in the ICA. These principles are also a base for their change and growth as shown in *Mondragon Co-operatives* and others. Reflecting the common core of the principles from the two documents, Article 5(6) states: "Cooperative societies shall serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional and international structures." As such, the content of this principle is a verbatim copy of the 6th ICA principle of co-operations while it draws the insight of the court ruling. This provision also clearly sets out that co-operatives in principle should serve their members most effectively. In addition, this legal provision is supported by Article 23 of Cooperatives proclamation which listed out the four conditions under which Cooperatives give service to non-members:

"The conditions under which cooperative societies give service to non-members shall be based on contract and for the following purposes: distributing inputs supplied by government to increase productivity and production, distributing consumable products supplied by government to balance supply and demand, distributing revolving funds and social service to the society availed by different development partners and supply agricultural inputs and collect agricultural products from farmers engaged in farming."[67]

[65] Id., Article 6 (1).
[66] Id., Article 6 (2).
[67] Id., Article 23 (1)(a-d).

In listing the conditions, the law makers make the existence of a contract a mandatory element of the conditions. Also, the provision, while it makes the existence of purpose for rendering cooperative service, an essential element of the condition, it limits the number of purposes to five through an exhaustive list. In other words, the contrary reading of this provision would mean that except for the listed purposes, co-operatives are not allowed to serve non-members in any way.

Thus, except on the conditions listed in Article 23 (1), co-operatives are not allowed to serve non-members and get profit from that. They should only serve the members and not focus on profit maximization. Of course, the proclamation under Articles 23(2) requires the details for the implementation of sub-Article (1) of Article 23 to be determined in the by-laws of the cooperative society. By-law is defined, under Article 2 (13) of the proclamation, as the law governing a cooperatives society including amendments made to it and approved by 2/3 vote of the general assembly and registered by appropriate body upon fulfilling particulars specified under Article 12 of this same proclamation. Currently, there are several by-laws of Co-operative societies, and they need to be checked for any contradiction against the principle of serving members. Also, a regulation on the implementation of Cooperative Societies proclamation has been drafted. Yet the promulgation is delayed so long causing further problems .[68]

However, cooperative societies are unsuccessful in realizing their institutional mission stipulated in the law. The practice of this unique features and principles of co-operatives in Ethiopia seems distant from the law. According to Federal Cooperative Agency (FCA) official report of 2021, there are more than 92,755 cooperatives in Ethiopia with 21,043,370 members (6,743,429 female and 14,299,941 male). The numbers of employment opportunities created by Cooperative societies are 1,987,379. According to the same official

[68] Interview with Tesfaye Beyene, Legal Expert IV, Federal Cooperative Societies Agency (May, 14,2022)

report, there are 131 unions in the area. These cooperatives can be producers' cooperatives, marketing cooperatives, saving and credit cooperatives, consumer cooperatives, handcrafts cooperatives, mining cooperatives, housing cooperatives, construction cooperatives, multipurpose cooperatives and services cooperatives, among others.

The study further investigated the practice of the consumer cooperatives transaction in Addis Ababa city and other three regions of Ethiopia (Amhara, SNNP and Oromiya). Based on this investigation, the provision of service is not limited to members and most of the cooperatives are engaged in trade activities. For example, in Addis Ababa city, the numbers of consumer cooperatives are huge in number [69]and increasing rapidly from time to time comparing to other cooperative societies in the city.[70] To uncover the problem at greater depth, the researchers selected three sub-cities *(Arada, Bole and Ledeta)* out of the 11 sub-cities of Addis Ababa. Yet from these three sub-cities, the authors also randomly selected three Woredas from each sub-city. The evidence from this investigation in these target areas shows that, the Co-operatives in Addis Ababa city are almost profit-making institutions. They transact with members and non-members without any limit. The Co-operatives sell agricultural products, industrial products and others to non-members with no restriction.[71] Further, they are engaged in service businesses such as hotels, Restaurants, Grocery and others. To mention a sample case, *Shala Hotel Cooperative Societies Limited Liability, is established* as a cooperative societies institution. Yet this institution is officially a meat supplier to all societies of the city and a whole sealer of Beer and other beverages to the community in Bole area of Addis Ababa.[72] Surprisingly, the

[69] Interview with Habetamu Webetu, Legal Expert, Addis Ababa Cooperative Societies Agency (May 14,2022).

[70] Id.

[71] Interview with Sentayo Tesema, Cooperative Societies Office Market Study Higher Expert, Arada Sub-city (May, 15,2022).

[72] Interview with Mokriya Abdu, Cooperatives transaction group leader, Addis Ababa Cooperative Societies Agency, (May 15,2022).

authors observed Co-operatives engagement in super-markets businesses where they sell cosmetics products. One respondent also replied that, there is high corruption on Co-operatives transaction like; selling the subsidized product to traders at high price, hiding the goods to create shortage of that product and selling to friends, etc. The respondent believes that, the Cooperatives are a collection of rich traders and they hold a false name of cooperative and they are highly exposed to corruption.[73]

The authors also made an observation of the *Exhibition* organized by Addis Ababa Co-operatives Agency with a leading *theme of "*Co-operative Societies transaction for peaceful and stable market" undertaken from May 26-28, 2022. In the exhibition, the researchers could observe the Cooperatives selling a variety of products such as egg, vegetables, potato, onion, honey and other products which other ordinary traders do. The transactions in the exhibition were not limited to the products stated in Article 23 of the proclamation rather it incorporates every form of transaction to members and non-members.

After that, the authors visited the regulatory institutions of the city, namely Addis Ababa Cooperative Societies Agency and each sub-cities Cooperative society office. The institutions were well aware about the ***Exhibition*** as they facilitate such transaction with non-members. Most of the regulatory institutions are positive towards the transaction of Co-operative societies with non-members. Also, they justify their actions and attitude on a number of grounds. For example they pointed out that there are some products subsidized by the government for controlling the current inflation and these products should also be available to all residents of the city. Also, they believe that the service shouldn't be limited to members. Rather non-members should also be allowed to buy the goods.[74]

[73] Interview with Habetamu Webetu, *supra* note 69

[74] Interview with Dagne Kebede, Cooperatives inspection and legal expert group leader, Arada Sub-city, (May, 15,2022).

For example, in this fiscal year, nearly 1000,000,000 (one Billion) ETB was provided as a revolving fund for Addis Ababa Cooperative Agency to supply Teff and Wheat at lower price. As a result, the product is sold at a price of 40 ETB per Killo to all residents of the city who have a residence identification card (ID card).[75]

An attempt has been made to look into the processes of utilizing such fund against the stipulation under Article 23 (1c) of the Cooperatives Proclamation. The evidences from the examination, shows that the exception of distributing revolving funds and social services to the society availed by different development partners is misused and embezzled by the city cooperatives. Similarly, the informants reported that the sky rocketing inflation of the city can be relaxed through supplying goods and services to the residents of the city by cooperative societies. It is really helpful to stabilize the market.[76] Finally, the authorities unduly tried to justify their actions on thr ground of 'community concern'.

Like those in Addis Ababa, most respondents from the three regions of Ethiopia (Amhara, SNNP and Oromiya) agreed on the fact that Co-operatives, contrary to their missions, engage in different transactions with non-members. Asked about the legality of cooperatives transaction with non-members, some respondents pointed out that the Cooperative Societies Proclamation does not prohibit the transaction with non-members.[77] Yet a much deeper conversation with them reveals that they do not understand the features and principles set out in Article 5(6) of the proclamation and the contrary reading of Article 23.

[75] Interview with Gizachew Ali, Director, Addis Ababa Cooperative Agency, (May, 15,2022).
[76] Id.
[77] Interview with Seyum Muluneh, Auditor, SNNP Cooperative Societies Agency, (May,20,2022); Interview with Belachew Assefa , Director, Oromiya Cooperative Societies Agency, (May,25,2022).

A slightly different opinion is also reflected by a respondent from Amhara regional state who remarked that, though the proclamation is dedicated only to members under Article 5, the Cooperatives' transaction with non-members will help them increase the number of members. The respondent further noted that, unless they transact with non-members, no one could understand the benefit of co-operatives and join it as a member. So, such transaction will be an opportunity for them to show non-members what benefits could be gained if they join the membership.[78] However, the authors would object to this point of view on the ground that if non-members are able to find all the benefits that members of Cooperatives enjoy, what factors would encouraged others to join Cooperative Societies? It will have rather a discouraging effect on non-members to become members of Cooperative Societies.

Finally, the authors continued their journey to the Federal Cooperative Societies Agency and ask inquire into the above activities of Cooperatives of the country. The respondent replied that the consumers' co-operative boundless transaction with non-members in Addis Ababa city and the other three regional states is not lawful. It discourages and minimizes the interest of becoming a member of the co-operatives and may also negatively affect the healthy business makers in the city. The Co-operative Societies Agency in the target areas should, as per it mandate, regulate cooperatives 'transaction with non-members and ensure their compliance with the law.[79]

### 2.2. Income Tax Treatment of Cooperative Societies in Ethiopia

It has been reiterated so far that cooperatives are created mainly to serve the interest of its members. This is expressly stated in pertinent laws regulating their operation. Yet this over emphasis on the service of members begs the question as to whether the cooperatives are granted a special treatment by the relevant laws of the country. The Ethiopian Income Tax Proclamation No.

[78] Interview with Getenet Mengesha, team leader, Amhara Regional State Cooperative Societies Agency, (May, 12,2020).
[79] Interview with Tesfaye Beyene, *supra* note 68

979/2016, one of the relevant laws, in principle exempts *non-profit organizations* from in-come tax. Yet this exemption covers the income of *[*such institutions ] other than business income that is not directly related to the core functions of the organization".[80] Finally, it is important to note that the proclamation , though employs the term non-profit organization, does not mention *cooperative societies* per se . Thus, these privileges can apply only through close scrutiny of the transactions carried out by the institution in question.

An explicit mention of Cooperative Societies is made in Proclamation No. 985/2016 which also provides an income tax privilege to Cooperatives. According to this legislation , the members of cooperatives are required to pay income tax on their dividends and shares from participation..[81] Moreover, Article 45 (1) of the proclamation states that any cooperative society shall deduct 30% of the net profit and allocate for the reserve fund. The amount allocated for the reserve fund shall continue to be deducted until it reaches 30% of the capital of the cooperative society and it shall be deposited in the saving account of the society." It is also stipulated under sub-Article 2 that the distribution of the remaining 70% net profit be determined by the general assembly. Apart from this, the general assembly, through a by-law, may allocate budget for education, training, for auditing funds, or social services and incentivizing actions of institutions. The resource for financing all these purposes can be drawn only from a net profit based by-law of the cooperative society.

The reserve and capital of the co-operatives is exempt of income tax as the current co-operative proclamation exempts the Co-operatives from income tax at entity level by explicitly stating; "without prejudice to incentives permitted under investment laws and other laws, any cooperative society

[80] Income Tax proclamation, Proclamation No. 979/2016, Federal *Negarit Gazetta*, (2016), Article 65 (7m).
[81] Co-operative Society Proclamation, *supra* note 4, Article 43(1a).

which is organized and registered in accordance with this Proclamation shall be entitled to supports and incentives; *be exempted from income tax*….",[82]

The reason for this privilege might be to encourage the co-operation for achieving the objectives set out in the preamble and Article 4 of the proclamation. Moreover, the exemption tends to justify *the public utility of cooperatives* and the *mutuality principle* underlying the mission of the institution. Thus, one can argue that the spirit of the Ethiopian co-operative proclamation can be inferred from the definition, feature, principles and other provisions which mainly aim to *serve their members most effectively*.

To this effect, the proclamation makes direct a direct reference to the mutuality principle in the preamble in which it seeks to make people "bring together their finance, knowledge, resource and labour voluntarily to meet their common economic, social and cultural needs and other aspirations which would then allow *mutual support* and create savings."

The grant of this privilege to cooperatives is meant to fulfills the goal of easing poverty among the mass while limiting government revenue. However, the authors would argue that these aspirations remain unfulfilled and the ideals of non-profit institutions are becoming nearly obsolete because of the weak institutional capacity to enforce the laws formulated to regulate them. This has also become true in several countries where cooperatives deviate from the characteristics of non-profit making purpose and exist as independent profit earning entity. As a result, they are not exempted from the income tax.

Apart from the institutional inefficiency, the current Co-operative proclamation of Ethiopia contains a couple of ambiguities. The proclamation presumes cooperatives transaction be limited to members. At the same time, it exceptionally permits Cooperatives to transact with non-members under

[82] Co-operative Society Proclamation, *supra* note 4, Article 43(1a).

Article 23. Still, the law is silent on the taxation of income to be levied from non-members under such conditions. Even though it is silent, the basic principles of co-operatives income taxation (Mutuality and Non-mutuality) can be a base line to solve this problem. The rational for exemption of co-operatives from income tax is derived from the mutuality principle which recognizes in general law that a person cannot make a profit from him/herself. Similarly, if co-operative societies get any profit and income arising from a cooperative society's transactions with its members it is exempt of income tax. However, any income derived from business dealings with non-members need to be taxed as the contrary reading of mutuality principle also suggests that the income earned by a person from external source is taxable. As such, transactions with outsiders shall be taxed provided there is taxable surplus from such transactions. Thus, just because entity is formed as cooperative society, it does not mean all its transactions will be covered by mutuality. Income of co-operative society other than surplus from contributions of members is taxable.[83]

In this regard, the authors would hold that the income generated through the conditions listed in Article 23 of the proclamation and other conditions listed for outside members should be taxed. This is mainly because non-mutuality principle dictates that any income derived from business dealings with non-members is fully taxable.

In practice, the Cooperatives in Addis Ababa city and other three regional capital city (Bahardiar, Adama and Hawassa) transact with non-members not only in the above conditions but also on different activities and conditions without any restriction. As confirmed above, consumer co-operatives are almost involved in trade and sale to individuals and others who are not members of the Co-operatives. Thus, the co-operatives in the cities are making profit by selling primary consumable goods listed in Article 23 and

[83] CA Ramesh S Prabhu, *Taxation of Co-operative Societies* : 80P of Income Tax Act,( 1961) , p.9.

transacting with non-members.[84] However, the income generated through this process is receives treatment similar to the income from members. In effect it is not taxed.

Among others, there is no book record which distinguishes income from members and non-members though it is orally reported to each co-operative.[85] Due to this reason, any cooperative societies reserve fund, which is required to be deposited in the saving account (30% of the net profit), is free from income tax. All respondents from Addis Ababa city and three regional states revealed that Co-operative societies are free from income tax regardless of whatever the source of the income (from members or non-members). Most of them explained that although Co-operative societies transact with non-members, there is no legal reason to force them pay income tax even on benefits derived from non-members.[86] Revealing, one of the scrupulous actions happening in the institution, one respondent from Addis Ababa Co-operative Agency reported that for becoming a trader, individuals should come as Co-operative societies and he/she will be privileged technically. All the traders should act as Cooperatives and will benefit more by transacting with whom so ever they need. Now, a trader in Addis Ababa knows that and work's under a guise of Cooperatives and it's the associations of rich individual's instead of poor people. It is also open for corruption; the Co-operatives sold to traders and sometimes put in a buried warehouse. But, still there is no distinguished tax imposition on this transaction.[87]

The authors went to the Federal Revenue Authority, each region Revenue Authority and other Revenue Offices of the cities to make interview on issues relating to the illegal and unlawful activities of Co-operatives exemption of an

[84] Interview with Tesfaye Beyene, *supra* note 68.
[85] Interview with Abere Asefaw, Legal Director, Ethiopian Revenue Authority, (May, 17,2022).
[86] Interview with Fantaye Haile, Tesefa Co-operative Societies in Addis Ababa City, (May, 16,2022) & Interview with Getachew Fentahun Merkeb, Farmers Union, Amhara Regional State, (May,12,2022).
[87] Interview with Habetamu Wubetu, *supra* note 70.

income found from non-members. Most of the respondents were not well-aware on the taxation of an income found from non-members and few of them angered by the activities of Co-operatives. Finally, most of them agreed to implement the law and collect an income generated from the transaction with non-members transaction of Co-operative Societies.

Now we turn to the tax related to dividend, Article 43(1) of the proclamation which states that co-operative members shall pay income tax on their dividend at the rate of 10% of the gross value of the dividend. This co-operatives dividend, widely known in other countries as patronage refunds, stays for long as non-taxable rather deductible income. Recently, when patrons/members receive patronage refunds/dividends, they are required to expect that their share is taxable at the rate of 10 %. However, it is still contentious as to whether this 10% of dividend should be paid at the individual level or at primary/union/federation Cooperatives level. Two competing arguments can be found in the literature.

The first argument takes the view that the law, in using the phrase *"…that the members shall pay income tax on their dividends…"* in general and the word *"…Members…"* in particular shows that dividends are required to be paid at levels of individual members. People advancing this argument substantiate their points by making a reference to Article 2(10) of the proclamation which defines *member* as "any individual or a primary cooperative society or a cooperative societies union or cooperative society's federation who applied and admitted for membership upon fulfilling the minimum membership requirements." Thus, because the individuals are members of primary co-operatives, the primary co-operatives are itself the members of unions and the unions are also members of the federation co-operatives, these all members of the co-operatives receive dividend at each level. Thus, the dividend should be paid at each level of the co-operatives as they receive dividend from each co-operative chains.

Turning to the other argument, others hold that dividend should only be paid at the final receipt of individual members (i.e. the individual members of primary co-operatives only) to avoid double taxation of cooperatives. The proponents of this argument base their claim on the Amharic version of Article 43(1a) which reads; *"…ሆኖም ግለሰብ አባላት ከሕ/ሰ/ ማሕበራቸዉ ጋር በሚያደርጉት ተሳትፎና በገዙት ዕጣ መጠን ከሚያገኙት ገቢ ላይ አግባብ ባለዉ ሕግ መሰረት የገቢ ግብር ይከፍላሉ*". This version of the provision employs the phrase "individual members", therby making these subjects final recipients, Whereas the English version translated as "…the individual members shall pay income tax on their dividends based on the value of their share and transaction…" used "members" of both individual and other cooperatives to pay dividends.

These arguments were at the center of the scholarly and policy debate for a long time. The authors also investigated the rounds of both sides. Based on these analysis of the contents of the arguments, they would suggest the second grounds of argument (10% of dividend at individual level) as a viable interpretation of the law. This is because the Amharic version of the proclamation prevails over the English version of this law. It also avoids the double taxation of Co-operative societies. Similarly, in several countries including USA, only the final recipient of the income, the cooperative's patron/member, receives income on which tax is to be paid. This tax concept is usually called the "single tax principle".[88] As a result, the current practice of cooperatives dividend taxation in Ethiopia is only at the final receipt of individual member's level in all cities of the country. A circular is distributed to all regions of the country and other federal cities.[89]

Thus, 10 % of dividend from the 70% of co-operatives net income should be paid at individual level not at entity level. From the 70% net profit, the general assembly may allocate for education, training, incentive, audit fund, or for

[88] James R. Baarda, *Cooperatives and Income Tax Principles*, University of Arkansas, LLM Course, (2007), p. 154.
[89] Interview with Ato Tesfayo Beyene, *supra* note 68.

social service.[90] However, a closer look into this provision of shows that it takes a gross permissive position for financing the six activities ( education, training, incentives, audit fund and social services). Yet no clear stipulation is made as to the amount‒out of the 70% net profit to be allocated to each purpose. It is widely left to the discretion of the general assembly to determine the amount to finance vital activities such as social service. However, the new draft co-operative regulation .../ 2018/9 allocates 3% of the 70% net profit for social purposes. The researchers would take this move as an encouraging step towards addressing public interest. Yet it needs further effort to take the permissive position of the law to a mandatory status both in the regulation and the proclamation.

Taking the broader landscape, one would argue that an equal treatment of income tax from non- members and members (at 10% dividend) may create several problems. Among others, the government may lose high tax revenue as it only collects 10% from both members and non-members income instead of the business income tax schedule (which can be up-to 35%) and all traders who are the main source of income may also shift to co-operatives business. Similarly, this tax profit generated non-members' transaction may create unfair business competition between traders and co-operatives.

In practice**,** Cooperatives in Addis Ababa city and other regional states indicate that members of cooperative societies are paying dividend income tax in cases where the share is distributed among members. But, it is not strict and sometimes if the members agree that the dividend is funded to increase the capital of the Co-operative society then there will be no tax from it. Most respondents of the interview believe that the cooperatives should get high dividend from the service and this can also attract other non-members to join the cooperatives. There are sometimes conditions where individual members

[90] Federal Cooperatives Proclamation, *supra* note 4, Article 45.

did not pay tax even from the dividend.[91]The high income of cooperatives from members and non-members transaction is encouraged. Similarly, some responded that the cooperatives tax payment of 10% is burdensome. Something different is envisaged in Amahara regional States Cooperative Society Agency. People from this institution take the view that if the income is obtained from nom-members, such profit obtained from transaction with non-members will be taken directly to increase the capital of the Co-operative societies and neither will divided among members nor pay income tax on it and the researchers accept as it is in accordance with the law.

### 2.3. VAT Treatment of Co-operative Societies in Ethiopia

Ethiopia joined what is now a large chorus of nations in the world by introducing the value added tax (VAT) in 2002 (effective January 2003).[92] The VAT which replaced sales tax is a multiple-stage sales tax with the ability to reach all levels of economic distribution (manufacture, wholesale and retail).[93] Currently, the Minister of Finance and Economic Development increased the threshold of annual volume of transaction of businesses subject to VAT through circular from half a million to one million based on the power given in Article 16(2) of the 285/2002 .

On the other hand, for those businesses whose annual volume of trade did not reach 1 million birr, another tax was introduced along with the VAT, namely the turnover tax. The novelty as well as structural complexity of the VAT is

[91] Interview with Ato Tayo Masersha, Directorate Director, Addis Ababa Revenue office Income tax administration, (May 15, 2022).

[92] The value added tax has become one of the most remarkable fiscal phenomena of the modern times. All but one (i.e., the USA) of the industrial nations have adopted the VAT as one major source of government revenue, and more than 150 nations have now adopted VAT as their favorite indirect tax. In Africa, Ethiopia was the 36th African nation to catch the VAT-bug, As cited in Tadesse Lencho article on *To Tax or Not to Tax: is that Really the Question, p 265.*

[93] Tadesse Lencho, To Tax Or Not To Tax: Is That Really The Question? VAT, Bank Foreclosure Sales, and the Scope of Exemptions for Financial Services in Ethiopia, *Mizan Law Review*, Vol. 5 No.2, ( Dec. 2011), p.265.

such that small and medium-sized businesses could not be immediately brought within the umbrella of the VAT system.[94]

Although VAT is generally recognized as a broad-based general sales tax, the VAT laws of Ethiopia came out with a fairly long list of exemptions for certain transactions in goods and services.[95] However, in these VAT laws there are no provisions which exempt co-operative societies from payment of VAT. The assumption of non-profit motive of co-operatives only exempts them from income tax but not from VAT. This is because VAT does not take into consideration the motive behind a business. i.e., for profit or not. Rather it is applied to specific aspect of transaction. In other words, the key to the application of VAT to domestic supplies of goods and services is the notion of 'taxable transactions".[96] Every supply of goods or services must be a taxable transaction before VAT attaches to it. Article 7(3) of the VAT proclamation, as such, defines a taxable transaction as: "…a supply of goods or rendition of services in Ethiopia in the course or furtherance of a taxable activity other than an exempt supply."

From this definition, we can see that the three elements of taxable transactions in Ethiopia and in the course or furtherance of a taxable activity are fulfilled in Cooperative Societies transaction. Fist, with regard to, the supply of goods or services, co-operative societies which include primary, federation, union and

[94] Id,. p.266

[95] VAT Proclamation, Proclamation No. 285/2002, Federal *Negarit Gazetta*, (2002), Article 8(2).

[96] VAT (Amendment) Proclamation, Proclamation No. 609/2008, Federal *Negarit Gazetta*, (2008), Article 7(1)(a):

Subject to the provisions of this proclamation and subject to Sub-Article (2), there shall be levied and paid a tax, to be known as value added tax, at the rate of 15 percent of the value of-

(a) every taxable transaction by a registered person; and

(b) every import of goods, other than an exempt import; and

(c) an import of services as provided in Article 23, and , Article 3 of the VAT Proclamation which prescribes the scope of application of VAT; taxable transactions, imports of goods and import of services; for imports, it is not at all necessary for the imports to be taxable transactions.

league may be established to engage in production or service rendering activities or both in production and service rendering activities.[97] Further, this provision of the proclamation suggests the possibility that co-operatives can engage on the supply of goods and services to attract VAT. Similarly, the notion of 'taxable activity' which consists of at least three elements (continuity or regularity, involvement or intention to get involved in a supply for consideration and evidence of being carried on in Ethiopia or partly in Ethiopia) are also fulfilled by the Ethiopian co-operatives to be eligible for VAT. To this effect, Article 2(3) of the VAT amended proclamation 609/2008 explicitly states that phrases such as "any person" and "activity which is carried on continuously or regularly" employed in Article 6 of the former Proclamation are repealed and replaced by "any registered person" and "activity whether or not carried on continuously or regularly" respectively. This shows, the first element of VAT is met in the current proclamation.

In addition, the phrase "*…whether or not for pecuniary profit…"*in the definition part shows Profit motive in business is not essential for the purpose of eligibility to VAT. It is also immaterial whether cooperatives earn profit or incurs loss. Thus, co-operative societies, even if engaged in the trading activities at no-profit-no-loss basis, are liable to pay tax on their sales.

As a result, the current Ethiopian co-operative proclamation obliges the co-operatives to pay all indirect taxes including VAT.[98] Particularly, the cumulative reading of Article 18 (3) and Article 43 (1a) suggest that co-operative societies are only exempt of income tax but not VAT. Co-operatives are obliged to pay all indirect tax including VAT as there is taxable transaction and consumption within their members and sometimes outside members which are the bases for VAT.

[97] Federal Cooperatives Proclamation, *supra* note 4, Article 8.
[98] Article 18(3):
*"…except income tax cooperative Societies shall pay the necessary payments to government according to the law and on time".*

Moreover, VAT is imposed on the value added to the goods or services in each transaction. In Cooperative Societies there is also a value addition and this can be inferred from Article 21 (2F & 3g) of the proclamation which states.*"…Primary or Union cooperative societies can engage in collecting members product, add value and submit to their…."*[99]. From this, it can be deduced that the transactions of cooperatives are taxable transaction. Every cooperatives of the country whose annual transaction is more than a million is obliged to register for VAT and pay to the government by collecting it in each transaction. If the transaction is less than one million, cooperatives should pay alternatively turn over tax.

However, the evidence from the current investigation indicates that most of the Cooperatives in Addis Ababa city and other three regions of Ethiopia (Amhara, SNNP and Oromiya) are not practically indebted to pay VAT. Specially, the primary Cooperatives in the above three regions and in the city of Addis Ababa are not paying VAT. Similarly, except few Union Cooperatives & some Federation Cooperatives which are registered voluntarily, most are exempted from VAT.[100]

Respondents participating in the interview revealed a couple of reasons responsible for poor performance in the implementation of VAT laws. Some pointed out that there is lack of knowledge on the legal framework of the country related with VAT payment of Co-operative societies. Particularly, those some of the respondents engaged in varying businesses are not well-aware related to the obligation of VAT payment of Co-operatives in general.

[99] Article 21: Duties and Responsibilities of Cooperative Societies:

*2(f)-Primary cooperative Societies shall, mainly, engage in activities that are beyond the capacities of individual members and solve common economic and social problems and in particular shall include the following: collect members product, add value and submit to their union or federation, or sale by searching for better market outlets;*

*3(g)-Cooperative Societies unions shall, mainly, engage in activities that are beyond the capacities of member primary cooperative Societies and solve common economic and social problems and in particular shall include the following: add value on member's product and perform other activities as described in their by-laws.*

[100] Interview with Belachew Asef, Director, Adama city revenue bureau, (May 12,2022).

Similarly, others engaged on the cooperatives business are not also well aware on the obligation to register for VAT.[101] They did not consider the self-assessment obligation and raise the lack of knowledge defense to Revenue Authority. The Authority in each sub-cities and Woreda of the above four cities oblige cooperatives pay VAT along with its interest thereto, and this becomes sometimes a source of complaint.[102] Thus, the authors could confirm that there is confusion on the legal regime of Cooperatives law with regard to VAT payment. Also, in some areas of the regions, there were situations where Cooperatives were exempt through circular letters from VAT payment .[103] Some of the reasons mentioned in the circulars are the fact that co-operatives are non-profit and deal with social subordination instead of profit making. The authors find the justification mentioned in the circular over co-operatives exemption from VAT so weak. For example, the exemption on the justification of non-profit making is fallacious because in the proclamation profit making characteristics of the institutions is implied in several provisions such as; Article 4(4) "…finding better market prices to their products or services"; Article 5(3) " Members shall receive dividends from surplus"; Article 12(1j); "…allocation and distribution of profit" ;Article 21(2F) "… collect members product, add value and submit to their union or federation, or sale by searching for better market outlets"; Article 35(5) "decide the distribution of the annual net profit of the cooperative society"; Article 45(2)"… The distribution of the remaining 70% net profit…". Each phrase of these articles contains the word "Profit" or "Surplus", suggesting the profit earing features of Ethiopian co-operatives. If the co-operatives are presumed to be non-profit from the outset, why should the law make them exempt of income tax as entity? So, co-operatives get profit from members and non-members and pay tax at 10% dividend at individual level.

[101] Interview with Ato Habetamu Webetu, *supra* note 69
[102] Interview with Ato Tesfaye Beyene, *supra* note 68.
[103] Id.

Moreover, some other respondents also revealed that, though they are aware of, they believe that registering for VAT increases the price of the goods or services to the members and non-members of Cooperatives. As a result, the cooperatives intentionally disregard the registration to VAT though the annual income is greater than 1 million.[104] Further, few Cooperatives in SNNP region and Amhara region collect VAT from the cooperatives transaction but not refund to the government. They hold the money and consider as income of the Cooperatives. Thus, there are irregularities from the government in collecting VAT from Cooperative societies.[105]

Finally, most Cooperatives who do co-operatives business in the study sites responded that consumer co-operatives are exempt of indirect taxes including VAT. Only Federation cooperatives and few Union cooperatives are registered for VAT payment voluntarily. The reason for this volunteer registration is to avoid/minimize the challenges they face during market search for the product including, exporting products to abroad.

## Concluding Remarks

The contribution of Cooperative Societies is so enormous in societies living with multifaceted socio-economic challenges. Due to this reason, the government of Ethiopia provides several privileges and facilities such as exemption from income tax. This governmental policy is mainly meant to encourage co-operation and depend on mutuality principle. Consistent with these assumptions, co-operative Societies have unique features that distinguish them from other forms of business organization. Among others, they pursue the goal of promoting the interests of their members and do business only or mainly with their members as they exist solely to serve their members. The 6th ICA Principle and Paragraph 6(d) of the ILO R. 193 emphasize the same objective of the cooperation among cooperatives. The

[104] Interview with Ato Gizachew Ali, *supra* note 75.
[105] Interview with Bogale Borsamo, Expert on Tax, Southern Nations Nationalities Regional Cooperative Societies Agency (May, 20,2022).

Co-operative proclamation of Ethiopia which in force in the federal and other regional states of the country is almost a verbatim copy of these international documents. Principally, Article 5(6) and Article 23 of the proclamation expressly state the unique features and principles of *'serving only members of the co-operatives'.*

Nevertheless, the practical realization of the aspirations underlying the principles are very poor across Addis Ababa city and other three regions of Ethiopia (Amhara, SNNP and Oromiya). The Consumer Co-operatives transact with non-members on all conditions without following the chain of primary-federation. They buy and sell from/to non-members not only on the permitted conditions of Article 23 but also on all circumstances. They do trade through selling the goods at lower price without taking into consideration the restrictions laid down in the law.

The host of violation of the law is compounded with the untenable position of pertinent legislations on income tax treatment of cooperatives. The law is silent on the taxation of income found from non-members in the above conditions. Due to this reason, the Cooperatives in general and Consumer Cooperatives in particular are taxed in a similar way by disregarding the source of Cooperatives income in Addis Ababa city and other regions of the country. This crude taxation system of Cooperatives affects the national economy in different ways. Thus, the Co-operatives law should have a clear provision which distinguishes income from members and non-members for the purpose of tax. The income of Co-operatives from non-members on the conditions of Article 23 and others conditions should be taxed in a similar way to other ordinary business makers. The Co-operatives which generate income from non-members' transaction should be taxed similar to Schedule "C" of the income tax proclamation imposed on business person which is taxed up-to the rate of 35% and 30% at individual and entity level respectively. The Revenue Authority of each region and cities of Ethiopia should implement this tax rate on Cooperatives.

Finally, the current Ethiopian Co-operative proclamation obliged the Co-operatives to pay all indirect taxes including VAT. Principally, Article 18 (3) cumulative with Article 43 (1a) of the Co-operative Societies proclamation makes Co-operatives duty bound to pay VAT as there is taxable transaction. However, in Addis Ababa city and other three regions of Ethiopia (Amhara, SNNP and Oromiya), Consumer Cooperatives are not paying VAT. The government is not strict or consistent in imposing VAT on Cooperatives though their annual transaction is greater than 1 million. Except federation Cooperatives and few Union Co-operatives, other consumer Cooperatives are not registered and paying VAT. Thus, the Revenue Authority should apply the Co-operatives law and collect VAT from co-operatives in study sites.

# Issues of Design in Ethiopia's Property Tax Reform: Lessons from Previous Legislative Regimes and Other Jurisdictions[⇒]

***Tilahun Dires[∂] & Misganaw Gashaw[ϒ]***

*While property tax is the oldest of all types of taxes worldwide, the impulse to reform and reintroduce it in its 'modern forms' is a recent undertaking. Ethiopia has started property tax reform in 2011 intending to modernize the urban property valuation and taxation system across the urban centers of the country. The recent draft legislations and debates in the media seem to end the reform process that has stalled or been thrown into reverse. This article identifies and examines issues of design in Ethiopia's property tax reform based on lessons from previous legislative regimes and experiences of other jurisdictions. Primary data were collected through legal document analysis and semi-structured interviews while secondary data were collected through document review. The findings from the investigation showed that there are various property tax design options in the determination of tax bases, rates, valuation methods, rules of exemptions and administrative procedures. The article put an emphasis on the need to carefully draw lessons from own past and other jurisdictions to successfully end the ongoing property tax reform.*

**Keywords***: Property Tax Reform, Tax Design, Historical Development, Foreign Experience, Ethiopia*

---

[⇒]This article is the result of a research-project funded by USAID's Feteh (Justice) Activity in Ethiopia. However, the content and opinions expressed in the article are the views of the authors, and not necessarily the views of USAID.

[∂] LL.B, MSc, Institute of Land Administration, Debre Markos University. The author can be reached via: tilahun_dires@dmu.edu.et.

[ϒ] LL.B, LL.M, PhD Candidate, Assistant Professor of Law, School of Law, Bahir Dar University. The author can be reached via: misgepower@gmail.com.

## Introduction

While property tax is the oldest of all types of taxes, the impulse to reform and reintroduce it in its 'modern' form is a recent undertaking. Since the 1990s, property tax reform, in one form or another, has been a global phenomenon happening in both developed and developing countries.[1] In particular, post-Soviet transition and developing economies world have embarked on massive property tax reforms with renewed theoretical and policy justifications.[2] Studies have now confirmed that property taxes are more efficient, equitable, predictable, and simple compared to consumption and income taxes.[3] Property tax reforms are also associated with opportunities and challenges that rapid urbanization has posed in many developing countries over the past half-century.[4] Many have argued that property taxes have the potential to improve national revenue, promote local governance, and improve land and property administration.[5] Thus, over the past 30 years, many countries in Asia, Latin America, and Africa have strengthened property taxes reforms as a critical component of tax reform discourse and as part of land reforms, urban policies and decentralization, and local

[1] William J. McCluskey and Riël C.D. Franzsen,, Property Tax Reform In Africa: Challenges and Potential, Paper Presdented at the 2016 World Bank Conference on Land and Poverty, The World Bank, Washington DC, (2016).
[2] Richard M. Bird and Enid Slack, Land and Property Taxation: A Review, *In Workshop on Land Issues in Latin American and the Caribbean, Vol. 19,* (2002); See also, Tom Goodfellow, Property Taxation and Economic Development; Lessons from Rwanda and Ethiopia, *SPERI Global Political Economy Brief No. 4: Sheffield Political Economy Research Institute, (2016).*
[3] Merima Ali et als, Property Taxation in Developing Countries, *CMI Brief,* Vol. 16 No. 1, (2017).
[4] James R. Gillespie, The Property Tax and Urbanization, *Administrative Law Review*, Vol. 21, No. 3, (1969), PP. 319- 324; See also, Tom Goodfellow, Taxing the Urban Boom: Property Taxation and Land Leasing in Kigali and Addis Ababa, ICTD Working Paper 38, (2015), P. 12.
[5] *Id.*

government reforms.[6] Yet, the contribution of property tax to the national GDP remains scant.[7] Such low performance of property tax collection in developing countries is mainly attributed to problems with the current system and inappropriate tax policies including poor coverage, inequities between taxpayers, outdated valuations and lack of revaluations, and inappropriate basis of valuation.[8]

Property taxation historically coexists with the Ethiopian state since the pre-Aksumite and Aksumite periods. [9] However, its modern form is generally associated with the economic transformation and centralization programs of Emperor Haile Sellassie.[10] This was made possible by enacting the first Land Tax Proclamation No.8/1942 which continued in different forms until the end of the imperial regime by the 1974 revolution. The period is honored for modernizing the property tax regime and its collection modality although the attempt to abolish the serfdom land-holding system of feudalism and diminishing the political and fiscal powers of regional rulers was not successful.[11] The Derg Regime (1974-1991) focused on shifting the governance structure, the land, and property system, and the tax system as a foundation to restructure the political economy in line with socialism.[12] The regime in particular nationalized land and extra houses, and in effect

[6] *Id.*

[7] Richard M. Bird and Jorge Martinez-Vazquez (eds.), *Taxation and Development: The Weakest Link? Studies in Fiscal Federalism and State-local Finance series*, (2014)

[8] *Id.*

[9] Richard Pankhurst, Tribute, Taxation and Government Revenues in Nineteenth and early Twentieth Century Ethiopia, *Journal of Ethiopian Studies,* July 1967, Vol. 5, No. 2, (1967), PP. 37-87

[10] Ibid

[11] Wogene Yirko, History of the Post-War Ethiopian Fiscal System, in EshetuChole (eds), Fiscal Decentralization in Ethiopia, Addis Ababa University, (1994)

[12] Giulia Mascagni, A Fiscal History of Ethiopia: Taxation and Aid Dependence 1960-2010, ICTD Working Paper 49, (2016)

abolished land taxation.[13] In this way, the Derg government significantly reformed land revenue into fees and rents and constrained the property tax regime only to urban houses.[14]

Currently, while it is true that there is no property taxation in the strict sense of the term in Ethiopia, the existing property tax-like payments are fenced with legal, technical and institutional problems. Lincoln Institute of Land Policy identified four major problems of the property tax system in Ethiopia: the application of the outdated taxation law that continued for more than four decades, the land tenure system of the country (the legal and practical problem of fictitious separation of ownership to land and building, the sheer magnitude of informal property ownership and informal property market or transfer in urban centers (tortoise regularization) and lack of assertiveness on the part of urban local governments to identifying taxpayers and serving tax notices.[15]

In an attempt to reverse this situation, Ethiopia started property tax reform in 2011 to modernize the urban property valuation and taxation system across the urban centers. The country's interest is demonstrated by the findings of research conducted in three pilot cities, namely, Dire Dawa, Mekelle, and Bahir Dar on issues regarding real Property identification and valuation,

[13] Public ownership of Rural Lands, Proclamation No. 31/1975, *Negarit Gazeta*, (1975), See also, Government ownership of Urban Lands and extra Houses, Proclamation No. 47/1975, Negarit Gazeta, (1975).

[14] The land reform was accompanied by the promulgation of Rural Land Use Fee and Agricultural Activities Income Tax Proclamation No. 77/1976 (later amended by Proclamation No. 152/1978) and in the urban area, Urban Land Rent and House Tax Proclamation No. 80/1976 (later Proclamation No. 161/1979 and enforced by Legal Notice No. 64/1979).

[15] See Alemayehu Negash & Bekalu Tilahun, Property Taxation in North-east Africa: Case Study of Ethiopia, Lincoln Institute of Land Policy, Working Paper, (2009),

capacity design and building, and public engagement.[16] Draft and prototype legislations are also prepared for Federal and Regional Governments.[17] Despite all such moves taking place in the last 10 years, the final bill has not yet been ratified and the undertaking towards property taxation appears to be disorganized and too slow.[18] Apart from such a languishing scenario on the current process, there has not been a comprehensive study so far about property tax reform in general and issues of design in particular.

Against this background, this study examined and identified issues of design in Ethiopia's property tax reform. The investigation generated evidences through qualitative tools, which the researcher opted to use for their high degree of flexibility and docility to meet research objectives in depth. Primary data were collected through a critical examination of legal texts such as the Constitutions, Proclamations, Regulations, and other legislations enacted over the last sixty years in the country as well as the recent draft prototype legislations. In an attempt to explore existing situations and options for the reform, semi-structured interviews were conducted with purposively selected informants in the reform project offices in Addis Ababa and Bahir Dar. Laws of other countries such as Tanzania, South Africa, and Thailand are also consulted to draw lessons on the issues of design. These countries are purposively selected based on their relevance in associating property tax reform with land reform (Tanzania), local government empowerment (South Africa) and revenue mobilization (Thailand). Finally, the study relies on

[16] SuDCA Development Consultant, Overall Municipal Revenue Baseline Study in Three Cities of Ethiopia (Bahir Dar, Mekelle & Dire Dawa), Ministry of Urban Development and Housing, (2016)

[17] FDRE Real Property Tax Proclamation(Draft); Regional Prototype Property Tax Proclamation (Draft)

[18] Ethiopian Monitor, Public to Debate over Ethiopia's First Property Tax Bill, 25 June 2020 available at: https://ethiopianmonitor.com/2020/06/25/public-to-debate-over-ethiopias-first-property-tax-bill/ [last accessed on 30 January 2023]

secondary sources through analysis of research works, books, journals, articles, periodicals, web resources, conferences podcasts, etc.

The remainder of the article is organized into five sections. The first section has so far provided a backdrop to the investigation. The next section establishes the conceptual foundations of property tax by focusing on definitions, types, justifications, and theoretical debates. This is followed by an exploration of property tax reform experiences of selected countries, and section three reviews the historical account of property tax in Ethiopia. Section four raises the core issue in the article. It identifies and examines major design issues in Ethiopia's property tax reform. Finally, the last section provides concluding remarks.

## 1. Conceptual Foundations of Property Tax

Property, literally, tax is a direct tax imposed on a property (real or personal; immovable or movable; corporeal or incorporeal) that belongs to and is appropriated by an individual or entity. It's thus known by different designations in the literature such as "real estate tax", 'real property tax', "land and building tax", and "immovable property tax" depending on the form of property the tax is levied on. Still, others call it "ad valorem tax" for it is assessed based on a property's value and "local tax" for it is imposed, administered, and used mainly by local governments. Black's Law Dictionary defines property tax as a tax levied on the owner of the property [especially real property] usually based on the property's value.[19] Joan M. Youngman also narrowly defines property as "a tax on ownership and other legal interests in land and buildings to achieve important fiscal, political and legal objectives". [20] Other scholars, of course, do not confine the meaning to this

[19] Bryan A. Garner, Black's Law Dictionary, Seventh Edition, West Publishing Co., St. Paul Minn, United States of America, 1999, P.1526.

[20] Joan M. Youngman, *Tax on Land and Buildings*, in Victor Thuronyi (eds), *Tax Law Design and Drafting,* IMF, (1996), P. 9

designation arguing that although property tax is commonly associated with real property, property taxes are also imposed on personal properties, movable assets, or intangible properties. [21] Accordingly, scholars Riël Franzsen and William McCluskey point out that, in addition to the recurrent or annual taxes, property taxes include taxes on the transfer (acquisition, alienation, or both) of property such as stamp duties, real estate transfer taxes, capital gains taxes, gift taxes, and death and inheritance taxes. [22]It is important to note that these are transaction taxes and such definitions are used mainly for purposes of national revenue statistics. Turning to the Ethiopian conceptualization of the term, the draft Property Tax Prototype Proclamation adopts the narrow view and defines "property tax" as tax levied in respect of urban land use, including building and other land improvements located on urban land but chargeable from a taxpayer.[23] Accordingly, the main focus of this study is the recurrent property tax on real properties or immovables because other property-related taxes are covered by the different income and consumption tax laws in Ethiopia.

Understanding why countries adopt property tax and why it has generally become a reform agenda worldwide is well worth a thorough discussion. Property taxes, especially taxes on immovable property, have many virtues.[24] Firstly, in terms of efficiency, property tax has the potential to be a significant revenue producer, especially for subnational governments in rapidly urbanizing developing countries. Secondly, property tax is said to be fair because an immovable property is often a primary repository of wealth and, in most societies, such properties are found concentrated in the hands of

[21] Riël Franzsen and William McCluskey, *Property Tax in Africa: Status, Challenges, And Prospects*, the Lincoln Institute of Land Policy, (2017), P. 4.
[22] *Id.* P. 3
[23] FDRE Real Property Tax Proclamation (Draft), Art. 2 (2)
[24] *Supra* note 3, P.32; Jay K. Rosengard, The Tax Everyone Loves to Hate: Principles of Property Tax Reform. In William J. McCluskey etals (eds.), *A Primer on the Property Tax: Administration and Policy*, Wiley Blackwell, (2013), PP. 173–86

the few. The third prominent justification in support of property tax is local government autonomy and accountability. In many countries, property tax is taken as an effective tool for decentralization and reducing local government dependence on fiscal transfers from higher tiers of government. Fourthly, property tax is also used to promote the efficient use of land and building and to counter speculation, price hike, and volatility.

At this point, it's plausible to pose the question of why many countries and cities especially in developing and transition economies poorly perform with property taxes. Despite its virtues, property tax is not free from limitations and criticisms.[25] Firstly, as a direct tax, property tax is visible or noticeable and politically sensitive. The second challenge with property tax is the cash flow or liquidity problem. Characteristically, property tax is imposed on the imputed value and does not reflect a real cash flow or the taxpayer's real current situation. Fourthly, it is argued that property tax revenues are inelastic compared to income or sales taxes. Volatility is also seen as a problem as the tax rise and fall quickly with changes in property values in the market. Finally, there is a concern that although property tax is said to be local, the tax is not usually under full local control. In most jurisdictions, property tax is not truly a local tax because local governments have no or less discretion for the levying (determination of tax base, rate, valuation, and exemptions rules) and administration (assessment, collection, enforcement, and dispute settlement procedures) of the tax.[26] However, such criticisms cannot in any way do away with the adoption of property tax in a country. It is also worth noting that, like other taxes, property tax has its own advantages and disadvantages. Effective property tax reform must, therefore, be designed and implemented to address these concerns in design and administration.

[25] Id., Jay K. Rosengard; *Supra* note 3
[26] *Id.*, Jay K. Rosengard

## 2. The Experience of Other Countries

Property taxes, perhaps tax in general, are almost as old as the age of ancient state societies. Various forms of property taxes were levied and collected in the time of ancient Egypt, Greece, Babylonia, China, and other parts of the ancient world to generate funds for government expenditure and to maintain imperial armies.[27] In medieval times, many of these ancient taxes were replaced by a variety of obligatory services and a system of aids or gifts to the King.[28] In the feudal system, landlords provide land to the tenants in exchange for their loyalty, service, and tribute. Peasants paid one-tenth (a tithe) of the value of crops to the lord who then passed on a percentage to the king.

The turn of the 20th Century marked quite a new and unpleasant episode in the history of property taxation. Problems in the international economy such as the Great Depression (1929-1939), the rise of socialist movements and the resultant economic restructurings, the growing interdependence of economies, and the internationalization of markets (globalization) have brought fiscal reform movements to implement sales and income taxes and parallels movements towards property tax cut.[29] However, the end of the 20th Century has brought a new era in the history of property tax for several reasons. This new development and expansion of property tax reform around the world are

---

[27] Carlson, Richard Henry. "A Brief History of Property Tax" *Fair and Equitable,* Vol. 3 No. 2, (2005), PP, 3-9.

[28] Tsebo Moses, The History of Taxation Around the World from Ancient to Modern Times, (2021). available at: https://www.yoair.com/blog/the-history-of-taxation-around-the-world/ [last visited on 06/01/2022]. However, despite all developments in the ancient history, the word "tax" had not even existed and it was used as an official word only in the 14th century as derived from the Latin word "taxare" which means "to assess".

[29] Odd-Helge Fjeldstad and Ole Therkildsen, *Mass Taxation and State-Society Relations in East Africa*, in Deborah Braütigam et al (eds), *Taxation and State Building in Developing Countries*. Cambridge: Cambridge University Press, (2008) PP.114 – 134.

particularly associated with the dissolution of the Soviet Union (1988–1991) and the collapse of the Communist regimes in other parts of the world.[30] Thus, over the past 30 years, several developed and developing countries have strengthened property taxes reforms as a critical component of tax reform discourse and as part of land reforms, urban policies, decentralization, and local government reforms. Reflecting such changes, the continent of Africa has also seen extensive work on property tax reforms in more than half of the 54 countries during the last 20 years as part of land reforms and local government reforms, out of which Ethiopia can draw important lessons.[31] Therefore, in the next sections, an attempt has been made to draw lessons from four different jurisdictions with a specific focus on their reform experiences and design issues.

### 2.1. Tanzania

Although property tax has a long history of ups and downs, it is the re-establishment of local government authorities through Local Government Finance Act No. 9/ 1982 and Urban Authorities Rating Act No. 2/1983 (as amended in 2019) that celebrate the rebirth of property tax and reforms in Tanzania.[32] The Tanzanian property tax laws use buildings as a tax base. The value-based taxation covers buildings within the taxing jurisdictions in actual occupation and improvements therein with the exclusion of undeveloped land. Exempted properties include those personally occupied by the President, properties used for public utilities or public worship, public libraries and museums, cemeteries and crematoria, civil and military aerodromes, sporting

[30] *Id.*

[31] *Id.*

[32] Kayuza, H., Real Property Taxation in Tanzania: Reflections from Dar es Salaam City, *Utafiti Journal,* Vol. 7, No. 1, (2018); Massawe, Hanifa T., Regulation of Property Tax in Tanzania: Legal and Administrative Challenges, *KAS African Law Study Library* 7, No. 3, (2020): 424-438.

facilities, railway properties, and any other property as the Minister responsible for Local Authorities shall prescribe.[33]

While responsibilities for the various phases of property tax administration are shared by respective government authorities, the ultimate power of property tax collection rests within local governments. In Tanzania, the market value for a building or improvements made to it forms the basis of property tax.[34] The property tax rates are prescribed by the local authorities.[35] Tanzania's property tax regime also provides mechanisms for tax enforcement systems (confiscation of payments and profits from the respective property, fines, and interests on late payment) and dispute settlement bodies that consists of relevant skilled and qualified personnel to adjudicate.[36]

### 2.2. South Africa

South Africa has a long history of property tax practice and currently performs relatively well in terms of tax collection efficiency. [37] While over 64% of its population is living in urban areas, more than 90% of individual properties are formally registered and more than 80% of property holders are listed on the land and property tax roll.[38] Currently, municipalities update the list of properties (including those subjected to exemptions, deductions, and rebates), assess all of their properties, and enforce property taxes by attaching the property of delinquent taxpayers.[39] Municipalities derive their power to levy property tax from the Constitution of the Republic of South Africa,

[33] Urban Authorities Rating of Tanzania, (1983), Section 7.
[34] Id, Section 22.
[35] *Id.*, Part IV
[36] I*d.*, Section 26 and 29.
[37] Franzsen, R. C. D. and W. H. A. Olima, Property Taxation in Southern and East Africa: Lessons from South Africa and Kenya, *SA Mercantile Law Journal* 15, no. 3, (2003), PP. 309-325.
[38] *Id.*, P. 324
[39] *Id.*

which establishes three independent tiers of government with defined powers and functions.[40] Later the national law, which is enacted to repeal previous provincial laws and provide for a uniform system of property tax, gives the power of levying and collecting property tax to local metropolitan and municipalities.[41] Yet, local governments adopt property tax legislation as far as it is consistent with the central government municipal property rate Act.[42]

Regarding the tax base, property tax is levied on owners of immovable property based on the market value, comprising land and buildings as one composite value.[43] Tax rates are set locally and annually by municipalities and the SAMPRA allows municipalities to levy different tax rates on different categories of property.[44] Coming to the property tax exemptions, the SAMPRA under section 15 exempts residential properties whose threshold market value is at least the first ZAR 15,000; a hundred percent of public infrastructures such as roads, waterways, railway lines and airports; thirty percent of the value of taxable public services infrastructure such as the coastline and offshore islands; mineral rights; property used primarily as a place of public worship; property owned by land reform beneficiaries.[45] Yet it is important to note that such an exemption applies only for 10 years from the acquisition; and parts of national parks, nature reserves, and botanical gardens.[46]

### 2.3. Thailand

[40] The Constitution of the Republic of South Africa, (1996), Article 229.
[41] The South Africa's Local Government: Municipal Property Rates Act 6/2004, Article 2, {hereinafter SAMPR}
[42] *Id.* Article 2(3)
[43] Id., Section 46.
[44] Id., Section 8.
[45] Id.
[46] Id., Section 15.

Before a couple of decades, Thailand levied an annual real property tax such as Local Development Tax (LDT) or House and Land Tax (HLT).[47] In addition to these two forms of taxes, there was also a property transfer fee on the market value of the transferred property. [48] The Thailand Land and Building Act provides that local governments have the power to collect tax on land or buildings located in their jurisdictions and use the revenue therefrom.[49] The law also obliges individual or legal entity that owns, possesses, or has usage rights of land or buildings, including condominium units to pay land and building tax.[50]

The tax base is the total value of land or building.[51] The value of land or a building is determined based on its pre-assessed value, which shall be published by local governments each year and the tax rates shall be specified in a Royal Decree. For land or buildings which are vacant or unused for more than 3 consecutive years, the tax rates will increase by 0.3% every three years. The property of the State, the property or offices of the UN and other international organization, property serving as an office of an embassy, the property of the Thai Red Cross, the religious asset of any religion and used only for carrying out religious activities, the property owned by the charitable organization, property privately owned, the common asset for common benefits of co-owners, public utility land, etc. are exempted from land and building tax.[52]

Each year local governments notify tax assessment with particulars of land or buildings, the pre-assessed value of the property, tax rates, and the amount of

[47] Laovakul, D., Property tax in Thailand: An Assessment and Policy Implication, *Thammasat Review of Economic and Social Policy, 2(1)*, (2016), 24-53.
[48] William McCluskey, Roy Bahl, and Riël Franzsen, Strengthening Property Taxation within Developing Asia, *ECON Publications. 105*, (2021), PP. 1-16.
[49] Thailand Land and Building Act, *B.E. 2562*, (2019), Section 7.
[50] *Id*., Section 9.
[51] *Id*., section 35.
[52] *Id*, Section 8.

tax payable.[53] A taxpayer who received such notices has the right to object to the assessment and ask the local administrator for review. In a case where taxpayers are not satisfied with the decision of the local administrator, an appeal can be lodged with the Tax Assessment Appeal Committee. In cases where a taxpayer has failed to pay tax within the specified time, the taxpayer shall be liable to make a penalty amounting to forty percent of the tax in arrears. As an exception to this rule, in cases where the taxpayer has paid tax before receiving the written warning, the taxpayer shall be liable to make a penalty payment amounting percent of the tax in arrears.[54]

The other experience worth noting from Thailand relates to the "Land and Buildings Tax Decision Committee". This committee consists of different heads of office including the Director-General of the Department of Lands, which is entrusted with duties and powers to decide over questions on the collection of tax, to give counseling statements or advice in connection with the collection of tax, and the compliance, and to perform any other activities as provided by law.[55]

## 3. The Genesis and Development of Property Tax in Ethiopia

### 3.1. Pre-1940s Property Taxation

Ethiopia, whose history as a nation-state can be traced back to antiquity, had passed through various forms of property tax under different land tenures and political administrations. As is the case in other parts of the world, its tax system, especially land and agriculture taxation, dates back to ancient times. In the Aksumite kingdom, like other dynastic kingdoms of the time, kings resorted to compulsory tributes and other traditional forms of taxes from

[53] *Id.*, section 44.
[54] *Id.*, section 62.
[55] *Id.*, section 16.

conquered peoples and kingdoms. [56] Some other sources argue that it was during the Zerayacob time that the first tax system was introduced in Ethiopia.[57] Central and provincial rulers compelled subjects to provide compulsory service to the kingdom. Shreds of evidence found in some inscriptions attest that particular property taxes, such as taxes on crops, livestock, livestock products (such as butter, milk, and wool), hunting products (ivory and honey), and handicraft products were imposed and collected in the ancient and medieval periods in Ethiopia. The king was at the center of his imperial rule, while there were powerful provincial lords who had substantial power over the lands and the people in their respective provinces. It can be emphasized that land played a significant role in the development of the Ethiopian state and taxation in general. The traditional system of land tenure in Ethiopia is essentially based on the concepts of Rist and Gult.[58] Although there is no record evidence as to what type and how taxes were levied, the tax system was generally traditional and in-kind criticized as excessively burdensome, arbitrary, and oppressive.[59]

In 1907, a landmark legislation recognizing private ownership of urban land was enacted. This legislation provided tax as one of its objectives in which government shall assess the amount of money to be paid depending on its value. In the 1920s, the government made early attempts to simplify and

---

[56] Addis Chamber –Alliance Professionals, Tax System Manual, (2004), [hereinafter Tax System Manual]

[57] *Id.*

[58] Rist is a group right emanated from family relations and inherited among descendants. On the other hand, gult is not the right to hold land but the right to administer and collect tribute from landowners. Hence, rist was relatively secure in that there was less eviction and state interference. But taxes were payable in both cases**. See generally**, Temesgen Gebeyehu, Land Tenure, Land Reform and the Qalad System in Ethiopia 1941–1974, *Journal of Asian and African Studies,* Vol. 46, No 6*,* (2011), PP. 567–577; Dechasa Abebe, A Socio-Economic History of North Shäwa, Ethiopia 1880s-1935, PhD Thesis University of South Africa, (2015).

[59] Tax System Manual, *Supra* note 56.

standardize the agricultural tax system. For example, in 1929 practical measures such as the introduction of new regulations for the survey and measurement of lands, abolition of unpaid services, greater equity in taxation, and making *Asrat* a tax paid yearly to the Government and equivalent to one-tenth of the produce of the land payable in cash. In 1935, a law establishing a single land tax was introduced, which among others, provided that all landholders were henceforth required to pay 30 Thalers (silver coins) per Gasha per annum and were to be relieved from all other taxes and obligations of service. During the Italian Occupation, the colonial administration canceled all land taxes, collecting only the Asrat and imposing corvees i.e., forced labor exacted instead of taxes.

### 3.2. Property Tax During the 1940-1974- Signs of Progress

As part of Post-liberation measures, administrative and temporary reforms were made to centralize taxation and reintroduce the land tax in the 1940s. In 1942, a special regulation was issued for the payment and collection of the *Asrat.* This was followed by the introduction of the first land tax, i.e., Land Tax Proclamation No. 8/1942.[60] According to the Proclamation, an annual land tax is collected at the rates of 15, 10, and 5 Birr respectively on a Gasha of fertile, semi-fertile, and poor land. In the provinces, where land had not been measured, land taxes were paid based on the 1935 law, the rate being half the rate on measured lands. In 1944, Land Tax Proclamation No. 70/1944 was enacted to repeal Proclamation No. 8/1942 and continued in service for more than two decades. This law introduced two land-based taxes: the *Asrat* and the Land Tax. The tax provides for the classification of lands into fertile, semi-fertile, and poor lands and authorizes the Minister of Finance, subject to the approval of the Council of Ministers, to change or amend the rates for the payment of the *Asrat.*[61] The Land Tax (Amendment) Proclamation No. 84/1947 also introduced some minor changes concerning penalties for default

[60] Land Tax Proclamation No. 8/1942, *Negarit Gazeta,* (1942).
[61] Land Tax Proclamation No. 70/1994, *Negarit Gazeta, (*1994), **Article 5.**

in the payment of the tax. Subsequently, the Land Tax Amendment Proclamation No. 106/1949 was enacted. Later, Land Tax Regulation Legal Notice No. 257/1962 came to effect, providing for a reclassification of all measured land as fertile, semi-fertile, and poor.

The other major amendments to the 1944 tax law included the introduction of "Education" and "Health" taxation. The Education Tax Proclamation No.94/1947 levied taxes on all lands. The Education Tax is basically a proportional tax since the relative tax burden remains constant with increases in the size of private landholding. Later, Additional Education Taxes Proclamation No. 279/1970 imposed a 30 percent education tax on urban property and on personal emoluments at the rate of 0.50 Birr on monthly earnings of 50.00 - 100.00 Birr and at the rate of 2 percent on all monthly earnings in excess of 100.00 Birr. Finally, health tax Decree No. 36/1959 provided for the payment of tax on measured and unmeasured land in various provinces.

In 1954, the Cattle Tax Proclamation No. 142/1954 was enacted, and according to this tax law all cattle breeders had to pay an annual tax on each head of cattle: Camels, 0.50 Birr; Horned cattle, 0.25 Birr; Horses, 0.25 Birr; Mules, 0.25 Birr; Donkeys, 0.10 Birr; Goats, 0.05 Birr; Sheep, 0.05 Birr; Pigs, 1.00 Birr and suckling animals are excluded from any form of taxation. This law was amended through Cattle Tax Assessment Legal Notice No. 187/1954. In 1961, another tax legislation, targeting incomes from the exploitation of woods and forests for lumber purposes was enacted as Income Tax Proclamation No. 173/1961. It should be recalled also that Income Tax Amendment Proclamation No. 255/1967 makes certain agricultural activities liable for taxation.

With regard to municipal governance, the mayorship system which includes municipal council and municipal management under a 'Kentiba' (Mayor) or Town Officer was introduced in 1945. The law assigned specific competencies and functions to municipalities. Accordingly, municipalities

were entitled to fix local rates on fares for taxis, carts, and saddles; and on all immovable properties; to assess and collect charge fees for water supply, and for municipal public services such as licenses on trade and professions, use of market places, vehicles and driving license, slaughtering and meat delivery fees, sanitary charges, land survey and registration fees advertising, cattle registration, and to collect rental income tax, as well as health tax. Property taxes on land and buildings were assessed by area or calculated as a percentage of the rental value of the Property.

### 3.3. Property Taxes During 1974-1991- Regresses

Following the 1974 socialist revolution, the Marxist military regime, known as Derg, enacted a series of radical reform measures across the economy. It was started with the nationalization of all rural and urban lands[62] and complemented by reforms in the revenue sector. In rural areas, the new Rural Land Use Fee and Agricultural Activities Income Tax Proclamation No. 77/1976, and in urban areas, Urban Land Rent and House Tax Proclamation No. 80/1976 were promulgated consistent with the new political economy. These laws made some tax laws obsolete and replaced them with new ones, others were amended, and new ones were introduced. In particular, the Land Tax Proclamation No. 70/1944 (as amended), Legal Notice No. 257/1962 (as amended), the Education Tax Proclamation No. 94/1947, the Health Tax Decree No.37/1959, and the relevant provisions of the Income Tax Amendment Proclamation No. 255/1967 were expressly repealed. As it can be read from the heading, Proclamation No. 77/1976 introduced two types of levies in the rural area (land use fee and an agricultural income tax) and Proclamation No. 80/1976 levied two kinds of payments in the urban area (urban land rent and house tax). Proclamation No. 80/1976 was amended by Proclamation No. 161/1979 and reinforced by the 1979 Provincial Urban Land Rent and Urban Houses Tax Regulation Legal Notice No. 64/1979. Proclamation No. 77/1976 was also amended by Proclamation No. 152/1978,

[62] *Supra* note 13

which increases the fees and the rates in rural areas. Peasants Associations (PAs) and Kebele Urban Dwellers Associations (KUDAs) were established as local administrative units through Peasant Associations Organization and Consolidation Proclamation No. 71/1975 and the Urban Dwellers Association Consolidation and Municipalities Proclamation No. 104/1976. These local administrative units were purely policy implementers of the central government and were in charge of implementing land reform, coordinating land redistribution, and collecting taxes. In short, as far as urban revenue sources are concerned, the governing law was Proclamation No. 80/1976 and a legal possessor of urban land was required to pay an annual land rent assessed on the basis of the size of the plot and the quality of its location within the city (categorized as Grade 1, 2, or 3) and for urban houses assessed as a percentage (progressive rate from 1 - 4.5%) of the annual rental value. The proclamation exempts some properties for state and social functions and covers tasks of billing, collection, enforcement and other tax administration responsibilities.

### 3.4. Property Tax in the Post-1991

The FDRE Constitution decentralized the administration of land to the regional governments while it kept the formulation of land policy at the center.[63] Looking at the division of taxation power under Articles 96-99, most land and property-related taxes, fees, and charges were assigned to regional states. However, the Constitution has no clear provision about the power of property taxation. The determination of the power to tax property tax has been one of the critical questions in the post-2011 reform process. While some consider the tax as assigned to the regional states under article 97, others argue that the tax is undesignated under article 99 waiting for the decision of the House of Federation (HoF) and House of Peoples Representatives (HPRs)

[63] The Constitution of Federal Democratic Republic of Ethiopia, Proclamation No.1/1995, Federal Negarit Gazeta, (1995) (Hereinafter FDRE Constitution) Article 55 (2) (a) cum 52 (2) (d)

joint session. Still, the literature and some policymakers contend that it's legitimate and timely to snatch this power out of the hands of the regional and federal governments and bestow the power to urban local governments. Recently, in their 1st joint special meeting of the 2nd year of the 6th HoF and HPRs joint session, decided to give the authority of property tax to regional states, which are supposed to devolve the power to local governors as per their constitutional powers.

This being the case, it should be noted that, in the early days of EPRDF, the Derg laws on agricultural taxation and land use fee and urban land rent and house tax remained in force and was used by regional states. Later, regional states continued imposing and collecting various rural land use fees and agricultural income taxes. In urban areas, the urban rent and urban houses tax law of 1976 as well as the regulations issued by City administrations remained in force long after Derg was toppled. While Addis Ababa continues to rely upon municipality tax laws issued during the Derg and Imperial times, some of the regional states have issued their own legislation on fees and taxes following the decentralization of power in the post-1991 period.

In Sum, there is no property taxation in the strict sense of the term, and the existing property-like payments are riddled with legal, technical, and institutional problems. The only referable national legislation for property taxation is the Urban Land Rent and Urban Houses tax Proclamation No. 80/1976. However, this proclamation has no force of law and needs to be significantly revised to reflect the legal, political, economic, and social changes that have occurred over the decades in this country. The existing municipal revenue sources are not property taxes *stricto sensu* and Ethiopia is undertaking property tax reform since 2011 with the general goal of introducing recurrent property tax in the urban centers of the country. So far pilot studies have been carried out, draft prototype legislations are prepared and parliamentary discussions are underway. Property tax law design, which is a critical component of the reform process, involves a number of issues and the following section tries to explore design options.

## 4. Major Design Issues in Ethiopia's Property Tax Reform

While property tax remains the most important local revenue source across the world, there is no uniform structural design and administrative procedure. Both the law and the practice feature substantial differences across countries. There is also considerable empirical and theoretical literature justifying such different approaches by policymakers. Understanding such alternatives in designing the structural and administrative components of property tax is crucial in countries like Ethiopia undertaking a reform for this category of tax. According to Sjoquist and Sweat, operationalizing property tax requires a mix of choices regarding design issues and questions such as: what property will be taxed (land, improvements, personal property); what is the basis of assessing the tax (market value, rental value, area or something else; who will the taxpayer (owner or user); what will the tax rate structure be (a flat rate or rates that differ by value, type or location of property); what options will be available to enforce collection (foreclosures, police force), etc.[64] This is to refer to some of the key components of a property tax system such as determining the tax base, assessing that base, setting the tax rate, and running the system through levels of government. This section highlights some notable legal and practical issues in designing and administration of property tax law. For this purpose, an attempt is made to survey how the various structural and administrative questions are answered in various countries and the literature with a special focus on arguments for and against alternative approaches. In addition, reference is made to the laws in force during the Imperial and Derg governments. Finally, it looks into major design issues as a way to inform the Draft Federal Prototype Proclamation.

### 4.1. Tax Bases: What shall be taxed?

[64] David L. Sjoquist and Dan E. Sweat, Foreword, in William J. McCluskey et als (ed), *A Primer on Property Tax Administration and Policy*, Blackwell Publishing Ltd, (2013) p. xvii.

Property tax is supposed to be levied on the different types of property: real or personal, movable or immovable, private and public, corporeal or incorporeal, tangible or intangible, etc. as recognized by legal systems. Thus, the first important question with respect to the tax base is determining the tax modality and types of property subject to such tax.[65]This issue has attracted different views and countries have no uniform approaches in the determination of property tax base. The general property tax that taxes all types of property (movable, immovable, tangible, or intangible) is common in countries such as the USA but became untenable in other countries as movables, financial assets and other intangibles are inherently difficult to identify and assess.[66] This is particularly true for developing countries such as Ethiopia. Property tax legislation during the Haile Sillasie and Derg regimes taxed only land and buildings. Even within the category of immovable property, an important choice exists between a tax on land and a tax on buildings or both.[67]In some countries, like Kenya, only the land portion of the property is taxed; while in countries, like Tanzania, only buildings are taxed. Many supports taxing land because its value increment is largely contributed by the state and the public, it's most concentrated in the hands of the rich and speculators, it shares the greatest value as a portion of real estate value, and it has a fixed supply and tax encourages good use.

It is also argued that taxing buildings might be counterproductive for it stifles or retards urban renewal and capital formation, it tends to be progressive, and shifting the tax burden to the poor and public/citizens involvement is minimal on building compared to land. Studies indicated that most countries, like

[65] Richard M. Bird and Enid Slack, *Supra* note 2, P. 12.

[66] *Id.*

[67] Harry Kitchen Property Tax: A Situation Analysis and Overview, in William J. McCluskey et als (ed), *A Primer on Property Tax Administration and Policy,* Blackwell Publishing Ltd, (2013), P. 3. Harry Kitchen describes the experience of countries in Choice of tax base as some countries tax land only, few countries tax buildings only, and most countries tax both land and buildings.

South Africa and Thailand, prefer to tax both land and buildings (improvements). There is no uniformity even among those countries that levy tax on both the land and the improvements. Some of these countries such as South Africa value land and buildings together and others like Thailand value the two separately.

In countries where both land and improvements are taxed, the land portion is sometimes taxed more heavily than improvements.[68] This is to discourage speculation and encourage property developments, especially in urban areas. However, not all land and buildings are the subjects of the same tax. In almost every country, owner-occupied residences and farm or agricultural land and property receive favorable tax treatment, while the non-residential property is subject to higher taxes. There are also exemptions that we will see down the lines. Although few in number, some countries such as South Africa also levy what is known as 'site value taxation'.[69] These countries prefer to impose a tax on location or site value regardless of other attributes. The literature recommends such a tax be more progressive than a tax on land and improvements.[70]

The Ethiopian legal system classifies all goods (the subject matter of property rights) as either movable or immovable.[71] Furthermore, it considers land and

[68] *Id.*

[69] *Id.*

[70] *Id.*

[71] Ethiopian Civil Code, *Negarit Gazetta*, (1960), Article 1126. The reading into the subsequent articles of the civil code and other legislations also reveals the recognition of incorporeal (intangible) things as subject matter of property. Separate legislations are currently developed for the four types of intellectual property rights (IPRs): patents, trademarks, copyrights, and trade secrets. See The Copyright and Neighboring Rights Protection Proclamation No. 410/2004; A Proclamation Concerning Inventions, Minor Inventions and Industrial Designs Proclamation No. 123/1995; Trademark Registration and Protection Proclamation No. 501/2006. Ethiopia doesn't yet develop a

buildings as two separate types of immovables and provides for the private ownership of both.[72] Accordingly, the imperial government introduced land tax through the first Land Tax Proclamation No.8/1942, which remained in force, in different forms, until 1974. The separate treatment of land and improvements under the civil code was further reinforced in the 1975 land reform, which nationalized all land by two different proclamations (Proclamation No. 31/1975 and Proclamation No. 47/ 1975) and restricted private ownership to improvements over land. The regime further abolished land taxation and introduced urban land rent and house tax through Proclamation 80/1976 and rural land use fee and agricultural activities income tax through Proclamation No. 77/1976. Under Proclamation No. 80/1976 it was only buildings that were the subjects of property taxation. After the downfall of the Derg regime, the FDRE Constitution envisages that ownership of land is vested in the state and the people, while ownership of the building is given to the individual.[73] The Constitution assigns the power to levy and collect the various tax and non-tax revenues from land and buildings to the regional states that attempt to devolve power to urban and rural local governments. Thus, land and buildings are separate things and are owned by two separate bodies under the Ethiopian legal system. The determination of tax bases in the ongoing property tax in the country will be guided by these historical and constitutional dictates.

From an interview with Belete and Atsede, it was possible to learn that the determination of the tax base was one of the policy issues in the property tax

separate tax regime to IPRs. The various taxes applicable to IPRs are found scattered in the income tax laws.

[72] Id., Articles 1130 and 1204. This is an unusual position different from other legal systems such as the French Civil Code, which declares that ownership of surface of land means ownership of all things above and below the land.

[73] *Supra* note 63, Article 40(3), (7)

reform process in Ethiopia.[74] Taxing land remains a debatable issue in the country. In present-day Ethiopia, urban land is jointly owned by the state and the people and exists in at least three forms: old possession, lease holding, and informal holding. The government of Ethiopia remains hesitant to tax usufructuary or holding rights land and tax was restricted to housing since the Dreg time. However, the Draft Federal Prototype Proclamation seems to break this tie. Article 3 of this draft provides that property tax shall be levied on all urban land and buildings located in Ethiopia unless expressly specified by this Proclamation. Moreover, according to Article 6, land use tax should apply to urban leasehold land and land improvements other than buildings and building tax should apply to buildings on urban leaseholds. On the other hand, permit fees shall be charged and collected from all land uses and buildings constructed or to be constructed on all urban land and landed properties outside the leasehold land tenure. The possibility of separate and joint rating of land use tax and building tax is also indicated under Article 7. Thus, the draft tends to favor tax levying on both land and buildings although there can be a separate assessment.

### 4.2. Property Tax Assessment and Valuation

Once the tax base is decided, a second key question in designing property tax law is how to determine the value to which the tax rate will be applied. This is commonly known as assessment or valuation. The international practice shows that countries widely employ four methods of assessment: area-based assessment (area-based taxation), market value assessment (market value as a tax base), rental value assessment (income-based valuation), and land (or site)

[74] Interview with Belete Alemayehu, Urban Revenue Reform Project Bahir Dar Coordinating Office, (23 may 2022), Interview with Atsede Hailu, Urban Revenue Reform Project Office, Ministry of Ministry of Urban and Infrastructure, (16 May 2022).

value systems.[75] A closer look into the experiences shows that countries use these methods ide dependently or in combination

While these methods are widely recognized, scholars such as Enid Slack and Richard M. Bird broadly classify them into two categories: area-based (specific systems) and value-based (*ad valorem* systems) assessments, with the latter again divided into capital, rental, and site value approaches.[76] Further, as shown in the table below there is no uniform property tax base or methods of assessment that apply in every country.[77]

**Table 4: Experience of Selected Countries on Tax Base and Assessment**[78]

| **Country** | **Tax Base** | **Basis of Assessment** |
|---|---|---|
| Tanzania | Buildings, structures, or limited development | The market value of buildings |
| South Africa | Land and/or improvements | The market value of land or buildings |

[75] Roy Bahl, Property Tax Reform in Developing and Transition Countries, USAID, (2009), P. 6, See also Enid Slack, Why Value-Based Property Taxation? Institute on Municipal Finance and Governance, University of Toronto, (2013),

[76] Enid Slack and Richard M. Bird, *Supra* note 65, P. 8.

[77] The conventional consensus is that value 55 systems are best for benefits from services are more closely reflected (in property values than in its size) and it enable to capture the value added by government or public expenditures. On the other hand, countries use area-based systems of taxation because they lack the necessary information, expertise, and resources to determine market values or perhaps because the market-value approach is considered politically unacceptable. Some countries also give the choice to taxpayers.

[78] Kitchen, Harry, Property tax: A Situation Analysis and Overview*, A Primer on Property Tax: Administration and Policy, (*2012), PP. 1-40.

| | | |
|---|---|---|
| Thailand | Land or Buildings | The market value of land or buildings |

Under the area-based assessment method, which is widely used in developing countries, each unit of property is taxed at a specific rate per area unit of land and improvements or structures.[79] The advantage of the area-based system is that it is simple, transparent, and fairly easily administrable compared to value-based systems. This also makes the system affordable to even countries with no or only a fledgling property market. However, it is not free from defects. In the first place, it hardly appears fair for the tax to be imposed based on the size or physical characteristics of a property without considering the quality of any improvements or value increments. It also casts doubt that an area-based system cannot generate adequate revenue growth. It can only generate increased revenue through growth in the number of buildings, or by periodic and unpopular tax rate increases. In other words, there is no automatic growth in the tax base and its buoyancy is limited for it cannot enable tracking market price developments. Scholars such as Roy Bahl argue that developing and some transition countries should focus on administrative considerations and the area-based approach is the most realistic option available for effective administration.[80] The market value assessment methods start with defining the base as the market value[81] of the property in an open market.[82] This is known as the capital value of land and improvements or structures. The comparable sales approach, which relies on valid sales of similar properties, is the most commonly used method to estimate market value. Comparisons are often accompanied by adjustments based on the physical characteristics of the site, construction materials used, size, availability of infrastructure services, and homogeneity of zones. This

[79] Roy Bahl, *Supra* note 75, PP. 10-11.
[80] Roy Bahl, *Supra* note 75, P. 12.
[81] Market value is the price that would be struck between a willing buyer and a willing seller in an arm's length transaction.
[82] Roy Bahl, *Supra* note 75, PP. 7-9.

approach is recommended when the market is active and similar properties are being sold frequently. The "depreciated cost approach" and the "income approach" are also used to arrive at market values. The first approach values the property by estimating the land value as if it were vacant and adding the cost of replacing the buildings and other improvements to that value. Such an approach is recommended when the property is relatively new, where there are no comparable sales, and the improvements are relatively unique. In the second approach, valuations are made by estimating the potential gross rental income the property could produce and deducting operating expenditures. This approach is recommended if properties have actual rental income.

The market value assessment method is the most equitable method for it helps to identify the extent to which a property value benefits from public or neighborhood investment, i.e. unearned increment. Proponents of the method also claim that it is easily understandable and makes taxpayers feel a low tax burden with nominal tax rates. Of course, this is not to say that the capital value approach is easily implemented. The key problems with this assessment method are the scarcity of accurate data reflecting market transactions or sales values of properties and under-declaration of prices. In part, the under-declaration is attributable to property transfer taxes that often are levied at high rates. There is likely great variation across as well as within countries in the quality of the data on the sales value of properties and oftentimes these data are supplemented by the "expert judgment" of assessors and real estate professionals. The administrative cost of the system can also be high for valuations are often provided by expert assessors. Recently countries are applying computer models to undertake valuation more accurately and at a better speed. The market value assessment method is used in most developed countries although there is a global trend to shift towards this method in other countries.

In the rental value assessment method, tax authorities define the tax base as the rent reasonably expected in a fair market transaction.[83] The justification is that it is appropriate to tax income (a flow) rather than wealth or the property itself (a stock). In general, the rental value assessment method is simple to conceptualize and enforce. Yet, the method can be challenging to use in practice. In the first place, there is usually a scarcity of data rents actually paid. Without such direct evidence, it's problematic to put the method into practice and countries often look for the estimated, not actual, rental value as a tax base.

In some countries, rental values are determined by estimating the market rental values that can be imputed to all properties in a neighborhood based on available rent data from surveys or expert judgment. This method is used mainly for flats and some houses. The other problem is that some properties may not be found in the rental market. This is particularly true for properties such as owner-occupied housing, larger commercial establishments, factories and industrial properties, and vacant land. The same problem can also happen with respect to properties covered under the rent control regime. For such kinds of properties, countries tend to use capital value and cost of acquisition to determine rental value.

In the land (or site) value systems, countries assess and tax the market value of the land alone.[84] Although the system is introduced very recently, it has been in use in countries such as South Africa. Many support the system for good revenue-raising potential, incentivizing efficient use of land and requiring low administrative costs. However, assessing land value is complex, especially in highly urbanized areas. The system also suffers from the same type of administrative shortcomings as the capital value tax. Finally, limiting the tax base to land may result in some arbitrary rules in assigning tax liability

[83] Id., PP. 6-7.
[84] Id., PP. 9-10.

within multi-unit structures in cases where there is no private or single owner of the land.

The analysis of the experience of different countries leads us to the conclusion that the best system for a given country probably depends on the administrative capacity of the state, the present state of property markets, the availability of transaction data, land and housing tenure, and policy objectives, i.e., what the country wants most to accomplish with the property tax. One can notice various options here as an example. Obviously, valued-based assessment systems are adopted in countries where there are fully functional property markets, whereas, in countries where property or real estate markets are not fully developed, area-based assessment is preferred.

The international practice further shows that developing and transitional economies eventually move to a value-based system as their economies develop and real estate markets emerge. If the overriding policy goal in the country is to treat taxpayers equitably, it's the value-based systems that can work well. In some developing countries, property tax reforms are designed to treat the property tax as an extension of the individual income tax. The idea is that as rental income is often under-declared for income tax purposes, the property tax can be seen as a backup. In this regard, a rental value system is considered appropriate. However, property tax revenue is affected by underreports in rental income tax. On the other hand, in developed countries, property taxes are seen as wealth taxes. In these countries, a capital value or a land value property tax is a reasonable approach. On the other hand, if most of the properties are held in rental tenure, the focus might be on annual rental value, and if tenure is dominated by owner-occupancy, there is a stronger argument for an (improved) capital value base. The area-based system works best in rural areas while the *advalorem* system is good for urban places, especially for large cities. In urban areas where land is subject to speculation or is not being developed intensively, a land value tax might be considered preferable for its ability to encourage efficient land use and internalize social costs. The identification and valuation of the property tax base are difficult, if

not impossible, where land ownership is not in the private sector, where there is a slow or no real property market, and land registries and cadastres are weak, and not regularly updated.

Turning to the Ethiopian tax landscape, we could find some assumptions underlying the ends and process of taxation. For example, the valuation and assessment of annual property tax under Proclamation No. 80/1976 begin with the assumption that land is a property of the state and cannot be sold in the market. Moreover, land rent values were nominal amounts for it was not considered as an investment return but rather as exploitation. In other words, the annual assessed rental value of properties for tax purposes was far below the market rate. Thus, the method of assessment and valuation under proclamation No. 80/1976 was largely area-based. The Tax Administration Proclamation No. 983/2016 also recognizes the fair market value principle although its applicability to the coming property tax law remains questionable.[85]

However, the draft Federal Prototype proclamation under Article 12 (2) (a) provides that the annual tax rating schedule shall take into account the annual value or rental or market value of landed properties assessed in the valuation roll applicable to the concerned urban area.[86] Thus, the property tax reform intends to adopt the rental or market value method of assessment. The adoption of the *advalorem* system can be supported from the perspective of equitability. However, its feasibility remains questionable given the administrative capacity of the state, the state of the property market, the availability of transaction data, and the land and housing tenure in the

[85] Tax Administration Proclamation, *Federal Negarit Gazeta,* Extraordinary Issue, Year 22, No 103, No. 983/2016, Article 3.
[86] FDRE Draft Federal Proprty Tax Prototype Proclamation, Article 12 (2) (a).

country.[87] For many experts, it is unaffordable for the Ethiopian tax system and land administration.[88]

### 4.3. Property Tax Rates

The determination of property tax rates is one of the basic design elements making up the scholarly dialogue and policy debate in this tax regime.[89] The first major issue on this subject is related to the source of legitimate authority to determine the tax rate. This is to say should the tax rate be set centrally or locally? As also discussed in section four of this study there is a considerable difference among countries regarding the responsibility for determining tax rates. In some countries such as Thailand, property tax rates are essentially set by the central government; in other countries such as South Africa local governments are empowered to fix the tax rate with the range of rates set by the central government; yet in others such as Tanzania, the local government has full right to determine the tax rate.[90]The choice among these alternative approaches is usually determined by the commitment of the higher government to fiscal decentralization.[91] Thus, it can be a question in Ethiopia as to whether the federal, regional, or local governments assume the role of determining the tax rate. Many agree that local governments need to have control over the property tax rate with due accountability to the local electorate. However, there is a fear that local governments may not have the

[87] Belete Alemayehu, *Supra* note 74

[88]Interview with Lakachew wubale, Urban Revenue Enhancement Expert, Ministry of Ministry of Urban and Infrastructure, Addis Ababa, (16 May 2022), Interview with Seleshe Woldegabriel, Municipal Finance Consultant, Addis Ababa, (16 May 2022).

[89] Richard M. Bird and Enid Slack, *Supra* note 2, PP. 21-24

[90] Id. P.21. see also, Richard Almy, A Survey of Property Tax System in Europe, Department of Taxes and customs, Ministry of Finance, Republic of Slovania, (2001), P. 13.

[91] Kurt Zorn, Establishing a Tax Rate, in William J. McCluskey et als (ed), *A Primer on Property Tax Administration and Policy,* Blackwell Publishing Ltd, (2013), PP. 125-140.

required level of capacity or may enter into unnecessary tax competition.[92] Thus, it's recommended that a maximum rate must be set by higher governments to overcome these problems.

Moreover, static property tax rates would adversely affect revenue buoyancy, especially in an inflationary environment and where there is no regular revaluation of properties. In other words, there shall be room for flexibility in a way it does not invite administrative complexity, arbitrariness, and abuse of power. Regarding the amount and nature of the tax rate, there is a consensus on the need to keep the tax rate generally low, especially in developing countries.[93] When it comes to the question of design, property tax can be designed with proportional or progressive rates. Like the case in other taxes, progressive rates are good in terms of equity (those who own more expensive properties have a greater ability to pay), yet it has also limitations as it is difficult to administer taxation and induces tax avoidance.

The other question in property tax is about the choice between uniform and differential rates deepening on the types, uses, ownership, location, or value of a property. In some countries such as Tanzania and South Africa, a uniform tax rate/single statutory tax rate is applied on all taxable properties irrespective of variations. However, others like Thailand apply differential or classified tax rates based on ownership (owned by individuals or by legal entities or state-owned), location (center or periphery), tenure status (vacant/undeveloped or developed), land use (residential commercial, or agricultural use), type of real property (land or buildings), or a combination of two or more of these features.

Differential or variable tax rates among property classes are justified on a number of grounds. The first and the most obvious reason is that benefits

[92] Roy Bahl, *Supra* note 75, P. 13.

[93]Richard M. Bird and Enid, Slack, Land and Property Taxation in 25 Countries: A Comparative Review, Cesifo Dice Report 3/2005, (2005), P.35.

from local public services are different for different property classes. For example, although the reality is the opposite presumably for political reasons, scholars recommend that non-residential properties must be taxed at lower rates than residential properties for business capital tends to be more mobile than residential capital.[94] Farmland and properties are favored in many countries compared to their urban counterparts. However, some argue that differentially higher taxation would distort land-use decisions (residential, commercial, and industrial uses) and efficient use of the factor of production (land and capital).[95] Experts such as Belete looked into the Ethiopian tax landscape, and hold that it is difficult and unaffordable to implement differential tax rates in Ethiopia today.[96] Looking further into the Ethiopian tax laws in light of the analysis, one finds different sources of authority for the determination of tax rates. During the imperial and Derg regimes, the tax rate was set by the central government and the rate was largely proportional and differential. For example, Article 6 of Proclamation 80/1976 stipulates that the rate shall be based on the grade or quality of the land. Post 1991 Ethiopia follows a federal system of government that relatively decentralizes the power to levy and collect tax at least to the regional governments. In this regard, Article 11 (1) of the Draft Federal Prototype Proclamation provides that property tax rating at the local level shall take into account estimated annual expenditures divided by the total assessed value of all taxable leasehold rights and buildings. Sub-article (2) further states that subject to sub-article (1) and taking into account reasons for macroeconomic stabilization and balanced development based on the categorization of cities, the initial property tax rate to be imposed by any local government shall not be less than 0.4 % and more than 2.5% of the real property value and the annual increment, excluding inflation. Finally, the law requires the tax rate to fall in the range of 1% and 2.5% of the value of the property at most. Thus, compared to the previous laws, the draft law sets a framework to empower local governments.

[94] Enid Slack and Richard M. Bird, *Supra* note 65, p. 10
[95] *Id.*
[96] Belete Lemayehu, *Supra* note 74

### 4.4. **Exemptions**

Like the case in other tax categories, it's common for property tax laws to provide exemptions to some domain of owners or users of property for social, economic, political, or administrative accounts.[97] In many countries including those discussed in section four, the common exemptions include residential houses, principal residences, public service infrastructure or public utilities, property owned and used for public worship, cemeteries, public educational institutions (schools, colleges, and universities), charitable institutions, public museums and libraries, foreign embassies and property owned by international organizations, public roads, parks, sports facilities, and public hospitals and medical facilities and agricultural land.[98] One can also find similar exemptions from the laws enacted during the period of the imperial and Derg regime. The perceived social benefits, consideration of economic neutrality, administrative efficiency, and political implications are the most common reasons used to justify exemptions. Yet, exemptions are criticized on several grounds.

The most common challenge is that most of the exemptions tend to be politically driven, substantially erode the tax base, introduce unfairness to the system, and are prone to abuse.[99] Countries devise some mechanisms to address this concern. Some strictly restrict exemptions to those properties that meet certain criteria such as properties with merit uses (such as schools and churches), properties of low value[100], or properties that are protected from

---

[97] David L. Sjoquist, A Brief History of the Property Tax in Georgia, Fiscal Research Center, Andrew Young School of Policy Studies, No. 182, (2008), P.18.

[98] Roy Bahl, *Supra* note 75, P. 14; Enid Slack and Richard M. Bird, *Supra* note 65, P. 7.

[99] Richard M. Bird and Enid Slack, *Supra* note 2, P. 24;

[100] Such exemptions are primarily granted to protect low-income families who live in areas that are not well serviced. In the same and related note,

domestic taxation by international treaties (such as foreign embassies). They also place a "sunset clause" on exemptions so that exemptions in the coming tax period are dependent on a successful evaluation if exemptions continue to serve their intended purpose. Such approaches are followed in many countries such as India and Kenya to limit or avoid the danger of blanket exemptions.[101]

According to Belete, one of the resource persons in the Ethiopian property tax reform process, property tax exemptions shall be designed considering various interests.[102] For him, it shall take into consideration the low stage of property formation and development in most urban centers of Ethiopia. Article 14 of Proclamation No. 80/1976 provided some lists of exemptions from land rent and property tax. These included public roads, squares, recreation, and sports centers, cemeteries, places of worship and their compound, non-profit making private schools, hospitals, charitable institutions, government institutions drawing their budgets from the central treasury, and properties with an annual rental value of less than 300 Birr. A similar list is recognized under Article 14 of the Draft Federal Prototype Proclamation. There are no however qualifications and requirements to limit or avoid the negative impacts of exemptions on revenue, fairness of the system, or economic decisions.

### 4.5. Property Tax Administration

The structure and quality of the administration of the tax system are crucial to the equitable and efficient operation of property tax. A considerable amount of evidences show that poor tax administration impedes the implementation

properties have low assessed values so that the cost of collection could be as much as the revenue takes, if not more.

[101] Roy Bahl, *Supra* note 75, P. 15

[102] *Supra* note 74. This idea is also supported by another interviewee who is also expert in the field. Interview with Mulay Weldu, Tax Policy Directorate Director, Ministry of Finance, Addis Ababa, (18 May 2022).

of the property tax and is the main reason why property tax reforms fail to achieve the expected result in developing and transition countries.[103] In particular, local governments are often reluctant to make investments in property tax administration for they wrongly see the cost needed as very high relative to the revenue increase.[104] There are some key components of property tax administration such as identification of properties being taxed, preparing records and keep updating valuation, collection, enforcement, and appeals.[105] These elements form parts of conventional recommendations and many agreed that property tax reforms are not likely to be successful without recognizing them.

Building a viable property tax administration requires successful actions of identifying properties taxable in the jurisdiction, determining the owner, and ensuring that such information is periodically updated and consistent. Where these actions are successfully accomplished, assessed values bear little relationship to market value or annual rental value. Looking into the Ethiopian administrative practice, one notices a number of deficiencies in the system. This is mainly because most land and other properties are new, informal, and not titled and reported in the real estate cadastre.[106]

Thus, there is a lot to be done on specific parcel identification number physical descriptions, tenure and ownership forms, (such as owner-occupied and non-residential), uses (such as residential, commercial, or mixed), assessment, tax payment history, and constant update on record. Without such parcel information, it's difficult to track changes and apply timely and accurate data for tax purposes. In many developing countries, only partial information is available, the system is not automated and records are not

[103] Roy Bahl, *Supra* note 75, P. 16, and Richard M. Bird and Enid Slack, *Supra* note 2, PP. 29-31

[104] *Id.*

[105] Roy Bahl, *Supra* note 75, P. 16.

[106]Interview with Atsede Hailu, Urban Revenue Reform Project Office, Ministry of Ministry of Urban and Infrastructure (16 May 2022).

regularly updated.[107] Moreover, there shall be reliable transaction values, adequate qualified valuers, and an efficient assessment process.[108] The other administrative concern relates to collection, enforcement, and appeal. Weaknesses in such areas of administration often result in low performance, low public trust, low compliance, and tax avoidance. In particular, while the tax authority should enforce the tax by using the powers granted, frequent use of draconian measures such as penalties and property seizure, foreclosure, and lack of an independent and efficient appeal system frustrate compliance. A lesson can be drawn from the experience of South Africa and Tanzania discussed in section four above.

Finally, property tax administration, especially in developing and transition economies, requires collaborative efforts across various tiers of government and different government departments.[109] The major activities in property tax administration can be the responsibilities of one or more institutions and can operate at various levels of government.[110] For example, projects such as cadastre and computerized property registration systems are naturally expensive national projects that require commitment by the central rather than local governments. The central government is additionally responsible to prepare valuation manuals, deliver training, and provide other forms of technical assistance. This is because central authorities arguably can have better human, material, and budgetary resources. Yet, the full reliance on central authorities is not feasible for local governments shall play their role and eventually assume full responsibility for property tax administration. In many jurisdictions, central and state governments can be responsible for enacting legislation and setting up administrative bodies and their functions. It is generally recognized that the day-to-day or more specific functions are best

[107] Roy Bahl, *Supra* note 75, P. 18.
[108] Interview with Habtamu Menesha, Legal Service Directorate Director, Ministry of Finance, Addis Ababa, (18 May 2022)
[109] Roy Bahl, *Supra* note 75, P. 17.
[110] *Supra* note 20, PP.23-67.

undertaken at the local level. This suggests the need to empower local governments through human and material resources to improve administration and service delivery.

Some studies associate low collection performance with governance and political factors. Lack of attention is common when the responsibility for collections is at one level by revenues are shared with the other level of government. Governments also hesitate to aggressively enforce property tax collections to keep the political flavor. On the other hand, unlike other taxes, property tax needs the existence and the synergetic cooperation of different organs (revenue department, land management, and registration department, valuation authorities, urban governance, and judicial organs) and levels of the government (federal, regional, or local).[111] These institutions should be adequately equipped with material, human and technological resources.

In Ethiopia, the role of all these organs and levels of government is well appreciated as a foundation for property tax reform.[112] It is, in particular, suggested that MoFEC and MoUID should have specific responsibilities. The synergy of the Federal, Regional and Local Urban Governments is also well noted under the draft legislation. Ethiopia has enacted a separate tax administration proclamation governing the administration of domestic taxes in general intending to render the tax administration system more efficient, effective, and measurable.[113] Once the ongoing property tax reform is completed, property tax administration including the rights and duties of taxpayers will be regulated with better effectiveness.

[111] Interview with Mulay Weldu, Tax Policy Directorate Director, Ministry of Finance, Addis Ababa, (18 May 2022).
[112]MoUDHC, Concept Note to Reform real Property Tax Legislation, (2013), PP.13 & 15.
[113] *Supra* note 85

## Concluding Remark

Ethiopia has initiated property tax reform in 2011 as part of the global post-soviet global phenomenon. The reform has the goal of modernizing the urban property valuation and taxation system across urban centers of the country. The draft and prototype legislations are already prepared and the country is planning to introduce the tax in three pilot cities namely, Dire Dawa, Mekelle, and Bahir Dar. However, the reform process has been unnecessarily delayed and contentious. At the center of this process and the legislative debate are the issues of design and administration. As already articulated in the body of this article, drafting a tax law, especially a tax on land and buildings, poses a number of challenges and frustrating questions. This study was conducted with the belief that there is a lot that Ethiopia could learn from its own past as well as contemporary property tax reforms in other countries.

The international experience is so rich that one finds diverse modalities of practice across countries in designing the key components of a property tax system such as the taxing power, tax base, tax rate, valuation and assessment, and administration. Ethiopia can draw a lot of insights from the reservoir of these experiences. The insights can be consumed at the drafting stage, in the process of enforcing, or for the purpose of amending the law. The Ethiopian practice over the decades is largely weak, yet provides a fertile space for learning from it. This study has documented the various design options and indicated the best alternatives to the context of Ethiopia based on these lessons from other jurisdictions and its own previous legislative regimes. Thus, the Ethiopian government should finalize the reforming process by drawing the hosts of insights to determine the tax base, assessment and valuation, tax rates, and exemptions.

# A Critical Legal and Practical Appraisal of Ethiopian Fault Based Liability Rules[→]

**Haile Andargie,[∂] Esubalew Amare[ϒ], Honelign Hailu[Ψ], and Abay Addis[θ]**

***Abstract***

*Ethiopia's Civil Code governing tortious liability was adopted six decades ago and is still applicable without any amendment. The basic purpose of this research is to explore the shortfalls and practical application of the Ethiopian tort law on liability arising from fault. To this effect, a qualitative research method is employed. Therefore, relevant laws are critically analyzed and data is collected by interviewing judges, attorneys, and law professors. The research findings reveal that the special part of the fault-based liability section of the Code is insufficient and does not adequately address breaches of human rights recognized under the FDRE constitution. The findings of the research also demonstrate that some of the provisions on fault-based liability are not practically applied by courts. Therefore, this article suggests an amendment to accommodate constitutional stipulations. The article also recommends extending the list of special faults to embrace emerging issues.*

---

[→] This article is the result of a research-project funded by USAID's Feteh (Justice) Activity in Ethiopia. However, the content and opinions expressed in the article are the views of the authors, and not necessarily the views of USAID.

[∂] LL.B, LL.M, PhD, Assistant Professor of Law, School of Law, Debre Markos University. The author can be reached via: haile_andargie@dmu.edu.et.

[ϒ] LL.B, LL.M, Lecturer of Law, School of Law, Debre Markos University.

[Ψ] LL.B, LL.M, Ph.D Candidate and Lecturer of Law, Debre Berhan University.

[θ] LL.B, LL.M, Lecturer of Law , Jimma University, Editor- in- Chief of Jimma University Journal of Law.

**Keywords**: Ethiopia; Tort; Fault-based liability; Special Cases; Causation

## Introduction

The life and time of individuals in an egalitarian society are typified by a multitude of, at times complex, interactions. In as much as these interactions are imperative for the sane existence of individuals, they do have their own perils. Societal interactions normally result in misdoings, faults, harms, and breaches of trust. These perils of societal interactions necessitate a remedial mechanism. As such morality, religion, custom, and law have been employed to fix the wrongs of societal interactions. That partly explains why the law is commonly understood as a social engineering device. Viewed from this vantage point, the law is a means to achieve societal goals. Consequently, one may conceive tort law as a "public standard of conduct" having two-fold goals: "deterring the most harmful and costly forms of social behavior, and indemnifying its victims."[1]

Tort law provides rules of redress that enable a victim to seek remedy in cases of breach of duty prescribed by law. Tortious liabilities normally arise by virtue of law.[2] In other words, the law fixes the duties in which infringements result in tortious liabilities, not by the parties. Oftentimes, the remedial mechanism for breach of duty in tort is an action for damages.[3] One might say the central aim of tort law is "to restore the claimant, in so far as money can do so, to his or her pre-accident position".[4]

[1] Gerald J. Postema, Search for an Explanatory Theory of Torts, in Gerald J. Postema, (ed.), *Philosophy and the Law of Torts*, Cambridge University Press,(2001),p. 4
[2] Vivienne Harpwood, Principles of Tort Law, 4th edition, Cavendish Publishing Limited, (2000), p. 1.
[3] Id., p.
[4] Id., p. 4.

Tracing its historical development, the modern tort system is a post-industrial revolution phenomenon.[5] The industrial revolution was a turning point in the development of tort law. During this period, modern means of production and machines with an enormous capacity to severely cripple workers were invented, thereby necessitating a new tort system. Highlighting the need for a new tort system right after the industrial revolution, Lawrence Friedman was quoted as writing: "[f]rom about 1840 on, one specific machine, the railroad locomotive, generated, on its own steam (so to speak), more tort law than any other in the 19th century".[6] Consequently, one can rightfully say the modern tort system emerged as a response to the perils of the industrial revolution.

In Ethiopia, the origin of the modern tort system is traceable back to the adoption of new laws in the country that is commonly called the Codification Era. The Civil Code of Ethiopia (the Code) was promulgated in 1960. The Code containing five books and 3367 articles "is the biggest body of law that regulates large areas of life in the country today."[7] Title XIII of the Code, which comprises 135 articles, regulates tortious liability and unlawful enrichment. This section of the Code identifies three sources of tortious liability.[8] The first is liability arising from a fault; wherein a person is liable if the damage is attributable to his fault. The second consists of tortious liability arising irrespective of fault. This category is commonly called strict liability as it arises irrespective of the defendant's fault. The third source comprises liability for others. This type of tortious liability makes a person vicariously responsible for the acts of another person.

[5] Mark Geistfeld, Economics, Moral Philosophy, and the Positive Analysis of Tort Law, in Gerald J. Postema, (ed.), *Philosophy and the Law of Torts,* Cambridge University Press, (2001), p. 255.

[6] Id., p. 271.

[7] Yirga Gelaw, Native Colonialism: Education and the Economy of Violence Against Tradition in Ethiopia, Red Sea Press,(2017), pp. 107 – 108.

[8] Civil Code of the Empire of Ethiopia, Proclamation No. 165/1960,*Federal NegaritGazzeta Extraordinary*, (1960), Article 2027, [hereinafter Civil Code].

As a long-standing body of law regulating fault-based liability cases in the country today, an inquiry into the practical applicability of this section of the Code is essential. In this regard, one of the practical issues in the area of fault-based liability relates to post-traumatic stress disorder (PTSD). A victim of PSTD may experience various symptoms including nightmares about the traumatic happenstance and an absence of interest in life.[9] The modern tort system comprises extensive rules of redress for victims of PSTD. However, the Code provides little to no rule governing PTSD. The other notable practical issue in fault-based liability law relates to the way the Code addresses breaches of human rights. However, a study conducted on these rules revealed that the tortious liability section of the Code is mostly impractical and inadequate to address breaches of human rights.[10]

This article analyzes the practical application of Ethiopia's fault-based liability rules, as it constitutes the principal source of liability under Ethiopia's tort law. The writers have appraised the stipulations contained in domestic legislation governing fault-based liability. In addition to a critical analysis of the relevant laws, the writers have gathered data from 9 judges, 15 attorneys, and 3 law professors through interviews and questionnaires.

Primary data is mainly gathered from the Federal First Instance Court eleven benches. These are Kirkos, Nefas Silk Lafto, Kolfiehеranio, Addis Ketema, Lideta, Yeka, Bole, Akaki Kaliti, Arada, Menagesha and Dire Dawa Benches. A preliminary survey before the study was started showed that tort cases except issues of bodily injury are the least entertained civil cases in Ethiopia. Moreover, most of the tort cases in Ethiopia are entertained by the first instance courts. According to the Federal courts proclamation number

[9] Vivienne Harpwood, *Modern Tort Law*, 7th edition, Routledge-Cavendish,(2009), pp. 38 – 39.

[10] Tilahun Gebre, Compensation of Victims of Human Rights Violations in Ethiopia in Light of International Human Rights Law: With Specific Reference to Addis Ababa and Oromia, (LL.M thesis, Addis Ababa University),(2010)

1234/2021, first instance courts have the jurisdiction to entertain cases that amounts up to a maximum of 10 million birr[11]. Reasonably, most of the tort claims especially those which involve moral compensation are below the 10-million-birr limit. Therefore, the judges from the federal first instance court benches are taken as a sample for interview. The judges of high courts and the Supreme Court were not part of the data collection plan as interviewees, except the Supreme Court cassation decisions are taken into consideration. The federal high courts and the Supreme Court mostly entertain cases through their appellate jurisdiction which is slightly out of the scope of the article. In other words, the article is basically about the sufficiency of the fault-based liability rules which makes the appellate justice less relevant to the issue of this article. The writers believe that data collected from the federal first instance court judges, attorneys all over Ethiopia and law professors from different universities are enough to draw conclusions for this study.

The article is composed of four sections. The first section briefly outlines the concept and notion of fault-based liability. The second section examines the Ethiopian law of tortious liability arising from fault. The third section assesses the practical application of the Ethiopian fault-based liability law. The fourth section provided concluding remarks.

## 1. A Brief Account on Concepts and Notions of Fault based Liability

Authors have been advancing various conceptions of tort. Vivienne Harpwood offers a picturesque description of tort. For Harpwood, "[t]ort is a broad church and many hymns, ancient and modern, can be heard within it."[12] This description of tort succinctly signifies the extensive realm and evolutionary process of tort. The "ancient hymns" of tort are said to be

[11] Federal Courts Proclamation, Proclamation No. 1234/2021, Article 11(1).
[12] Harpwood, *supra* note 9, preface.

composed in the earliest civilizations of humankind. Many propagate Mesopotamian ancients were pioneers of the concept of tort. The ancient Mesopotamian law identified some commissions and omissions as civil wrongs, thereby laying stepping stones for the ideation of tort.[13] The law of Mesopotamia addressing civil wrongs was generally concerned with "the protection of person, property, and commerce from forced divestiture of a right or a prerogative."[14] The ancient Romans also played a profound role in the emergence of the concept of tort. M. Stuart Madden in an essay titled *"Tort Law through Time and Culture: Themes of Economic Efficiency"* asserted "[r]egarding delicts or harms that were neither crimes nor grounded in contract, it became the special province of Roman lawyers and lawmakers to record and categorize a sprawling array of specific wrongs and consequent remedies."[15] These "harms that … [are] neither crime nor grounded in a contract" form the basis of tort.[16]

Many associated the emergence of the "modern hymns" of tort with the industrial revolution. According to Percy H. Winfield, the invention of industrial machinery in general and railways in particular as offspring of the industrial revolution stimulated the development of the modern system of tort.[17] In his words, "[a]t that time railway trains were notable for neither speed nor for the safety. They killed any object from a Minister of State to a wandering cow, and this naturally reacted upon the law."[18] Hence, the emergence of modern means of production and machinery with a devastating

[13] M. Stuart Madden, Tort Law through Time and Culture: Themes of Economic Efficiency, in M. Stuart Madden, (ed.), *Exploring Tort Law*, Cambridge University Press, (2005), p. 22.
[14] Id., p. 23.
[15] Id., p. 34.
[16] Id., pp. 34-35.
[17] Id., p. 40.
[18] Id.

capacity to cripple workers during the industrial revolution necessitated a new tort system.

Writers generally identify two broad functions of tort law: compensation and deterrence. Emphasizing the compensatory function of tort law, Winfield and Jolowicz wrote: "[i]n the great majority of tort actions the claimant is seeking monetary compensation (damages) for the injury he has suffered, and this fact strongly emphasizes the function of tort in allocating or redistributing loss."[19] Mark Geistfeld augmented this function of tort law by describing its central aim as restoration of "the claimant, in so far as money can do so, to his or her pre-accident position".[20] Others prefer to conceive tort law as "public standard of conduct" having "deterring the most harmful and costly forms of social behavior" as overriding function.[21] Nevertheless, these two functions of tort law are not mutually exclusive. Commenting on the conceptual and historical interplay between these two functions of tort law, Mark Geistfeld in an essay titled *Compensation as a Tort Norm* wrote:

> *By the middle of the twentieth century, scholars had reached a consensus that "tort law ought primarily to be a means for compensating injured people" rather than "an instrument for admonishing currently undesirable civil conduct." Since then, scholars have coupled the function of compensation with that of deterrence, yielding "the baseline proposition . . . repeated at the outset of countless law review articles published in the last fifty years" that "the function of tort law is to compensate and deter."*[22]

[19] Edwin Peel and James Goudkamp, *Winfield and Jolowicz on Tort* ,19th edition, Thomson Reuters and Maxwell, (2014), p. 1-028.
[20] Id., p. 1-002.
[21] Postema, *supra* note 1, p. 4.
[22] Mark Geistfeld, Compensation as a Tort Norm, in John Oberdiek, (ed.), *Philosophical Foundations of the Law of Torts,* Oxford University Press,(2014), p. 66.

Hence, historically, the function of tort law was confined to compensating persons who sustained an injury; and the place of deterrence as a function of tort law was infinitesimal. But modern tort systems are principally set to compensate injured persons; and at the same time, deter harmful social behaviors.

## 2. Ethiopia's Law on Fault-based Liability

According to the Ethiopian law of tort, a person may be extra-contractually liable if he is at fault. A fault is a type of liability in which the plaintiff must prove that the defendant's conduct was either negligent or intentional.[23] Faulty conduct or offense is a piece of conduct that would not have been pursued by a prudent person placed in the same external circumstance as the author of damage.[24] The prudent person for sociologists is what lawyers call a "*reasonable man"*. However, the Ethiopian law of extra-contractual liability nowhere defines fault. Rather, it chooses to describe the elements of fault instead of defining fault. Basically, the general principle is envisioned under article 2028 of the Code which reads "whosoever causes damage to another by an offense shall make it good." Some conditions must be cumulatively fulfilled for the tortfeasor to be held liable under tortuous liabilities arising from a fault. Firstly, his faulty conduct must be shown. This element tends to be the duty of care though not clearly indicated under Article 2028. Secondly, there needs to be a causal link between the defendant's faulty conduct and the damage sustained by the plaintiff. Causation is set to determine whether the defendant's failure to meet the applicable standard of care is casually connected to the plaintiff's harm.

[23] Civil Code, *supra* note 8, Article 2029.

[24] YohannesTakele, Note on Ethiopian extra-contractual liability law, Lecture at Addis Ababa University School of Law,(2003-2007) available at https://www.studocu.com/en-us/document/university-of-maryland-global-campus/torts/lecture-note-on-tort-law-specifically-on-ethiopian-extra-contractual-law-by-yohanes-tekle/6889484 (accessed Feb. 20, 2022).

As dealt with in detail below, unless otherwise provided by law, the Ethiopian legislator makes use of an objective criterion in the determination of the defendant's fault without taking into account such subjective parameters like age or mental condition.[25] Some tend to argue that this position of Ethiopian legislator is too harsh. This is because; it is not a fault-based liability, but strict liability at the level of minors and mentally deficient persons. Others argued that such a position is taken by the legislator in order to strike a balance between the minor wrongdoer and the innocent victim.[26]

When it comes to the structural arrangement of the provisions regulating tortuous liability arising from fault, Ethiopia has borrowed concepts from both civil law and common law legal systems. While articles 2028 to 2037 of the Code set the general rules, articles 2038 to 2065 are meant to regulate special cases of fault. The civil law legal system tries to regulate every factual circumstance in terms of reasonable person standard, reasonable professional standard, or presumption of fault.[27] Not every misdeed that may result in fault-based liability is listed, as is the case in Article 2038 of Ethiopian extra-contractual liability law. On the other hand, the common law legal system specifies every source of liability like criminal law.[28] Articles 2038 to 2065 of the Code are partly structured in line with the common law approach, which specifies the sources of fault-based liability. These provisions are designed to protect constitutionally guaranteed fundamental rights. However, the Civil Code was enacted before the coming into effect of the 1995 FDRE Constitution and the ratification of international human rights instruments. This means investigation as to the viability of the Civil Code concerning the

[25] Civil Code, *supra* note 8, Article 2030(3).
[26] Yohannes, *supra* note 24.
[27] Id.
[28] Id.

enforcement of human rights standards recognized under the Constitution and international human rights treaties is required.[29]

The rules governing fault-based tortious liability provided intention and negligence as important elements. Article 2029 (1) of the Code clearly declares that "an offense may consist in an intentional act or mere negligence". Nonetheless, the Code refrains from elaborating on what constitutes intention or negligence. On top of that, decisions of courts (including the decision of the Cassation Division of the Federal Supreme Court) fail to provide a jurisprudential explanation of negligence as an important aspect of the mental element in fault-based liability. This entails that the meaning, scope, and requirements of negligence are left to the subjective determination of judges. With this backdrop, the meaning and essence of intention and negligence can be inferred from Articles 58 and 59 of the Criminal Code. Unlike criminal law, intention and negligence in the case of extra-contractual liability are simply alternatives. Both of them may equally result in extra-contractual liability. This makes extra-contractual liability different from criminal liability as the major concern for criminal law is punishing criminal intention. Hence, reference to criminal law cannot give a full picture of the notion of intention and negligence in the context of tortuous liability.

## 3. Practical Application of the Ethiopian Fault-Based Liability Law

### 3.1. Raison D'être and Functions of Ethiopian Tort Law

One can hardly find explicit provisions of the Ethiopian tort law that provides for its raison d'être and functions. However, interpretive reading of some provisions sheds light on the raison d'être and its functions. As far as the raison d'être is concerned, the close reading of Articles 2027(1), 2028, and

[29] As explained below, this research reveals serious incompatibility between the two.

2030 seems to suggest that the drafters of the Ethiopian Civil Code have intended to attribute accountability to a person who causes damage to another person as a result of his faulty behaviour. By so doing, the Ethiopian tort law considers fault or offense as a failure on the part of the wrongdoer to live with the moral standard expected of a reasonable person.[30] The Ethiopian legislator's intent to ensure the morally blamed defendant's accountability for his or her moral failure went to the extent of disregarding subjective considerations in the assessment or determination of fault. According to Krzeczunowicz, this approach taken by the drafters of the Ethiopian Civil Code is unusual and quite different from the experience of many other legal systems.[31] Empirical data collected from the participants of the study seems to show a lack of consensus in this respect. Some support the position of the law that an offense should be determined without taking into account the subjective conditions of the wrongdoer. They justify their stand based on the argument that the primary purpose of tort law is to compensate the innocent victim not to protect the wrongdoer whether or not the latter is in a position to appreciate the consequences of his conduct because of his infancy or insanity.[32] On the other hand, some other participants contend that the law was supposed to take into account the subjective conditions of the wrongdoer while determining fault and the approach taken by the legislature under Article 2030 needs some kind of revision.[33] This group of people tried to justify their position by making an analogy with the criminal law that excludes responsibility for those who may not be able to understand the

[30] Civil Code, *supra* note 8, Article 2030(1) cum. Article 2030(2).

[31] George Krzeczunowicz, *The Ethiopian Law of Extra-contractual Liability*, (1970), p. 36.

[32] Interview with Dawit Bezabih, Judge, Federal First Instance Court, Akakai Kaliti Bench, (May 12, 2022); Interview with Iyasu Mesfin, Lecturer of Law, Jimma University, (May 12, 2022).

[33] Interview with Daniel Abebe, Judge, Federal First Instance Court, Menagesha Bench, (May 12, 2022).

consequence of their acts because of their age or mental condition.[34] However, the researchers are of the view that the reason d'etre of the Ethiopian tort law shall mainly focus on redressing the victim, and thus the fault of the wrongdoer should be assessed objectively.

### 3.2. The Establishment of Causation

Although causation is an important element in establishing the required causal link between the defendant's faulty conduct and the damage that ensued as a result of such conduct, the Ethiopian law of extra-contractual liability provides little or no guidance as to its meaning and scope. However, the cumulative reading of Articles 2091 and 2101 provides a clue that the defendant can be liable for unforeseeable damage caused to the plaintiff subject to the possibility of a reduction of compensation. Moreover, sub-article 2 of Article 2101(2) provides that the reduction of compensation does not apply to damage caused by an intentional fault. This implies that causation is a requirement in the establishment of liability based on fault

As Krzeczunowicz clearly provided, the experience of other legal systems suggests that the conduct which caused harm to the plaintiff needs to be adequate in fact and in law for the defendant to be held liable and the defendant could raise the inadequacy of the causal link as a defence.[35] Showing the adequacy of the cause would have practical relevance where there is an intervening cause that resulted in the greater damage while the initial cause in itself cannot under the normal course of things result in that damage or where multiple causes are contributing to the result the damage sustained by the plaintiff. Therefore, the Ethiopian tort law fails to sufficiently cover these and similar issues related to causation. In such circumstances, resorting to the criminal code's provision on causation will not be a matter of

[34] Id.
[35] Krzeczunowicz, *supra* note 31,pp. 134-135.

choice and Krzeczunowicz claimed that such resort is warranted by virtue of Article 101 of the Criminal Code read together with Article 2035 of the Civil Code.[36]

The practice of courts regarding the establishment of causation shows that causation is taken for granted or as though it is given. This appears to be related to the fact that there are no such complicated cases brought to courts requiring detailed analysis and interpretation of causation.[37]Krzeczunowicz also contemplated the rare occurrence of complicated cases related to causation and he stated "in the run-of-the-mill cases, the occurrence of damage and its causation is sometimes so obvious that the courts do not analyse them distinctly, but stress only the problems of fault and compensation".[38] The only real experience mentioned by the judges concerning causation is related to the application of Article 2084 that provides about the collision between motor vehicles where in such cases the law makes the presumption that both motor vehicles have contributed to the accident and the owner of each motor vehicle will be responsible for half of the damage caused.[39] However, the application of such provision is limited to liability irrespective of fault cases, only between two motor vehicles that collided with each other (it fails to regulate scenarios where more than two motor vehicles are involved in the collision) and where it appears difficult to ascertain the

[36] Id. Of course, Krzeczunowicz refers to Article 100 of the repealed Penal Code of 1957and this provision is more or less similar to Article 101 of the 2004 Criminal Code of the FDRE. Compared to the Criminal Code, the 1957 Penal Code provided detailed explanations about joining claims for civil and criminal liability together where the latter resulted in damage for compensation including the procedure to be involved in this respect.

[37] Interview with Judge Dawit, *supra* note 31; Interview with Judge Daniel, *supra* note 33.

[38] Krzeczunowicz, *supra* note 31, p. 63.

[39] Interview with Judge Dawit, *supra* note 32; Interview with Judge Daniel, *supra* note 33.

fault of either of the drivers.[40] Despite the non-appearance of cases related to causation that tested judges so far, the judges have realized the insufficiency of the Ethiopian law of extra-contractual liability. In such cases, they contend for reference to the criminal code's provision on causation.[41] However, they did not clearly indicate whether they have actually applied the criminal code's provision on causation to deal with tort cases brought before them so far. Hence, it can be safely concluded that there exists a clear legal and practical gap related to causation under the Ethiopian tort law.

### 3.3. Substantive Scope of Fault-based Liability

The general rules of fault-based liability run from Articles 2028- 2037. As general rules, Articles 2028-2037 will apply to all possible scenarios of fault-based liabilities even though there is no infringement of specific provisions of the law (as provided under Article 2035) or the particular offense is not covered by the "Special Cases" provisions of the fault-based liability (Articles 2039-2065). That means the strict application of the principle of legality in criminal law does not work for fault-based extra-contractual liability.[42] The main focus of this article is on some of the general provisions. These are the type of offenses[43], the reasonable person standard on the assessment of fault[44], professional fault[45], and infringement of the law as an offense (fault)

[40] As Article 2084(3) of the Civil Code provides where the collision has resulted from the fault of either driver entirely or chiefly, only the driver at fault or the owner of such vehicle will be held liable.
[41] Interview with Judge Dawit, *supra* note 32; Interview with Judge Daniel, *supra* note 33.
[42] Krzeczunowicz, *supra* note 31,p. 65.
[43] Civil Code, *supra* note 8, Article 2029.
[44] Id., Article 2030.
[45] Id., Article 2031.

as they are principal sources of tort-based liabilities[46]. It also touches upon a few provisions of the "Special Cases" (Articles 2038-2065).

### 3.3.1. Type of Offence

As provided under article 2029 of the Civil Code, a person will be at fault when he/she commits an act or fails to commit an act either intentionally or out of negligence.The Ethiopian tort law nowhere defines what constitutes an intentional fault or negligence. As a result, it is very much open to the discretion of judges to determine whether the particular offense is intentional or negligence based. From the interview with judges of the Federal First Instance Court (FFIC) and law professors, it is learned that the law was supposed to provide guidance that enables judges to determine what constitutes intentional fault or negligence.[47] As far as negligence is concerned, it is important to make a distinction between negligence by an ordinary person under Article 2029 (who may be judged in light of the reasonable person standard under Article 2030) and negligence by a professional (whose negligence or otherwise will be determined by having regard to the reasonable professional in his/her stead) by taking into account the professional standards and practices within the specific profession at hand. However, there appears to be confusion in this respect where the driver's fault as a result of negligence may be assessed based on the reasonable person standard (Article 2030) instead of the reasonable driver's standard (Article 2031).[48]

In this regard, it is important to make a distinction between intentional fault or intention that simply shows the doer of the act has actually intended to do that particular act amounting to a fault (e.g. the intentional contact with another

[46] Id., Article 2035.

[47] Interview with Fistum Herpassa, Judge, Federal First Instance Court, Dire Dawa Bench, (May 6, 2022); Interview with Tsegaw Bahiru, Lecturer of law, Debre Berhan University, (May 28, 2022); Interview with Iyasu Mesfin, *supra* note 31.

[48] Interview with Judge Dawit, *supra* note 32.

person against the latter's will that amounts to physical assault under Article 2038) and the expressions such as "intent to injure" or "intentional fault" referred in various fault based liability provisions of the Code. In the latter's case, their absence or presence may be invoked to establish or exclude liability. It could also be invoked for the reduction or increase of damages.[49] However, as the interviews with judges have revealed, the difference and practical relevance of such expressions don't seem to be appreciated by courts in the real disposition of cases.

### 3.3.2. The Objective Assessment of Fault

The Ethiopian tort law determines fault objectively regardless of the subjective conditions of the wrongdoer including his/her age and mental conditions. Article 2030(2) of the Civil Code provides that regard shall only be made to the reasonable person standard so that any conduct that deviates from this standard constitutes fault irrespective of the condition of author of the wrongful conduct. Krzeczunowicz provides three possible policy reasons to explain the strict approach taken by the Ethiopian legislator in the objective determination of fault. These policy reasons include the practical need to solve tort cases by courts expeditiously which would be otherwise hampered when courts delve into the assessment of subjective situations of the defendant, the need to make life predictable for society, and to make sure that everyone relies on other members of the society will adhere to certain average conduct, and that justice requires the need to protect an innocent victim over a morally blameless harm doer.[50] Compared to many other legal systems which supplement the objective (social standard) with subjective (moral) factors in the assessment of fault, the Ethiopian legal system is said to be harsher by adopting the strictly objective assessment of fault while showing its lenience when it comes to the determination of the compensation by taking into

[49] Krzeczunowicz, *supra* note 31, p. 66.
[50] Id., pp. 35-36.

account subjective considerations (including age and mental condition of the wrongdoer).[51]

The objective assessment of fault under Article 2030 is a subject of controversy among academics and practitioners. From the interview with judges and professors as well as the questionnaires filled by selected attorneys of law, it can be said there exist different views. Those who argued that the drafting of the existing provision of the law is appropriate supported their argument on the fact that the main purpose of tort law is to compensate the innocent victim irrespective of the subjective conditions of the defendant causing harm to such victim. This group of people further argued that unless the law put such strict requirements in the assessment of fault the number of people left uncompensated will be higher and that might lead to uncertainty and even social chaos.[52] On the contrary, the other group strongly argues that the law should be crafted in such a way that exempts some categories of persons like minors and the insane who are unable to meet the objective standard of the reasonable person under Article 2030.[53] In between the two, some people argue that the law as a matter of principle should determine fault objectively while providing some discretion to courts that enable them to also take into account subjective considerations by way of exception.[54]

### 3.3.3. Professional Fault under the Ethiopian Tort Law

While the Ethiopian tort law provides the assessment of fault based on the reasonable standard person under Article 2030, it provides another level of

[51] Id.
[52] Interview with Judge Dawit, *supra* note 32; Interview with Iyasu, *supra* note 32; Interview with Daniel Mekonnen, Judge, Federal First Instance Court, Nifas Silik Bench, (May 10, 2022).
[53] Interview with Judge Daniel, *supra* note 33.
[54] Interview with Fasika Aberra, Judge, Federal First Instance Court, Lideta Bench, (May 11, 2022).

assessment when it comes to the assessment of fault by a professional. A professional fault is assessed in accordance with Article 2031 by taking into consideration the professional standards or rules applicable to that specific profession. Professional faults entailing extra-contractual liability are difficult to visualize outside contractual relationships as they are most likely to be incurred by a professional having a valid contractual relationship with his/her clients when the former breaches his professional duty as directly or impliedly specified in the contract. The common professional fault instances resulting in extra-contractual liability are incurred by drivers of motor vehicles and in the case of employers' vicarious liability for their employees.[55] The application of Article 2031 could also overlap with Article 2035 where a professional violates the rules or standards explicitly regulated by law or regulation, the professional will be held liable for the violations of that specific provision of a law or regulation under Article 2035 without the need to show his/her fault ensued by the failure to observe the practices governing that activity or profession.[56]

Despite providing the legal basis for professional fault and the resulting extra-contractual liability arising from such fault under Article 2031, the Ethiopian tort law nowhere provides the meaning of important terms used under this provision including what constitutes a profession, professional activity, scientific facts, and accepted rules of the practice of one's profession. This would leave the courts with no guidance in the interpretation of such terms and by so doing the law paves the room wide open for the subjective interpretation of such terms by judges. Moreover, by failing to put certain requirements as to what constitutes a profession or a professional, it is quite possible for anything claimed to be a profession or for anyone claiming to be a professional. Although the Federal Supreme Court Cassation Division has

[55] Krzeczunowicz, *supra* note 31, p. 77.
[56] Id., p. 78.

tried to indicate the application of Article 2031 concerning certain professional faults (for example in the medical field)[57], the judicial decisions are far from providing an adequate jurisprudential explanation of the above issues related to the professional fault. The rare occurrence of cases related to a professional fault (except in those cases related to a motor vehicle which are primarily involving the strict liability of the owner while the driver could be held liable for failing to observe the rules of the profession by way of Article 2035 or 2031) has actually contributed to the lack of well-developed jurisprudence concerning professional fault.[58]

### 3.3.4. Infringement of the Law as Fault

Article 2035 clearly provides that infringement of the law by/in itself is fault or offense without the need to prove the existence of fault on the part of the defendant. This provision is significant as it provides a remedy for the one who alleges that he/she has sustained damage as a result of the defendant's violation of the specific law which by virtue of Article 2035 constitutes a fault. Article 2035 covers all possible violations of any law irrespective of its nature or author or the purpose to which the law is destined. The fact that the scope of application of Article 2035 is so wide to include the infringement of all relevant laws as a fault has also practical significance to hold the defendant in violation of an international treaty[59] and to provide the plaintiff with the opportunity to avail him/herself of the remedy available in such international instrument that may not be otherwise available in other domestic laws. By so doing, the Ethiopian tort law's incompatibility to contemporary developments

[57] See for instance *Hayat Hospital v. W/ro Aster Solomon*, Federal Supreme Court Cassation Decision, File No. 96548, Sept., 24, 2008 E.C.

[58] Interview with Judge Dawit, *supra* note 32.

[59] See Constitution of Federal Democratic Republic of Ethiopia, Proclamation No.1/1995, *Federal Negarit Gazeta*, (1995), Article 9(4), [hereinafter FDRE Constitution]. By virtue of this provision, treaties ratified by the HPR are integral part of the law of the country.

(for instance human rights instruments ratified by Ethiopia) can be somehow dealt with.

Despite this, the infringement of some laws is also excluded from the application of Article 2035. For instance, laws related to contract are excluded from the application of Article 2035 by virtue of Article 2037 while the application of Article 2035 is also excluded where the specific legislation provides a remedy for the violation of its provision in which case the plaintiff can only avail himself/herself of the remedy provided by that specific law rather than invoking Article 2035. Obviously, Article 2035 will not also be applied where the defendant's fault arises from the violation of the "special cases" provisions (Articles 2038-2065) as well as where the plaintiff's claims are based on Articles 2030-2033.[60]

When one looks into the contents of Article 2035 of the Civil Code, it contains some imprecise terms that are vulnerable to subjective interpretations by judges. For instance, it has used the term "specific and explicit provision" which leads to different interpretation in the absence of guiding rules or principles that helps courts to determine the specific and explicit nature of the relevant provision of the law. Besides the lack of clarity on such terms, the application of Article 2035 needs also to be seen in accordance with the existing Federal system of the country that has created a plurality of laws and a federal-state structure where both levels of the government have their own legislative power.[61]

As far as what constitutes law at the federal level is concerned, Proclamation No.3/1995 provides that "all laws of the Federal Government shall be published in the Federal *Negarit Gazeta*".[62] Moreover, it is also provided that

[60] See Krzeczunowicz, *supra* note 31, p. 98.
[61] See FDRE Constitution, *supra* note 59, Article 50(2).
[62] A Proclamation to Provide for the Establishment of the Federal Negarit *Gazeta*, Proclamation No. 3/1995,*Federal Negarit Gazeta*, (1995), Article 2(2).

"all Federal or Regional legislative, executive and judicial organs, as well as any natural or juridical person, shall take judicial notice of Laws published in the Federal *Negarit Gazeta*".[63] According to the cumulative reading of these provisions, subsidiary legislations made by the executive (such as directives or manuals) which are not published in the Federal *Negarit Gazeta* are not laws and therefore the infringement of such laws will not constitute fault within the meaning of Article 2035. This interpretation does not seem to be compatible with Article 2035 which clearly provides that law includes administrative directives or regulations. By the same token, the decisions of the Federal Supreme Court Cassation Division, which serve as a precedent on all lower levels of courts, will not also constitute law within the meaning of Article 2(2) and 2(3) of Proclamation No.3/1995 since such decisions are not published in the Federal *Negarit Gazeta.*[64]

Of course, the requirement of publication of laws in the Federal *Negari Gazeta* has some important purpose to serve (the requirement of notification). It is only in such circumstances that persons can have access to such laws and the principle of "ignorance of the law is no excuse" incorporated under Article 2035(2) of the Civil Code should work. Therefore, it can be said that the government owes the duty to make laws accessible to all among other things through publicizing in the Federal *Negarit Gazeta*. However, practically, it is only Proclamations enacted by the House of Peoples' Representatives and Regulations made by the Council of Ministers that are published in the Federal *Negarit Gazeta.*

The Federal Administrative Procedure Proclamation No.1183/2020 has also provided that any administrative directive that fails to fulfil the requirements of filing by the Federal Attorney General and posting on the Administrative

[63] Id., Article 2(3)
[64] Federal Courts Proclamation, Proclamation No. 1234/2021, Federal *Negarit Gazeta*, (2021), Article 10(2).

Agency's website may not be enforced.[65] This means that the violation of a directive issued by an administrative agency may not amount to a fault where such a directive fails to fulfil such legal requirements. Therefore, the above and similar theoretical and practical problems could be invoked in relation to the application of Article 2035 of the Civil Code and legislative reforms related to this provision should take into account these concerns. Provided that Article 2035 is the most frequently invoked and applied provision of the Ethiopian fault-based tort law, its revision and amendment require serious attention.[66]

### 3.3.5. The "Special Cases of Fault"

The special cases are categorized into fault on one's person and injury to the rights of spouses, a fault against property, and fault against other economic interests.

#### i) Fault on One's "Person" and Injury to the Rights of Spouses

Fault on one's person is one of the oldest forms of wrongdoing for which claimants would be able to obtain a remedy from the English courts.[67] These include physical assault (battery), interference with the liberty of another person, and defamation. According to Article 2038(1) of the Civil Code, "a person commits an offense [of physical assault] where he intentionally makes contact with the person of another against the latter's will." Intentions, making personal contact or contact by use of an animate or inanimate object, and against the victim's will are the main elements of physical assault under the

[65] See Federal Administrative Procedure Proclamation, Proclamation No. 1183/2020, Federal *Negarit Gazeta*, (2020), Article 18(1).

[66] According to the interview with Judge Dawit, *supra* note 32, Article 2035 of the Civil Code is a stipulation that applies to a considerable number of cases related to fault-based extra-contractual liability.

[67] Nicholas J. McBride and Roderick Bagshaw, *Tort Law*, 6th edition, (2018), p. 46.

Civil Code. However, if the defendant could not reasonably have foreseen that the plaintiff would object to his actions, or if the act was done, in a reasonable manner, in legitimate self-defence, or in the legitimate defence of another, or to safeguard the property of which the defendant is the lawful owner or possessor, or if the act consists in reasonable corporal punishment inflicted by the defendant on his child, ward, people or servant, or if the plaintiff was a dangerous lunatic whom it was necessary to restrain from doing harm, and the act was done in a reasonable manner, or if in the eyes of a reasonable person, the circumstances of the defendant's action can be justified, then no physical assault is deemed to be committed.[68] Corporeal punishments on a ward, pupil, or servant are clearly unconstitutional and hence this justification cannot be presented to a court which makes this provision of the Civil Code invalid and as such there is a need for amendment.

But, even though, pursuant to the constitution, every child has the right to be free from corporeal punishment in schools and in institutions responsible for the care of children,[69] it is not clear to what extent the punishment is prohibited. The constitution is silent about corporeal punishment by parents which is open to interpretation as reasonable corporeal punishment by parents is somehow allowed. To what extent a corporeal punishment is reasonable is another question worth asking. Since the provision is not clear in this regard, there is a possibility of confusing judges to decide on this matter. The criminal law puts the parental relationship, parental guidance, and reasonable corporeal punishment as a defence for criminal liability.[70] Criminal law is adopted after the adoption of the FDRE Constitution and, therefore, we can conclude that reasonable corporeal punishment is a justification for parents to be free from the liability of physical assault. According to Judge Daniel Mekonnen, it is

[68] Civil Code, *supra* note 8, Article 2039.
[69] FDRE Constitution, *supra* note 59, Article 36(1) (e).
[70] Interview with Judge Daniel, *supra* note 33.

possible to interpret reasonable corporeal punishment by parents as a defence for physical assault. The law should be as clear as possible in this regard so as to avoid confusion.

A person commits an offense of 'interference with the liberty of another' or false imprisonment if he prevents the victim from moving about without due legal authority even for a brief time and notwithstanding that no injury is done. However, if the defendant has authority conferred upon by law and imposed confinement in a reasonable manner if the plaintiff is reasonably suspected of a crime and a 'citizen arrest' happens, and if the defendant is a bailer that confines the plaintiff because he has a good reason to believe that he is preparing to abscond, then the law does not make the defendant liable for the tort of false imprisonment.[71] From the pieces of literature about the tort of interference with the liberty of another and the practices assessed, it is safe to conclude that this part of the Civil Code does not have problems.[72]

According to Article 2044 of the Civil Code, the false claim should make another living person detestable, contemptible, or ridiculous and jeopardize his credit, his reputation, or his future to find someone liable for defamation. Absence of intent to injure, when an opinion is expressed on matters of public interest, when the alleged facts are entirely true or when he has immunity, and when the utterances are made in parliamentary debates or in the course of legal proceedings are stipulated as defences.[73] An offense of defamation is in between the two rights: the freedom of expression and protection of the reputation, honour, and dignity of others. Both rights are constitutional rights.[74] If one exceeds the freedom of expression, then there is a possibility

[71] Civil Code, *supra* note 8, Articles 2041-2043.
[72] From the interviews of judges about what the commonly entertained cases, no one says false imprisonment is one of them.
[73] Civil Code, *supra* note 8, Articles 2045-2049.
[74] Article 24 of the FDRE Constitution says everyone has the right to respect for his human dignity, reputation and honour. Article 27(5) also provides the freedom of

of committing defamation. The question that remains here is what is the demarcation line between freedom of expression and defamation which the Ethiopian tort law needs to define defamation with respect to the relatively new concept of the right to freedom of expression as embodied in the FDRE Constitution.

Injury to the rights of spouse is the other tortious fault in which someone induces the spouse of another to leave that other spouse. Receiving, harboring, or detaining a married woman against the will of her husband in full knowledge of the husband's opposition constitutes an offense of injury to the rights of spouses.[75] The practical assessment with regard to this issue shows that injury to the rights of spouses is not as common as in other tort cases. Irrespective of the practical reality, the Ethiopian Civil Code on this part is designed in a way that the husband is the head of the household. The law does not have an answer if a person receives, harbors, or detains a husband against the will of his wife in full knowledge of the wife's opposition. The fact that applies to a husband should also apply to a wife since according to the Revised Family Code, the husband is not the sole head of the family as opposed to what was provided under the 1960 Civil Code. The law in this regard should be updated.

### ii) Fault against Property

Trespass is an assault on immovable property: land and house. The Civil Code provides: "[a] person commits an offense [of trespass] where, without due legal authority, he forces his way on the land or into the house of another, against the clearly expressed will of the lawful owner or possessor of the land

expression. The freedom of expression has limitations as prescribed by law and when necessary for protecting public safety, peace, health; education, public morality or the fundamental rights and freedoms.

[75] Civil Code, *supra* note 8, Article 2050.

or house."[76] Who can be the victim of trespass to land in the Ethiopian context? According to FDRE Constitution, individuals can only have possessory or holding right in both rural and urban land.[77] Thus, possession or holding right over the land is enough to fulfil one of the elements of trespass. However, since the tort law is outdated in this regard, it has to be amended to be consistent with the FDRE Constitution and to apply it without confusion.

As per article 2054 of the Code, a person commits an offense where, without due legal authority, he takes possession of property against the clearly expressed will of the lawful owner or possessor of the property. Actual damage of goods, use of goods, or moving goods from one place to another are conducts that constitute elements of assault on property. The Civil Code does not seem to have a problem in this regard.

### iii) Fault against Other Economic Interests

If a person arbitrarily abandons his intention of entering into a contract and if the potential contracting party incurs damage due to that, the tort law considers it as an offense.[78] Moreover, as per Article 2056 of the Civil Code, entering into a contract with a person with full awareness of an existence of a previous contract and making the previous contract impossible to be performed is an offense. These tort issues are rarely brought before Ethiopian courts[79] and though the provisions are clear, it is hard to assess the sufficiency of these provisions from the practical standpoint.

Unfair competition law is primarily made up of torts that cause economic harm to a business through deceptive or wrongful business practices. The

[76] Id., Article 2053.
[77] FDRE Constitution, *supra* note 59, Article 40.
[78] Civil Code, *supra* note 8, Article 2055.
[79] Out of all the data collected from several judges, only one judge: Judge Fitsum asserted that cases related to pre-contractual negotiations are brought before his bench.

Civil Code makes a reference to acts compromising the reputation of a product or the credit of a commercial establishment through false publications or by other means contrary to good faith as acts that constitute an offense of unfair competition.[80] There are many ways in which an offense of unfair competition might be expressed. The law specifically puts false publications as one of the means to compromise the reputation of a product or the credit of a commercial establishment. The law on this should include some details so as to govern contemporary matters of unfair competition.

An offense of false information is committed if a person supplies false information to another knowing that the person would act according to the information supplied or when he has a professional duty to give true information.[81] False information can be written or verbal statement or representation of the fact that is false and was made intentionally, knowingly, or without taking reasonable steps to determine whether or not the information was true, and that information harms the victim's interests. Incurring damage due to false information from the side of the victim is another basic element of the offense. The Ethiopian law on this issue is clear.

In summary, from the practical standpoint, generally, there is a view that the Civil Code which deals with fault-based liability is sufficient to entertain the cases commonly brought before the courts.[82] The argument for this conclusion is that the law provides principles in some provisions like Articles 2027-2029 and 2035 and it is possible to apply those provisions to any case brought before courts by interpreting[83], applying through analogy,[84] and using

[80] Civil Code, *supra* note 8, Article 2057.
[81] Id., Article 2059.
[82] Most of the judges say that they don't face any problem in implementing the law to the cases brought before them.
[83] Interview with Judge Daniel, *supra* note 33; Interview with Judge Fitsum, *supra* note 47.

the cassation bench's interpretation of vague provisions.[85] However, there are also arguments that say the law is not sufficient from different viewpoints. The first reason that makes the law insufficient is the type of offense. False imprisonment is one of the offenses that need detailed dealing by the law.[86] Additionally, even though interpreting the general principles and applying them to any case seems a way to deal with the sufficiency of the law, this might create a bigger problem. The decision of the judges would be/is subjective and hence different judges give different decisions on issues that are virtually the same. Therefore, actions that are considered as fault should be included in the law in a detailed fashion.[87]

## Conclusion

Tort laws play a paramount role in societies where misdoings, faults, harms, and injuries are rampant. In Ethiopia, liability arising from fault constitutes the core source of tortuous liability. The rules regulating liability arising from fault are chiefly contained in the Code that has been in use for the last sixty-plus years. The aim of this study was to examine the legal and practical application of Ethiopia's law of tortious liability arising from fault. The section of the Code on fault-based extra-contractual liability is structured as general rules and special cases. However, both the general and special parts of the Code suffer from some limitations. Pertaining to the general part, the establishment of causation under Ethiopia's tort law is found to be inadequately addressed. That is, in spite of the fact that causation is a crucial element in establishing the required causal link between the tortfeasor's faulty

[84] Interview with Hussien Shiferaw, Judge, Federal First Instance Court, Addis Ketema Bench, (May 7, 2022)
[85] Interview with Tsegaye Lombabo, Judge, Federal First Instance Court, Kirkos Bench, (May 11, 2022)
[86] Interview with Judge Hussien, *supra* note 84; Interview Judge Fitsum, *supra* note 47.
[87] Interview with Judge Fasika, *supra* note 54.

conduct and the damage that ensued as a result of such conduct, Ethiopia's tort law provides little to no guidance as to its meaning and scope.

Besides, professional fault and infringement of laws form consequential parts of Ethiopia's law on fault-based liability. Nonetheless, these parts of the law are also found to be problematic. The provision on professional fault fails to provide a substantive scope for basic terms utilized under the very provision including profession and professional activities. Infringement of law as a major part of fault-based liability in Ethiopia is also found to be surrounded by a handful of inadequacies. First, the provision stipulating this form of liability has employed the generic term "specific and explicit provision" which could lead to different interpretations in the absence of guiding rules or principles. Second, the current federal political structure of Ethiopia results in two sets of laws: federal and state laws. Ethiopia's rule on an infringement of law cannot solve issues arising from the intricacies of the federal political structure.

With respect to the special cases of liability arising from fault, the rules on physical assault; defamation; injury to the rights of spouses; and trespass are found to be insufficient in guaranteeing the protection and enforcement of constitutional rights.

Therefore, Ethiopia's law on fault-based liability needs some amendment. As the law is found to be commendable in some respects, the task of the legislator should be confined only to filling the gaps in the law. In particular, the law ought to include explicit grounds that could help courts in establishing causation between the tortfeasor's action and the resultant harm sustained by the victim. The section on professional fault must encompass qualifications with respect to what constitutes a profession or who is a professional. In addition, the legislator needs to revisit the provision on infringement of the law in light of the current federal politico-legal structure of Ethiopia; and the

rules on physical assault, defamation, injury to the rights of spouses and trespass should be amended and made compatible with the rights and freedoms enshrined under the FDRE Constitution. The revisiting and extending the special case of fault to embrace emerging faults is also an issue worth considering.

# The Ethiopian Tort Law Vis-a-Vis Constantly Evolving Technology: An Empirical Analysis of Cyberspace and Product Defects Tort Liability.[⇓]

***Mamenie Endale[∂] &Yenew Bitew[ר]***

***Abstract***

*Book IV, Title XIII, of the 1960 Ethiopian Civil Code governs the three categories of tortious liability—fault-based liability, strict liability, and vicarious liability—and the quantum and modalities of compensation. This law has existed for the last seven decades without significant revision. Consequently, one might hypothesize that Ethiopia's vast majority of tortious liability provisions must be more responsive to contemporary development. Hence, there are efforts to incorporate tort provisions in different legislations of the country, including the 1995 FDRE constitution, the 2005 FDRE Criminal Code, the Computer Crime Proclamation No. 958/2016, the Freedom of the Mass Media, and the Access to Information Proclamation No. 590/2008 (as amended by the Media Proclamation No. 1238/2021). Despite this, legal scholarship still needs to give tort law issues the proper attention they deserve. There needs to be more research outputs and a comprehensive analysis of Ethiopian tort law. Evidence-based research and recommendations in addressing the gaps in tort law contribute to*

[⇓]This article is the result of a research-project funded by USAID's Feteh (Justice) Activity in Ethiopia. However, the content and opinions expressed in the article are the views of the authors, and not necessarily the views of USAID.

[∂] LL B, LLM, Assistant Professor , Bahir Dar University, School of Law. The author can be reached via: mamenieendale@gmail.com.

[ר] LL.B, LL.M, Lecturer of Law, Bahir Dar University, School of Law. The author can be reached at yenew.taddele@gmail.com.

*policymakers addressing existing problems and serve as input to the revision of Book VI-Title XII of Ethiopia's Civil Code of 1960 on extra-contractual liability. Accordingly, this study attempts to show the legal loopholes in Ethiopian tort law regarding cyberspace torts and product liability as a case study. A triangulation of doctrinal and empirical qualitative research approaches is employed for data collection. The researchers employed document analysis, desk review, and semi-structured interviews with the relevant stakeholders to collect primary data. The researchers consulted relevant books, journals, periodicals, reports, and newspapers as secondary data sources. The finding shows that the 1960 Ethiopian Civil Code needs to be updated to administer tort liabilities caused by cyberspace and product liability. Concerning cyberspace torts, it fails to regulate online gambling and defamation, pop-up advertising, cybersquatting, spamming, and other cybers mearing tortious liabilities. By now, cryptocurrencies in Ethiopia are operating in the gray area of the law, which results in tortious liability. It needs careful revision to regulate product defects arising from 3D printing and autonomous driving. Therefore, the study recommends reforming the existing tort law in Ethiopia to bring it up to date with emerging developments such as cyberspace torts and product defects.*

**Keywords**: Civil Code; Compensation; Cyber Security; Product Liability; Tort Law.

## Introduction

Tort law is strictly required to reflect the social, economic, and political culture of the state where it originated.[1] That is why continuous reform of tort

[1]John Goldberg et al., Tort Law: Responsibilities and Redress, ASPEN Publishers, 2004, P.40

law is the history of the developed world, especially since the 2nd half of the 20th century.[2] Historically, before the development of a comprehensive and detailed automobile liability law, courts were mechanically extending "horse and buggy law" to the automobile industry.[3] However, the rise of new technology requires courts to stretch traditional tort doctrines and create updated torts to keep pace with new civil wrongs.[4] For example, there was a lengthy "legal lag" between the widespread adoption of the new technology and the development of modern product liability, e.g., in the automobile industry.[5]

Moreover, we live in an interconnected, global digital society where the service of different operating systems is universal. The internet, including well-known websites and social media platforms such as Facebook, Twitter, Wikipedia, and YouTube, is the prime medium for communication worldwide.[6] The rapid assimilation of the internet in today's era creates maladjustments between technology and tort law.[7] The globally networked world has created new civil wrongs such as cyberpiracy, online gambling, pop-up advertising, cybersquatting[8], spamming, tarnishment through linking[9],

[2] Id., P.39.
[3] Richard M. Nixon, Changing Rules of Liability in Automobile Accident Litigation, Law and Contemporary Problems, Vol.3, 1936, P.476.
[4] Michael L. Rustad & Thomas H. Koenig, Cybertorts and Legal Lag: An Empirical Analysis, Sothern California Interdisciplinary Law Journal, Vol.13, No.1, p.77 [Hereinafter called Michael L. Rustad & Thomas H. Koenig].
[5] Id., p.78.
[6] Shakila Bu-Pasha, Cross-Border Issues Under E.U. Data Protection Law regarding Personal Data Protection, Journal of Information and Communications Technology Law, Vol.26, No.3, P.1.
[7] Michael L. Rustad & Thomas H. Koenig, *supra* note 4, p.78.
[8] "Cybersquatting" refers to the bad faith, abusive registration, and use of the distinctive trademarks of others as Internet domain names with the intent to profit from the goodwill associated with those trademarks.
[9] An example of "tarnishment through linking" is enjoining an entertainment site from using someone's trademarks as its Internet domain name.

cybersmearing[10], and dot.org hate websites for which effective legal remedies are only beginning to evolve.[11]

Furthermore, autonomous systems increasingly influence today's globalized human world.[12] Autonomous vehicles are already on the market, or they are getting closer to being deployed on public roads for the public[13]; it is tested on public roads in several countries on a large scale[14]; it has been replacing the human driver with an artificial entity.[15] Autonomous vehicles are becoming more self-reliant and independent of humans; they can park themselves with minimal human intervention, prevent accidents, and drive themselves on marketed roads with almost no human involvement.[16]

Also, the global community is a witness to some of the most dramatic and disruptive technological shifts, such as 3D printing. The 3D printing industry has dramatically expanded in the past few years, presenting a role model for growth that other industries may want to follow.[17] In principle, everything is

[10] "Cybersmearing" refers to an anonymous or pseudo-anonymous defamation on the Internet.

[11] Michael L. Rustad & Thomas H. Koenig, *supra* note 4, p.80.

[12] Ruth Janal, Extra-Contractual Liability for Wrongs Committed by Autonomous Systems, pp.174-205, In Martin Ebers & Susana Navas (Eds), Algorithms and Law, Cambridge University Press, 2020, available at https://www.cambridge.org/core. [Last accessed April 12, 2022].

[13] Nynke E. Vellinga, Legal Aspects of Automated Driving: On Drivers, Producers, and PublicAuthorities, Ph.D. Dissertation, the Universityof Groningen, 2020, available at available at https://www.rug.nl/research/portal/publications/legal-aspects-of-automated-driving(4459304c-deb4-43df-99a8- 7a677ea69530)/export.html [Last accessed April 12, 2022].. [Here in after called Nynke E. Vellinga].

[14] Id..

[15] Hin-Yan Liu, Irresponsibility, inequalities, and injustice for autonomous vehicles, Ethics Inf. Technol,Vol. 19, 2017, pp.193–207.

[16] Kyle Colonna, Autonomous Cars and Tort Liability, Journal of Law, Technology & the Internet, Vol.4, No.4,2012, pp.81-130.

[17] Samuel Alemu, 3D Printing and How it can Revolutionize Manufacturing, the Reporter, January 26, 2019, p.1[Hereinafter called Samuel Alemu].

3D printable such as consumer goods, medical devices, musical instruments, cars and car parts, and human organs. 3D printing is a disruptive innovation that is changing the landscape of business models in the manufacturing sector. 3D printers are currently available for commercial and home use. The consumer can now be a manufacturer and a retailer. A person can purchase the 3D printer, and through their skills, or the purchase or gift of a computer-assisted design file, they can now create their products for personal use or resale.[18]

In Ethiopia, 3D printing can change the face of manufacturing and provide a space for meeting the industrial production needs of Ethiopian consumers, companies, and organizations. It promises to turn Ethiopia into Africa's manufacturing hub.[19] Ethiopia is already using 3D printers for various purposes, mainly in the aerospace and automotive industries. The Boeing 787 Dreamliner Ethiopian has thirty 3D printed parts, but Boeing plans to use more 3D printed features in its aircraft. As of 2014, it has already printed over 22,000 parts for its various products. The other aircraft owned by Ethiopian Air lines, the Airbus A350 XWB, has one thousand 3D printed features. Designers of the Airbus are aiming towards printing the entire plane in one go at the press of the print button.[20]

The objective of this study is to examine whether or not the Ethiopian tort law governs cyber torts and product defects in line with the developments in the contemporary world. Specifically, this study tries to address the question: Are there any new developments in tort law that demand reform in the existing tort law, notably concerning cyberspace torts and product liability? How can

[18] Jane Nielsen And Lynden Griggs: Allocating Risk and Liability for Defective 3d Printed Products: Product Safety, Negligence, or Something New? *Monash University Law Review*, Vol 42, No 3, p.1.

[19] Samuel Alemu, *supra* note 17.

[20] See Hailemichael T. Demissie: From Manufacturing Service: Ethiopian Airlines Verging Towards 3D printing, the Reporter, August 13, 2016, p.1.

they be effectively incorporated into Ethiopian tort law? Accordingly, it will contribute to the revision of Book IV,Title XIII, of Ethiopia's 1960 Civil Code of on Extra-contractual Liability, which has been in place for the last seven decades without significant revision.

Methodologically, both doctrinal and empirical qualitative research approaches are employed. The researchers used semi-structured interviews with judges, advocates, public prosecutors, selected legal professionals from the Ethiopian Ministry of Transport, experts from some selected Ethiopian Insurance Companies, and legal experts from the Ethiopian Artificial Intelligence Authority. In addition, the researchers consulted relevant books, journals, periodicals, reports, and newspapers as secondary data sources. And content analysis techniques were employed depending on the research objectives and questions.

Structurally, the study has two parts: part one deals with cyberspace torts,and part two deals with product liability. Finally, there is a section on concluding remarks.

## 1. Cyberspace Tort

### 1.1 Meaning and Nature

In our daily lives, we entrust our personal data to various businesses to use their service or purchase from them. We submit our personal profiles to online service providers by signing up for their websites or transferring payment card data by swiping a card, inserting it into a chip slot, or paying online, in the belief that the data are securely processed. In multi-sided markets, the firms monetize the data to recover costs incurred in providing a free service or to increase profit.Some of them, however, maintain "lax security practices" such as improper managerial control, insufficient access control, absence of data encryption, and failure to install anti-malware

software or security updates.[21] These vulnerabilities increase the risk of data breaches such as unauthorized network intrusion, malware infection, theft or loss of storage media, or an insider's intentional or mistaken disclosure.[22] These data breaches may cause harm to users.

Before describing the tortious liabilities of cyber security and data security, we first need to differentiate "data security" from cyber security, which are often conflated. Data security is just one element of the broader concept of data privacy, which also relates to the collection, use, and disclosure of personal data in addition to its secure storage. Data security is not quite the same thing as cyber security either. Data security protects the personal information held by an entity, and cybersecurity protects the network's infrastructure..[23] The latter is best understood to include the integrity of the network itself and the prevention of problems like distributed denial of service attacks[24] or deployment of ransomware such as the "WannaCry bug."[25] These concepts may overlap in some cases, such as the use of a zero-day exploit to steal personal data. In other scenarios, such as a hacker deleting company documents that contain no personal data (cybersecurity only) or the theft of

[21]Sangchul Park, 'why information security law has been ineffective in addressing security vulnerabilities: Evidence from California data breach notifications and relevant court and government records', *International Review of Law and Economics,* 2019, PP.132-142, P.133[Here in after, Sangchl Park, why information security law has been ineffective in addressing security vulnerabilities]

[22] Id.

[23]Financial Industry Regulatory Authority, Report on Cybersecurity Practices (2015) available at http://www.finra.org/sites/default/files/p602363%20Report%20on%20Cybersecurity%. , [last accessed April 12, 2022] [Here in after, FINRA REPORT 2015].

[24] These typically are attacks that use botnets to overwhelm servers with traffic until they cannot function. Kim Zetter, "Hacker Lexicon: What Are DoS and DDoS Attacks?", https://www.wired.com/2016/01. [Last accessed April 12, 2022]

[25]Ian Sherr, "WannaCry Ransomware: Everything You Need to Know, CNET", available at https://wwwcnet.com/news/. [Last accessed April 12, 2022].

paper files containing personal information (data security only), they remain entirely distinct..[26]

In Ethiopia, over the course of years, a host of cyberattacks have been perpetrated on several financial institutions and other Ethiopian companies.[27] These cyberattacks appear to be indicative of a broader trend: the frequency and ferocity of cyberattacks are increasing, posing grave risks and damaging to cyber security and personal data security.[28] Thus, affected data should be subject to recovery as long as damage- amount to economic losses or emotional distress resulting from the breach. And database possessors must do anything, between the time of the breach and the moment of harm, to minimize their exposure to tort liability.

The newly emerging development Bitcoin & cryptocurrency that was created in January 2009, unlike fiat currency, is created, distributed, traded, and stored with the use of a decentralized ledger system, known as the blockchain. Cryptocurrency has its predecessors: electronic money, virtual currency, and digital currency. There is a tendency to confuse terminology among scientists: use these terms interchangeably, define one term using the other one, or describe the correlation of terms improperly. E.g., Chris Ross claims that digital currency is a form of virtual currency[29], overlooking features of virtual

[26]Edward R. McNicholas and Vivek K. Mohan, *An Introduction to the Law of Cyber Risk in Cybersecurity: A Practical Guide to The Law of Cyber Risk* 1st ed., UNKNO,2015, PP.1-14[Here in after CYBERSECURITY: A PRACTICAL GUIDE].

[27]Interview with Dawit Gebre Amannuel, CEO at Ethiopian Reinsurance S.C, on selling insurance services for newly emerging technologies to compensate tortious liability due to cyber-attack, March 29, 2022 [Here in after, Dawit, CEO]

[28]Id.

[29]Chris Rose, 'The Evolution of Digital Currencies: Bitcoin, A Cryptocurrency Causing a Monetary Revolution', online, *International Business & Economics Research Journal (IBER)*, Vol. 14, No, 4, Para., 617, available at https://www.researchgate.net/publication/297750676. [Last accessed May 6, 2022]

and digital currencies, therefore confusing the correlation between the two terms.

According to the European Central Bank, electronic money is broadly defined as an electronic store of monetary value on a technical device that may be widely used for making payments to entities other than the e-money issuer. The device acts as a prepaid bearer instrument which does not necessarily involve bank accounts in transactions. Electronic-money products can be hardware-based or software-based, depending on the technology used to store the monetary value.[30] Thus, electronic money means electronically, including magnetically, stored monetary value as represented by a claim on the issuer which is issued on receipt of funds for the purpose of making payment transactions, and which is accepted by a natural or legal person other than the e-money issuer.[31]

According to the European Banking Authority, virtual currency is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat (conventional) currency but is accepted by natural or legal persons as a means of exchange and can be transferred, stored, or traded electronically.[32] The digital currency as a broad

[30]European Central Bank "Electronic Money, available at",,https://www.ecb.europa.eu/stats/money_credit_banking/electronic_money/html/index.en.html. [last accessed April 10, 2022] [Here in after, European Central Bank "Electronic Money,]

[31]Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC (Text with EEA relevance)," https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32009L0110. [Last accessed April 10, 2022]S

[32]"European Banking Authority Opinion on 'virtual currencies'", available at https://eba.europa.eu/sites/default/documents/files/documents/10180/657547/81409b94422245d7ba3b7deb5863ab57/EBA-Op-2014-08%20Opinion%20on%20Virtual%20Currencies.pdf?retry. [last accessed June 17, 2022]

term can contain anything that digitally represents value. Digital currency includes e-money: money that is simply a digital representation of government-issued fiat currency. Digital currency can also cover virtual currency.

The takeaway from definitions given by the European Banking Authority [33], European Central Bank [34], International Monetary Fund[35], Committee on Payments and Market Infrastructures, a body of the Bank for International Settlements[36], the World Bank[37] and other institutions is that cryptocurrencies are a subset of virtual currencies. Then, the term 'virtual currencies' is defined as a "type of crypto assets, which is a digital representation of value that is neither issued by a central bank or a public authority nor necessarily attached to a fiat currency but is used by national or legal persons as a means of exchange and can be transferred, stored, or traded electronically.[38]

Again, the newly emerging, Bitcoin-a digital currency may cause tortious liability. All things considered, cryptocurrency platforms or other service providers may be held liable for cryptocurrencies' thefts or other customers' losses that occurred due to the breach of care.

[33] Id.

[34] "Virtual Currency Schemes," available at https://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemes201210en.pdf. (last accessed on May 23, 2002]

[35] Dong He et al., "IMF Staff Discussion Note. Virtual Currencies and Beyond: Initial Considerations" (Washington, DC: International Monetary Fund, January 2016): 7, available at https://www.imf.org/external/pubs/ft/sdn/2016/sdn1603.pdf. [Last accessed May 6, 2022]

[36] "Digital currencies" (Basel: Bank for International Settlements, November 2015): available at https://www.bis.org/cpmi/publ/d137.pdf. [Last accessed May 6,2022]

[37] Harish Natarajan et al., "FinTech note, no. 1: Distributed Ledger Technology (DLT) and blockchain", available at http://documents.worldbank.org/curated/en/177911513714062215/pdf/122140. [Last accessed May 6, 2022]

[38] European Central Bank "Electronic Money", *supra* 10

## 2.2 Cyberspace Tort under Ethiopian Tort Law

While Ethiopia is a state party to key international human rights treaties that guarantee the right to privacy, such as the International Covenant on Civil and Political Rights (ICCPR), it is yet to accede to any of the data protection instruments including, the Africa Union (AU) Convention on Cyber Security and Personal Data Protection (Malabo Convention).[39]

Ethiopia has laws that relate and deal directly or indirectly with cyber security and personal data security, including the 1995 Constitution of the Federal Democratic Republic of Ethiopia[40], the 2005 Criminal Code of the Federal Democratic Republic of Ethiopia[41], the 1960 Civil Code[42], the Computer Crime Proclamation No. 958/2016[43], Freedom of the Mass Media, and Access to Information Proclamation No. 590/2008 (as amended by the Media Proclamation No. 1238/2021)[44].

However, Ethiopia does not have a single and comprehensive legal instrument regulating cyber security and personal data protection. The draft Personal Data Protection Proclamation unveiled by the government in April

[39] African Union Convention on Cyber Security and personal data protection, 2014, Recalling Decision Assembly/AU/Decl.1(XIV)[Here in after, the Malabo Convention, 2014]

[40] Federal Constitution of Ethiopia, 1995, Federal Negarit gaz., Proc. No. 1, 1st year, No. 1, [Here in after, FDRE Constitution, 1995].

[41] The Criminal Code of the Federal Democratic Republic of Ethiopia, 2004, Federal Negarit gaz., Proc. No. 414, year 9, No. 34, [Here in after, The Criminal Code of the Federal Democratic Republic of Ethiopia, 2004].

[42] Civil Code of The Empire of Ethiopia, 1960, Negarit Gazzet, extraordinary issue, Proc. No. 165, , 19th year, No'.2, [Here in after, Civil Code, 1960]

[43] Computer Crime Proclamation, 2016, Negarit Gazzet, Proc. No 958, year 22, No 83[Here in after, Computer Crime Proclamation, 958]

[44] Freedom of the Mass Media, and Access to Information Proclamation, 2008, Negarit Gazzet, Proc. No. 590, year 14 No 64 (as amended by the Media Proclamation No. 1238/2021) [Here in after, Freedom of the Mass Media, and Access to Information Proclamation, 2008]

2020[45], considers salient features of the bill, including key definitions, data subject rights, conditions for lawful processing, relevant exemptions in the public interest, data breach notification requirements and the transfer of personal data across borders, as well as provisions governing the proposed national data protection authority, the data protection commissioner.[46]

The Ethiopia's Data Protection Proclamation conforms by and large to international best practices, including the Malabo Convention, the African Declaration on Internet Rights and Freedoms and the Declaration of Principles on Freedom of Expression and Access to Information in Africa. But Ethiopia's performance in ensuring respect for and protecting privacy and data protection is yet to be closely reviewed by international mechanisms, including by relevant treaty bodies and Human Rights Council's Universal Periodic Review (UPR). It shall be considered the extent to which non-governmental organizations are involved in privacy and data protection. Because privacy and data protection have, up until now, generally received little policy or societal attention in Ethiopia, such organizations are yet to flourish.

As cryptocurrency usage increases, so too do cryptocurrency regulations around the world that are put in place to govern them. The crypto landscape is constantly evolving and keeping up to date with the rules in different global territories isn't easy. While it is difficult to find a consistent legal approach at the state level, the US continues to progress in developing federal cryptocurrency legislation.[47] The Financial Crimes Enforcement Network (FinCEN) does not consider cryptocurrencies to be legal tender but

[45] Ethiopia's Data Protection Proclamation (draft), April, 2020.
[46] Id.
[47] Cryptocurrency Regulations Around The World, Available at https://complyadvantage.com/insights/cryptocurrency-regulations-around-world/. [last accessed May 24, 2022]

considers cryptocurrency exchanges to be money transmitters on the basis that cryptocurrency tokens are "other value that substitutes for currency."[48]

Cryptocurrency exchange regulations in South Korea are strict and involve government registration and other measures overseen by the South Korean Financial Supervisory Service (FSS). Although a rumored ban never materialized, in 2017 the South Korean government prohibited the use of anonymous accounts in cryptocurrency trading and banned local financial institutes from hosting trades of Bitcoin futures. Similarly, the Financial Services Commission (FSC) imposes strict reporting obligations on banks with accounts held by crypto exchanges.[49]

Although the Ethiopian Government has enacted a Proclamation on Prevention and Suppression of Money Laundering and the Financing of Terrorism, Proc. No' 657/2009, to prevent any "suspicious transaction" which means "a transaction which is inconsistent with a customer's known legitimate business or personal activities or with the normal business for that type of account or business relationship, or a complex, strange and unusual transaction or complex or unusual pattern of transaction"[50], we can understand, from the entire reading of the proclamation, that this prevention is restricted to transactions by "fiat money".

[48] Id.

[49] Korean Watchdog Tightens Rules on Crypto Exchange Bank Accounts, available at https://www.coindesk.com/markets/2018/06/27/korean-watchdog-tightens-rules-on-crypto-exchange-bank-accounts/. [last accessed May 24, 2022]

[50] Proclamation on Prevention and Suppression of Money Laundering and the Financing of Terrorism, 2009, Negarit Gazzet, Proc. No. 657, year 16, No 1, Article 2/14. [Here in after, Proclamation on Prevention and Suppression of Money Laundering and the Financing of Terrorism, 2009]

The National Bank of Ethiopia has issued a directive which obliges financial institutions to know their customer in enhanced and due diligence practices, including the introduction of a proper risk mitigation mechanism that enables them to effectively combat illegal and authorized transactions being operated through their infrastructure and platform in a manner that preventing shadow banking, which is critical to ensure proper identification of customers, appropriate assessment, and monitoring of transaction.[51] This directive is again restricted to prevent any shadow banking transaction by "fiat money". However, there is no any rule that regulates transactions of cryptocurrency though some practices of the cryptocurrency market have materialized in Ethiopia.

### 2.2.1 Cyber Security, Personal Data Security, Crypto Currency, and Tort Liability

Whether and to what extent courts hold database possessors liable for damages caused by improper data access are questions of huge importance.[52] Unless courts impose some form of liability, the persons often in the best position to prevent the losses caused by identity theft may have insufficient incentive to exercise care to avoid unnecessary harm. Despite the recent enactment of Computer Crime Proclamation, No. 958/2016[53] and Electronic Transaction Proclamation No' 1205/2020,[54] in Ethiopia, the laws governing the tortous liability of a data possessor and/or administrator is unsettled. For

[51] Licensing and Supervision of the Business of Financial Institutions, Requirements for Undertaking Accounts Based Transaction and Ensuring of Regulatory Limits Directive, National Bank Ethiopia, August 2021.

[52] Vincent R. Johnson, 'Data Security and Tort Liability', Journal of Internet Law, 2008, Vol.22, PP.22-31, P.22 [Here in after, Vincent R. Johnson, Data Security and Tort Liability].

[53] Computer Crime Proclamation, 958, *supra* note. 43.

[54] Electronic Transaction Proclamation, 2020, Federal Negarit gaz., Proc. No. 1205, year 26, No. 57, [Here in after, The Electronic Transaction Proclamation, 2020].

instance, the Ethiopian Civil Code, 1960[55] has been outdated to administer tort liabilities caused by online gambling and defamation, pop-up adverting, cybersquatting, spamming, cybers mearing tortious liabilities.

In considering this field of tort law, it is useful to differentiate three questions. The first issue is whether database possessors have a legal duty to safeguard data subjects' personal information from unauthorized access by hackers or others. Such obligations may be imposed by statutes, ordinary tort principles, or fiduciary duty law[56]. The second issue concerns not whether there is a duty to protect computerized information from intruders, but whether a database possessor has a legal obligation to disclose evidence of a security breach to data subjects once an intrusion occurs. The third issue is how far liability

[55] Civil Code, 1960, *supra* note 42.

[56] A person who has a fiduciary relationship with another person commits a tort when he or she breaches his or her fiduciary duty to the other person. The other person is entitled to damages from the fiduciary if he or she sustains damages because of the fiduciary's breach of his or her duty. A fiduciary relationship occurs between two persons when one person has a duty to act for the other person or has a duty to give advice for the benefit of the other person. Examples of fiduciaries include agents, personal representatives, trustees, guardians, or financial and legal advisors, such as attorneys, stockbrokers, or accountants. A fiduciary who breaches his or her duty to another person is liable only to the other person. He or she is not liable to third parties unless he or she owed a duty to the third parties.

A person who assists a fiduciary in breaching his or her duty to another person may be liable for the fiduciary's breach of duty. However, that person's liability is based upon the harm that was caused to the other person and not upon his or her breach of duty to the other person. A tort action for violation of a fiduciary duty may be brought in a court of law or in a court of equity. If the action is brought in a court of law, the person who was harmed by the violation may be entitled to compensatory or punitive damages. If the action is brought in a court of equity, the person may be entitled to an injunction or an accounting from the fiduciary. The person may further be entitled to restitution from the fiduciary, which restitution may consist of the profits that the fiduciary made because of his or her breach of duty. Examples of violations of a fiduciary duty include a bank's disclosure of its customer's financial information, a trustee's mismanagement of an estate, or an attorney's disclosure of a client's privileged information.

should extend when the database possessor has failed to exercise reasonable care to protect data or to disclose information about an intrusion.

### A. *Duty to Safeguard Cyber and Personal Data Security*

A statute may impose a duty to exercise care to protect data from intruders. An important example is California's Security Breach Information Act (SBIA)[57]. The California SBIA imposes a data protection obligation and expressly authorizes maintenance of a suit for damages caused by a breach of that duty.

The relevant language, which became effective July 1, 2003, states:

*"A business that owns or licenses personal information about a California resident shall implement and maintain reasonable security procedures and practices appropriate to the nature of the information, to protect the personal information from unauthorized access, destruction, use, modification, or disclosure".*[58] The legislation further provides that "any customer injured by a violation of this title may institute a civil action to recover damages".[59]

The SBIA leaves no doubt that businesses owe a duty under California law to protect customers' personal information and that customers may recover damages if businesses breach that duty.

Aside from statutes, ordinary tort law principles support judicial recognition of a database possessor's duty to safeguard information from intruders. Even if courts decline to impose a tort duty to safeguard data on database

57 An act to amend, renumber, and add Section 1798.82 of, and to add Section 1798.29 to, the Civil Code, relating to personal information, 2003, LEGISLATIVE COUNSEL'S DIGEST, senate Bill No 1386, Chapter 915[Here in after, The Act, 2003].

58 Id.

59 Id.

possessors generally (or at least on businesses), voluntary assumption of duty principles may create a legally enforceable data-protection obligation.[60] A person not otherwise under a duty to exercise reasonable care may voluntarily assume the responsibility to do so. One way of assuming this duty is by promising to exercise care and thereby inducing detrimental reliance. Another way is by "undertaking to render services" and consequently increasing the risk of harm to the plaintiff. Either way, the party that undertook the duty of reasonable care will be subject to liability if it breaches the voluntarily assumed duty and causes damages. These well-established principles may apply when consumers reveal personal information to financial institutions in reliance on financial institutions' stated privacy policies.

If a database possessor owes fiduciary obligations to a data subject, it is reasonable to argue that regardless of whether general tort principles would impose a duty, the fiduciary is obliged to protect computerized information relating to the data subject from unauthorized access by third parties. For example, the relationship between an attorney and client is fiduciary as a matter of law. Accordingly, lawyers have a special obligation to protect confidential client information, aside from any demands imposed by ordinary tort principles. A lawyer's broad fiduciary obligation of confidentiality extends to all forms of information about the client, including computerized data, for the existence of the duty turns on the content, not the form, of the information.[61] In light of the fiduciary duty rules on confidentiality (and the related obligations requiring safekeeping of client property), a lawyer or law firm could not plausibly argue that there is no duty to safeguard computerized

[60]Bank of America, Privacy Policy for Consumers, available at http://www.bankofamerica.com/privacy/index.cfm?template=privacysecur_cnsmr. (Last accessed May 02, 2022).

[61]David Hricik, 'The Speed of Normal: Conflicts, Competency, and Confidentiality in the Digital Age', *Computer L. Rev. & Tech. Journal*, 2005, Vol.10, P. 73[ Here in after, David Hricik, The Speed of Normal: Conflicts, Competency, and Confidentiality in the Digital Age]

client data from intruders. Indeed, the duty of safekeeping may even impose an obligation to encrypt sensitive information.[62] The same analysis should apply to all fiduciary relationships.

However, ordinary business relationships are not fiduciary. In business, parties normally deal with one another at arm's length. The "mere acceptance of confidential information" does not create a fiduciary relationship, nor does the fact that one party "trusts another and relies on a promise to carry out a contract." Consequently, while fiduciary-duty law may play an important role in determining whether professionals, such as lawyers, physicians, or trustees, have a duty to protect the information of clients, patients, and beneficiaries from intruders, it will not set the standard of care in most commercial settings.[63]

### *B. Duty to Reveal Security Breaches*

All USA States have enacted security breach information acts that require certain types of database possessors (typically businesses, but sometimes governmental agencies or other persons or entities, such as non-profit organizations) to notify data subjects of violations (or possible violations) of their information's security. States impose notification obligations and expressly authorize a civil action for damages.[64]

A variety of means are used to enforce the notification obligation, such as administrative or civil fines or an action by the attorney general to recover "direct economic damages" or to remedy deceptive trade practices.[65] Security

[62] Vincent R. Johnson, Data Security and Tort Liability, *supra* note 52.
[63] Id..
[64] Charles E. Cantu, 'An Essay on the Tort of Negligent Infliction of Emotional Distress in Texas: Stop Saying It Does Not Exist'," *St. Mary's L.J*., 2002, Vol. 33, PP. 455-468, PP.465-468.
[65] Id.

breach notification laws or data breach notification laws are laws that require individuals or entities affected by a data breach, or unauthorized access to data, to notify their customers and other parties about the breach, as well as take specific steps to remedy the situation based on the state legislature.

Data breach notification laws have two main goals.[66] The first goal is to allow individuals a chance to mitigate risks against data breaches.[67] The second goal is to promote company incentives to strengthen data security. Together, these goals work to minimize consumer harm from data breaches, including impersonation, fraud, and identity theft.[68]

### *C. Compensation for Security Breaches*

Modern society is built on the fragile foundations of computerized personal data. If this society is to endure and prosper, then it must vigilantly safeguard those foundations. Tort law offers an appropriate legal regime for allocating the risks and spreading the costs of database intrusion-related losses. Tort law can also create incentives, on the part of both database possessors and data subjects, to minimize the harm associated with breaches of database security.

Courts and legislatures must carefully consider the role of tort liability in protecting computerized data. If those who make and interpret the laws too hastily conclude that database possessors are not liable for losses occasioned by unauthorized data access, whether because there is no duty, no proximate causation, or no recoverable damages, important opportunities to reduce and distribute the costs of computerized technology will be lost. If liability is too readily assessed, important institutions will be adversely affected, and with them, the prosperity of modern society. Security in insecure times requires a

[66] General Data Protection Regulation, available at https://www.gdprsummary.com/gdpr-summary/, [Last accessed May 30, 2022]
[67] Id.
[68] Id.

sensitive balancing of competing interests. Established tort principles carefully applied to the contemporary problems of cybersecurity and identity theft can perform a key role in protecting the economic foundations of modern life.

### *2.2.2 Cyber Security, Personal Data Security, and Crypto Currency under the Ethiopian Civil Code*

A question here is whether the Ethiopian Civil Codeof the 1960has provided provisions dealing with the duty to protect cyber and personal data security, the duty to disclose any material facts of cyber and personal data security breaches, and compensation awarded to victims of such breaches. And again, whether the Ethiopian Civil Code, 1960 has any provision about the cryptocurrency market to enable any victim to claim, tort liability arising from cryptocurrency market transactions.

Principles of liability for fault are of general application. A person is, as a rule, always liable if the damage caused by him is due to his fault. Liability to fault is not restricted to cases provided for by law, while strict liability from harm caused by certain things or activities and vicarious liability for acts of others exist only "where the law so provides".

The Ethiopian Civil Code is not up to date to compensate damages caused by three tiers of organizations surrounding a firm's security practices, which include:

(i) an intra-firm organization (a firm exercises managerial control over the behaviors of its officers, employees, and contractors who manage information system assets),[69]

[69]Park, Sangchul, 'Reforming data protection law: an approach based on the concept of data ownership', *Korean J. Law Econ.*, 2018, Vol. 15, No. 2, PP. 259–278, P.

(ii) a firm's contractual relationship with customers or employees (a firm safeguards personal data that the individuals entrust under explicit or implied contracts),[70] and

(iii) inter-firm security chains (multiple firms form a security chain where the security practice of one firm affects that of another).[71]

These tiers of organizations pose a challenging problem of externalities that inherits in security chains.[72] An externality causes firms to produce more vulnerabilities, a kind of "bad" or harm than are socially desirable. An externality involves a situation in which separate property rights held by different persons collide, but things are different in ordinary information security problems; the personal data that a firm possesses are nothing other than what the individuals entrusted.[73] It is comparable to a warehouse person's custody of properties or directors' management of corporate assets.

Yet, what can have a more profound impact on a firm's unobserved behaviors and their payoffs is an appropriate legal remedy, which Book IV-Title III of the Ethiopian Civil Code has failed to address, provided for the customers or employees who entrusted their personal data to the firm but were injured by data breach incidents. Thus, to address the tort liability, the legal relationship between the individuals and the firm should be empowered to implement effective governance over the firm's hidden behavior. It happens when the firm's obligation to safeguard personal data is well grounded on a solid legal theory, regardless of whether it is formally based on contract, bailment, fiduciary duty, or any other kind of duty of care. The remedy should be

264[Park, Sangchul, 'Reforming data protection law: an approach based on the concept of data ownership].

[70]Id.

[71]Id.

[72] Id.

[73] Id.

extended to the firm's service providers or vendors, as well as a third-party transferee of personal data, based on an appropriate legal theory.

Lawyers argue that the Ethiopian Civil Codehas a provision, i.e., Article 2035 which stipulates: *"a person commits an offence where he infringes any specific and explicit provision of a law, decree or administrative regulation*" [74]; and *"ignorance of the law is no excuse*"[75], to redress any civil liability caused and in connection with cyber and personal data security. Although there is no tort law that deals with tortious liability of cyber security and personal data security in black and white, in contemporary Ethiopia, there have been Proclamations issued by the House of Peoples Representatives, Regulations enacted by the Council of Ministers and Directives to be issued by respective Ministries or governmental authorities.[76] These are federal laws. There are also state legislations enacted by state councils.[77] So, article 2035 should be read in line with these context.[78] For example, the breach the Computer Crime proclamation i.e. (a) committing a crime against a computer, computer system, computer data or computer network; (b) committing a conventional crime by means of a computer, computer system, computer data or computer network; or (c) illegally disseminating computer content data through a computer, computer system, or computer network[79] is, if harm ensues, for instance, equally redressable in tort except in the case of laws

[74] Civil Code, 1960, *supra* note 44, Art. 2035(1).
[75] Id, Art. 2035(2).
[76] Interview with Serkalem Tesfaye, Cyber Law Researcher at Information Network Security Agency of Ethiopia, on Whether Ethiopian Tort Law has addressed the newly emerging technologies related risks and casualty, March 29, 2022
[77] Interview with Hana Teshome, Team Leader of Legal Drafting at Information Network Security Agency of Ethiopia, on Whether an amendment of Ethiopian Tort law is required to address the newly emerging technologies related risks and casualty [Here in after, Interview with Hana Teshome]. March 29, 2022
[78] Id.
[79] Computer Crime Proclamation, 958, *supra* note 43 , Art. 2(1)

providing their own sanctions which by implication exclude distinct tort remedies.

However, the above justification may not give a complete answer to the question of whether the Ethiopian Tort Law has provisions to redress damages in connection with cyber security and personal data security. Because Article 2035, in its uniquely sweeping formulation, supplies a civil liability for the whole legal system of Ethiopia. Ethiopian Tort Law is, therefore, to a certain extent, not an independent branch of law, but a sanction of all other laws.[80] The legislator obviates the possibility of a restrictive interpretation of "law" to mean [The Civil Code] only, by adding the words "specific and explicit provision of law", "decree" and "administrative regulation" which terms are wide enough to cover in addition to the Civil Code or other enactments from House of People Representatives to the most minute administrative regulations.[81] Thus, with respect to the qualification of the provisions infringed, this article makes no difference between, for instance, Criminal Code and Computer Crime Proclamation, or any other substantive and procedural laws.[82]

For infringement of law to amount automatically to a fault, the provision allegedly infringed must be specific and explicit (clear) enough. But the more the level of generality of legal provisions rise, the more the automatic applicability of this article to an infringement of law become debatable. No doubt the Criminal Code and Computer Crime Proclamation contain provisions concrete enough for an infringement to be deemed a fault under article 2035; however, this cannot be always true because the provisions are

[80]George Krzeczunowicz, *The Ethiopian Law of Extra-Contractual Liability*, Haile Selassie I University, Addis Ababa, Ethiopia, P. 102[Here in after, George Krzeczunowicz, The Ethiopian Law of Extra-Contractual Liability]
[81]Id.
[82]Interview with Hana Teshome, *supra* note 77.

vague that they are open to conflicting interpretations.[83] with fault. Book IV,Title III, of the Ethiopian Civil Code has no provisions regarding tort liability issues in the crypto sphere and any tort law has not been yet enacted. In this case, the following problems arise:

i. to bring a claim to the court, the claimant should identify the defendant. Usually, the claimant may be an ordinary person that does not know much about the software development process. Moreover, identification of the coder whose programming code possibly produced the error requires substantial resources and/or permission from authorities to request needed information from third parties. Right this day, such power only belongs to judges, prosecutors, detectives, or intelligence agencies and they use it to fight crimes. No regular person possesses such power, thus, the instruments available for claimants for finding the wrongdoer and bringing him to court are inefficient.

ii. In a very unlikely scenario, an injured party may find the coder who supposedly caused the damage. The truth is that people often remain anonymous on the web. The biggest platform for code storing and code management where e.g., the source code of Bitcoin stored – "GitHub3800" – does not have proper Know-Your-Customer policies as payment and financial institutions have. No analogous platforms adhere to such policies because it was not needed at the time. Therefore, except for a nickname, email, and other un useful information for the injured party, the platform cannot give any relevant information to the potential claimant regarding the wrongdoer's identity.

[83]George Krzeczunowicz, The Ethiopian Law of Extra-Contractual Liability, *supra* note 80, P. 104.

iii. Another problem is application dependencies (development and production)-external libraries and frameworks written by other developers that were used for program creation. Those libraries, not the code written by program creators, may cause an error. Identification of a responsible person in such a case is very difficult or merely impossible.

Cryptocurrency-related companies owe a duty of care to their platform users and thus are liable for the breach of such duty. Contrastingly, independent coders that contribute to the open-source software do not owe a duty of care to the software users, thus not liable for code errors in the tort of negligence. So, not only injured parties should prove the existence of a duty of care, its breach by a defendant but also justify that exactly this breach caused the damage. Due to the high technicality of cryptocurrency claims, it would be merely impossible to find out, evaluate the causality, and prove this statement in court by applying this outdated Ethiopian Tort Law.

The breach of duty of care occurs when one party behaves in an unreasonable manner in case foreseeable damages to the other.[84] Usually, the "test of a reasonable person" is used in the evaluation of defendants' behavior. However, if we take into consideration the actors of cryptocurrency relations (coders, cryptocurrency platforms' staff, miners), this test is not sufficient because involved people almost always have special and even professional knowledge or skills. Thus, a test of "the ordinary skilled person in the same area", first mentioned in ***Bolam v Friern Hospital Management Committee***[85] should apply. When the damage arises from the glitch in the

[84]Iryna Arkhypchenko, Theoretical and Legal Perspective of Civil Liability in Cryptocurrency Relations, Master Thesis, Shevchenko National University of Kyiv, 2020, [unpublished, available at https://vb.mruni.eu/object/elaba:64874799/] P. 64

[85]Jenny Steele, *Tort Law: Text, Cases, and Materials*, Oxford University Press, Oxford, 2017, P. 129. Facts of the case: -The defendant was the body who employed a doctor who had not given a mentally ill patient (the claimant) muscle-relaxant drugs nor

program it is possible to assess the reasonableness of a coder's actions/omissions or evaluate some management decision that caused the damage using the test of 'the ordinary skilled person in the same area.

Book IV-Title III of the 1960 Ethiopian Civil Code, however, has not adopted the "the ordinary skilled person in the same area" test to compensate for any tortious liability caused by cryptocurrency transactions.

## 2. Is the Ethiopian Tort Law Responsive to Product Defects Associated with Autonomous Vehicles and 3D Printing?

***The machines are here, but the law is not*** *~~~~~ Ed Walters, Fastcase CEO*

The concept of product defects is broad. A product defect is any characteristic of a product that hinders its usability for the purpose it was designed and manufactured. Product defects arise most prominently in legal contexts regarding product safety, where the term is applied to anything that renders the product not reasonably safe. However, the scope of this paper is limited to

restrained them prior to giving them electro-convulsive therapy. The claimant suffered injuries during the procedure. The claimant sued the defendant, claiming the doctor was negligent for not restraining them or giving them the drug; Issue of the case: - Establishing the tort of negligence involves establishing that the defendant breached their duty of care to the claimant. To establish breach, the claimant must establish that the defendant failed to act as a reasonable person would in their position. This standard is higher in the case of professionals: they must act as a reasonable professional would. The issue in this case was how to assess the standard of care imposed on a professional defendant where a substantial portion of professionals opposed a particular practice, while others did not; Decision of the court: The High Court held that the doctor had not breached his duty to the patient, and so the defendant was not liable. McNair J set out the test for determining the standard of care owed by medical professionals to their patients (sometimes referred to as the 'Bolam test'). The professional will not be in breach of their duty of care if they acted in a manner which was in accordance with practices accepted as proper by a responsible body of other medical professionals with expertise in that area. If this is established, it does not matter that there are others with expertise who would disagree with the practice.

only two types of product defects related to autonomous vehicles and 3D Printing. Thus, following a brief conceptual explanation, this section assesses the responsiveness of the Ethiopian Tort Law towards tortious actions arising from autonomous driving and 3D Printing.

### 2.1. Overview of Product Defects in General

There are three broad classifications of product defects.

#### a) Manufacturing Defects

Manufacturing defects are the most common and obvious type of product liability claim when the product that causes the injury was defectively manufactured. A product with a manufacturing defect is faulty because of a mistake in the manufacturing process.[86]

#### b) Design Defects

A design defect is a product's inherently dangerous or defective design. So, these types of product liability claims do not arise from some mistake during the manufacturing process but rather involve the claim that an entire line of products is inherently dangerous irrespective of the fact that the product that

[86] Here are some of the most common examples of manufacturing defects:
- *For example, an elevator with a defectively manufactured pulley system causes the car to collapse or fall, injuring passengers.*
- *A vehicle with a missing steering part causes a loss of vehicle control.*
- *A bicycle with a defectively manufactured steering bar causes the bicyclist to lose control.*
- *Children's jewellery or toys contain unacceptable levels of lead, which could be toxic*. For further information, see available at https://www.greenbergrubylaw.com/product-liability-case-examples.

caused made the injury perfectly according to the manufacturer's specifications.[87]

### c) Failure to warn

Failure to warn is a claim that fails to provide adequate warnings or instructions about the product's proper use. These types of claims often involve a product that is dangerous in a way that is not apparent to consumers. In some cases, these include products that require consumers to use special precautions while using them.[88]

In Ethiopia, it is an everyday phenomenon for the community to experience product defects. For example, the Federal Police Commission report envisages that, since 2012/13, more than 3,000 people have died, and 6,000 people are injured each year due to RTA. Further, according to a 2018 WHO report, the number of road traffic deaths in the country has reached 4,352 people annually. Its rate remains high at around 27 deaths per 100,000

[87] Here are some of the most common examples of design defects:
- *For example, a pelvic mesh device disintegrates inside the body and damages internal organs because of its poor design.*
- *A poorly designed SUV rolls over when the driver takes a curve.*
- *A poorly designed coffee maker sprays hot liquid on users causing burn injuries.*
- *An inclined sleeper could cause children to suffocate due to defective design accidentally*. For further information, see available at https://www.greenbergrubylaw.com/product-liability-case-examples.

[88] Here are a few examples of situations that could result in a failure-to-warn claim:
- *Child car seats and booster seats should come with specific instructions about proper installation, failing which the seat may not adequately protect the child.*
- *A sleeping pill that does not include a warning that it may potentially cause dangerous side effects on its label.*
- *Toys that do not have warning labels, which could cause serious injuries*. For further information, see available at https://www.greenbergrubylaw.com/product-liability-case-examples.

population.[89] Among other things, poor conditions of the vehicles and technical inefficiency of the cars, i.e., production defects are the causes.

In this regard, the right to compensation of a victim who has suffered damage through using or consuming a defective product or exposure to a defective product is essential. Any producer of a defective movable must make good the damage caused to individuals' physical well-being or property.[90] For instance, a child injured by the explosion of a soft drink bottle, an employee who loses a finger by using a defective tool, or a pedestrian knocked down by a car with faulty brakes enjoy this right, whether or not there is negligence on the part of the producer. The legal framework should ensure the well-being of victims (by ensuring they are compensated and by discouraging the marketing of defective products) and of minimizing the costs to the industry to avoid excessive interference in their capacity for innovation, job creation, and exporting.[91]

Concerning product defects, Art. 2085 of the Civil Code deals as follows:

*(1) A person who manufactures goods and sells them to the public for profit shall be liable for any damage to another person resulting from the normal use of the goods.*

[89]WHO, Make Roads Safe: The Campaign for Global Road Safety United Nations Decade of Action for Road Safety 2011-2020, (2011), available at www.who.int/roadsafety/decade/of/action/plan/global/plan/decade.pdf

[90] Commission of the European Communities: Green Paper Liability for defective products, Directive 85/374/EEC, P.10, For further information, available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:51999DC0396&from=EN.

[91] Id..

*(2) No liability shall be incurred where the defect that caused the damage could have been discovered by a customary examination of the goods.*[92]

From the above statements, we can discern that the Ethiopian civil Code recognizes only manufacturing defects. Is it the law's intention to leave the victim uncompensated for an injury incurred while using a defective product due to design defects or a failure to warn? We will see the details as follows.

### 2.2. Tort Liability for Damage Caused by Autonomous Vehicles

#### *(i) Conceptual Overview of Autonomous Driving*

Autonomous systems increasingly influence today's globalized human world. The driver will be replaced by a computerized system that will take over the driving task in the coming years or decades.[93] The term 'automated vehicle' is used for a vehicle that can ultimately drive itself without human interference. Autonomous vehicles are becoming more self-reliant and independent of humans; they can park themselves with minimal human intervention, prevent accidents, and drive themselves on marketed roads with almost no human involvement.[94]

[92] Civil Code, 1960, *supra* note 42, Art. 2085. Concerning abnormal product use, a scholar points out that, akin to other pills, tetracycline is to be consumed as doctors prescribe. However, tetracycline is sold and purchased like any other ordinary product in many rural areas. The purchaser does not swallow the pill; instead, he distracts it and puts it on wounded skin. This is a practical example of abnormal use. If the purchaser sustained damage by using tetracycline in such a way, the producer could not compensate him. Mehari Reade, Lecture Notes on the Ethiopian Tort Law, Addis Ababa University, School of Law, 2003-2007, PP.1-90[Here in after, Mehari Reade, Lecture Notes on the Ethiopian Tort Law].

93 Ruth Janal, Extra-Contractual Liability for Wrongs Committed by Autonomous Systems, pp.174-205, In Martin Ebers & Susana Navas (Eds), Algorithms and Law, Cambridge University Press, 2020, available at https://www.cambridge.org/core.

94 Kyle Colonna, Autonomous Cars and Tort Liability, *supra* note 16, pp.81-130.

The SAE (Society of Automotive Engineers) issued a standard on taxonomy and definitions concerning the capabilities of automated vehicles. The SAE distinguishes between six levels of automation, explaining which part of the dynamic driving task is performed by the human driver or the automated driving system.[95] For more clarification, see the following table from the Society of Automotive Engineers.[96]

| | |
|---|---|
| level 0 | no driving automation<br><br>the human driver needs to perform the entire dynamic driving task |
| level 1 | • driver assistance<br><br>• a system can subtask the dynamic driving task, namely the longitudinal or lateral vehicle motion control. The driver performs the remainder of the dynamic driving task |
| level 2 | • partial driving automation<br><br>• a system serves both the longitudinal and lateral vehicle motion control while the driver performs the remainder of the dynamic driving task |
| level 3 | • conditional driving automation<br><br>• the automated driving system can perform the entire dynamic driving task within its operational design domain. The user is receptive to a request to intervene and can do so |

[95] Id, P.15.

[96] SAE International, Taxonomy and Definitions for Terms Related to Driving Automation Systems for On-Road Motor Vehicles. Standard J3016 (revised June 2018), pp.21-26. For further information, available at https://www.sae.org/standards/content/j3016_202104.

| | |
|---|---|
| | promptly. He is expected to resume the performance of the dynamic driving task when requested. |
| level 4 | • high driving automation<br>• there is no longer an expectation that the user will resume the performance of the dynamic driving task when asked. The automated driving system performs the entire dynamic driving task within a specific operational design domain, for instance, on a highway. The automated driving system can achieve a minimal risk condition when necessary |
| level 5 | • full driving automation<br>• the automated driving system performs the entire dynamic driving task. So, the automated driving system no longer has a specific operational design domain in which it can function. The automated driving system can also achieve a minimal risk condition, and a user is not expected to intervene. |

From the above table, we can discern that level 0 is not automation. Level 1 is driver assistance (the driver controls the vehicle but has to assist with features like blind spot detection). Level 2 is partial automation (the driver controls the vehicle, but the car has automated functions like automatic emergency braking). Level 3 is the vehicle can drive itself some, but the driver must be ready to re-take control (like self-park). Level 4 is the car can entirely go itself

under *certain conditions* (like highway autopilot). Finally, level 5 is the vehicle can drive itself *under all conditions.*[97]

### *(ii) The Likelihood of Deploying Autonomous Driving in the Market and the Potential Presence of Damage Arising from Autonomous Driving*

Autonomous vehicles are already on the market, or they are getting closer to be deployed on roads for the public[98]; it is being tested on public roads in several countries on a large scale[99]; it has been replacing the human driver with an artificial entity.[100] Tests are taking place with, for instance, self-driving cars moving cargo or small buses bringing multiple people from a station to a hospital. In addition, cars can become mobile meeting rooms, hotel rooms, or even gyms. This is part of developments that offer everyone mobility and make travelling more accessible while reducing pollution and increasing road safety. Automated vehicles are expected to contribute to all these goals. For instance, by making a human driver superfluous, the automatic car could be used by people currently unable to drive (such as children and people with physical impairments).[101]

Regarding the potential damage arising from autonomous vehicles, although automated vehicles are expected to be safer than human drivers, they will not

[97]Nynke E. Vellinga, Legal Aspects of Automated Driving: On Drivers, Producers, and PublicAuthorities, *supra* note 13.

98 Id..

99 Id..

100 Hin-Yan Liu, Irresponsibilities, Inequalities, and Injustice for Autonomous Vehicles, Ethics Inf Technol, Vol.

19, 2017, pp.193–207.

101 Nynke E. Vellinga, Legal Aspects of Automated Driving: On Drivers, Producers, and PublicAuthorities, *supra* note, 13.

entirely avoid road accidents. For example, a self-driving car recently killed a pedestrian in Arizona, the USA.[102]

In Ethiopia, a vehicle with driver assistance (level 2) and partial driving automation (level 3) is already on the market. Furthermore, conditional driving automation (level 4) is expected to be on the market in the coming few years.[103] Currently partial-autonomous flying is started to be employed in the aviation industry.[104]

Consequently, legal questions regarding liability arose, including who is liable for damage caused by an automated vehicle. From tort law perspectives, different parties are involved: The user, owner, producer, fleet operator, and injured party. Likewise, you are cycling to the University when you get hit by a self-driving car. You are ok, but your bike is in pieces. From which party would you claim damages? From the user? producer? or owner? The following section speaks about these and other related legal questions.

### *(iii) Ethiopian Tort Law vis a vis Autonomous Vehicles*

This section shows which aspect of automated vehicles differentiates them from normal cars regarding tortious liability. For example, in the presence of a producer, an owner, and a user, does the absence of a human driver create that much difficulty in establishing liability?

[102]Nathaniel Meyersohn, Matt McFarland, "Uber's Self-driving Car has Killed Someone. What happened?" *cnn.com*, money.cnn.com/2018/03/20/news/companies/self- driving-uber-death/index.html, Cited by Spencer C. Pittman and Mbilike Mwafulirwa: Not So Hypothetical After All: Addressing the Remaining Unanswered Questions About Self-Driving Cars, Oklahoma Bar Journal, Vol.90, 2019, p.36.

[103]Interview with two legal experts (anonymous), legal experts at the Ethiopian Road Authority, on whether an amendment of Ethiopian Tort law is required to address the newly emerging technologies related autonomous driving, March 28, 2022

[104] The recent Boing 737 MAX Ethiopian Airlines crash was due to system failure, failure in the Maneuvering Characteristics Augmentation System (MCAS), causing a fatal crash, in which 157 people died.

At the international level, the Geneva and Vienna Conventions are incompatible with automated driving. The notion of the driver within the 1949 Geneva Convention on Road Traffic and the 1968 Vienna Convention on Road Traffic does not accommodate automated driving. Within the meaning of these Conventions, a driver is a human who decides on the speed and direction by operating (some of) the vehicle's controls. As a result, fully autonomous driving (SAE Level 5 vehicle) is driverless within the meaning of these two Conventions.[105] Like the Geneva and Vienna Conventions, the Ethiopian civil Code assumes a driver is a human who decides on the speed and direction by operating the vehicle's controls.

Different lines of argument are forwarded regarding who is liable for the damage resulting from autonomous driving.

**i. Owner**

Art. 2081 of the Civil Code provides that an owner is strictly liable for a damage. It provides that the motor vehicle owner shall be liable for any damage caused by the vehicle, even if the damage was caused by a person not authorized to drive the vehicle. Moreover, Art. 2082 (1) provides that a person who has taken possession of the vehicle for personal gain shall be liable for any damage caused by the vehicle in his possession.

Some argue that since the civil Code establishes a strict liability of the car owner to compensate the victim, the same principle can be applied to autonomous driving. This means that the owner of self-driving cars will be held strictly liable for the damage.[106] However, in addition to victim

[105] See Art. 4 paragraph 1 Geneva Convention & Art. 1(V) of the Vienna Conventions.

[106] Interview with legal experts (anonymous), at the Ethiopian Road Authority, Federal High Court Judges, and Ministry of Justice, on whether an amendment of Ethiopian Tort law is required to address the newly emerging technologies related autonomous driving, March 28, 2022.

compensation, the owner of the car can control or mitigate the damage is the other justification for making the car owner strictly liable. So, it is not always justifiable to establish strict liability for the car's owner in the case of autonomous driving because it might be beyond the owner to control or mitigate the damage resulting from autonomous driving.

### ii. Manufacturer

The other line of arguments is making the manufacturer liable for the damage resulting from autonomous vehicles.

As mentioned above, Art. 2085 (1) of the Civil Code provided that "*a person who manufactures goods and sells them to the public for profit shall be liable for any damage to another person resulting from the normal use of the goods*."[107] The manufacturer must sell the goods to the public for profit, and the damage must have come from regular use. Only profit-oriented manufacturers are liable under Art. 2085 of the Civil Code, i.e., the cost of doing business. The claimant cannot rely on this provision when the manufacturer distributes the product free of charge unless it is shown that he committed a fault. For example, suppose that a defective Covid-Vaccine is distributed to the public free of charge and sustained damage; the victim cannot sue the manufacturer per Art. 2085. The justification is that without fault, a manufacturer who gives the vaccine free of charge should not be strictly liable.

Moreover, "*who manufactures goods and sells them*" indicates that the manufacturers would directly deal with the consumer. However, the producer produces an item and directly sells it to the consumer bringing a contractual relationship between the two parties. The governing law will be the contract or consumer protection law, not the extra-contractual liability law.

[107] The Ethiopian Civil Code, *supra* note 43, Art. 2085 (1).

On the other note, Article 2085 (2) provides that no liability shall be incurred where the defect that caused the damage could have been discovered by a customary examination of the goods. Therefore, the consumer must customarily examine the thing to the extent his knowledge permits. One way of customarily examining the good is to thoroughly read and stick to the directions/instructions given by the manufacturer. Well-developed manufacturers give directions on how and when to use the product. However, the guides are usually written in English, and it might not be easy to understand the manufacturer's instructions.

In addition, Article 2086 (1) of the Civil Code provides that the persons declared legally liable for the manufactured goods (2085) "***may relieve"*** himself of the liability to the victim by proving that he has committed no offence, that it was impossible to establish the cause of the damage, or that it was not within his power to prevent the damage or that the damage was due to the fault of a third party.

However, the Amharic version provides that persons legally declared liable "***may not relieve"*** themselves by proving they did not commit a fault. As it is strict liability, no one can relieve himself of liability by proving that he was not at fault. Moreover, the law makes a person liable not because he committed fault but because his activity was dangerous and caused damage to another, or it was the object under his possession and from which he gained benefit that caused damage to another. Accordingly, the Amharic version expresses the true intention of the legislature.

Regarding manufacturer liability, the challenge is that the would-be autonomous vehicle that brings about damage will be an input of foreign companies, and the victims cannot proceed against the manufacturers in Europe, the USA, or elsewhere.

**iii. Designer**

As stated above, Art. 2085 of the Civil Code recognizes only manufacturing defects. It leaves the victim uncompensated when he uses a defective product due to design defects or a failure to warn. Some argue that most of the manufactured goods have been imported from abroad. We must care about the victim's interest since it would be difficult for the victim to prove the design defect and act against the designer. So, it is recommended to make the manufacturer liable to the victim in case of product defects, whether manufacturing or design defects. Once he has compensated the victim, the manufacturer will seek a remedy from the designer per their contractual relationship.[108] However, the manufacturer can quickly shift the burden of proof if the product is free from manufacturing defects but has design defects. As a policy maker, the legislative organ should also consider which party should take the responsibility, as always making the manufacturer liable to the victim might not achieve the desired policy goals, for example, deterring the wrongdoing.

### iv. Joint and Several Liability of Manufacturer, Importer, Wholesaler & Retailer as per Consumer Protection Laws

Contract law and consumer protection laws may serve as a panacea to fill the gaps in tort law. When we see the contract law, the possible scenario is that the producer produces, for example, an autonomous vehicle and sells it to the whole seller; the wholesaler will again sell the purchased autonomous car to the retailer, and the retailer will sell it to the consumer. Under this chain of transactions, there is no contractual relationship between the producer and the consumer. The solution for such kinds of challenges will be the privity of contracts. Accordingly, the consumer will proceed against the retailer; the

[108] Interview with legal experts (anonymous), at the Ethiopian Road Authority, Federal High Court Judges, and Ministry of Justice, on whether an amendment of Ethiopian Tort law is required to address the newly emerging technologies related autonomous driving, March 28, 2022.

retailer will proceed against the whole seller; the wholesaler, on his part, will proceed against the producer.[109]

However, it is proved to be challenging to rely on the retailer because retailers are smallholders, they cannot compensate victims for the damage, and the retailers do not involve anything human as they deliver the product to the consumer as packed by the producer. Usually, the retailer is economically too weak to compensate the consumer. Therefore, so long as it is a civil case unless the defendant has a deeper pocket, the whole exercise of bringing an action will be useless. As a result, the privity of the contract will not be a solution for the liability arising from autonomous vehicles.

Alternatively, the Ethiopian competition and consumer protection laws may serve as a panacea to fill the gaps in tort law.[110] Art. 14 (5) of the Trade Competition and Consumers Protection Proclamation provides as follows:

*Every consumer shall have the right to: claim compensation or related either jointly or severally from persons who have participated in the supply of goods or services as manufacturer, importer, wholesaler, retailer, or in any other way for damages he has suffered because of purchase or use of the goods or services.*

Concerning defects in Goods and Services: Art. 20 of the Trade Competition and Consumers Protection Proclamation provides as follows:

*1/ Any consumer may report defects in goods and services purchased and the damage the defects may cause to the Ministry or the relevant bureau.*

[109] Id..
[110] Trade Competition and Consumers Protection Proclamation, FEDERAL NEGARIT GAZETTE, Proclamation No. 813/2013, Arts. 14-22.

*2/ A consumer may, without prejudice to warranties or legal or contractual provisions more advantageous to him, demand the seller, within 15 days from the date of purchase:*

*a) in the case of defective goods, to replace the goods or refund the price paid; or*

*b) in the case of defective service, to re-deliver the service free of charge or to refund the fee paid.*

*3/ Any consumer shall have the right to claim, in accordance with the relevant laws, payment of compensation for any damage resulting from the use of the defective goods or service or from the failure of the seller to meet his demand presented pursuant to sub-article (2) of this article.*

Given all that has been mentioned so far, one may suppose that product defect is not becoming an issue of contractual or extra-contractual liability but of consumer protection or public interest. Consumer protection laws may check whether the products being marketed to the public are up to the standard. In addition, inspecting the product or quality control may help us prevent possible risks associated with consuming a processed product.[111] Sometimes, despite quality control, we may not decidedly avoid the risk that may materialize through regular use. In such a case, the remedial scheme of the proclamation comes into the picture.[112]

[111] Trade Competition and Consumers Protection Proclamation, FEDERAL NEGARIT GAZETTE, Proclamation No. 813/2013, Arts. 14-22.

[112] Art. 14 (5) of the Trade Competition and Consumers Protection Proclamation provides as follows:

*Every consumer shall have the right to: claim compensation or related either jointly or severally from persons who have participated in the supply of goods or services as manufacturer, importer, wholesaler, retailer, or in any other way for damages he has suffered because of purchase or use of the goods or services.*

Therefore, as per Art. 14 (5) of the Trade Competition and Consumers Protection Proclamation, the injured party can claim compensation ***jointly or severally from the manufacturer, importer, wholesaler & retailer***.[113]

### 2.3. Tort Liability for Damage Caused by 3D Printing

#### *(i) Conceptual Overview of 3D Printing*

3D Printing is a process for making a physical real-world object from a virtual digital model. Items that have already been printed include human body parts, prosthetics, aircraft and automotive parts, medical devices and implants, guns, toys and the list is endless. In principle, everything is 3D printable.[114]

We are transforming from the two-dimensional world of printing/duplication to 3D-printed drugs, food products, hardware, and even biological organs.[115]

---

Concerning defects in Goods and Services: Art. 20 of the Trade Competition and Consumers Protection Proclamation provides as follows:

*1/ Any consumer may report defects in goods and services purchased and the damage the defects may cause to the Ministry or the relevant bureau.*

*2/ A consumer may, without prejudice to warranties or legal or contractual provisions more advantageous to him, demand the seller, within 15 days from the date of purchase:*

*a) in the case of defective goods, to replace the goods or refund the price paid; or*

*b) in the case of defective service, to re-deliver the service free of charge or to refund the fee paid.*

*3/ Any consumer shall have the right to claim, under the relevant laws, payment of compensation for any damage resulting from the use of the defective goods or service or from the failure of the seller to meet his demand presented under sub-article (2) of this article.*

[113] Art. 2085 of the Civil Code does not make the wholesale liable for selling a defective product. However, under the proclamation, the consumer can proceed against the whole seller, which is one of the gaps in tort law.

[114] https://www.acts-net.org/events/past-events/39-3d-printing-africa-s-development-the-3d-printing-revolution-and-ethiopia-s-unfinished-agenda-on-manufacturing

[115] Shardha Rajam & Adya Jha, 3D Printing - An Analysis of Liabilities and Potential Benefits within the Indian Legal Framework." NUJS Law Review, vol. 11, no. 3, 2018, pp. 361-393. p.1.

3D Printing is already becoming a significant industry with tremendous innovative potential for many applications, from dental and medical, to automotive, aerospace/aviation, toys, military, fashion, food, eyewear, and construction.[116]

With the adoption of 3D Printing, a product can be directly fabricated from a CAD file. This transformation lowers the production threshold, thus enabling ordinary people to engage in production activities, and drives consumers to take a proactive role in directing the production process by serving as the coordinators between CAD file designers and object fabricators.[117]

### *(ii) The Usage of 3D Printing in Ethiopia*

In Ethiopia, 3D Printing has the potential to change the face of Ethiopian manufacturing sector and provide a space for meeting the industrial production needs of Ethiopian consumers, companies, and organizations. 3D Printing is a perfect investment for Ethiopian manufacturers that could become an alternative to costly, non-environmentally friendly manufacturing processes and imported spare parts. Ethiopia opened large industrial parks that would accommodate many jobs. 3D Printing could foster industrial manufacturing development in Ethiopia as the Federal and Regional governments invest and support industrial projects. It is an opportunity to

[116] James M. Beck & Matthew D. Jacobson: 3D Printing: What Could Happen to Products Liability When Users (and Everyone Else in between) Become Manufacturers." Minnesota Journal of Law, Science, and Technology, Vol. 18, no. 1, pp. 144 & 145; for further information, see at https://scholarship.law.umn.edu/cgi/viewcontent.cgi?article=1419&context=mjlst [Here in after called James M. Beck & Matthew D. Jacobson].

117 Shu Li, The Quest for Product Safety in the Context of 3D Printing: A Law and Economics Analysis, PhD. Dissertation, 2021, for further information, see https://www.eur.nl/en/events/phd-defence-s-shu-li-2021-02-12.

contribute to Ethiopia's economy. It is also a chance to help manufacturing companies improve the quality and reduce the costs of their products.[118]

The fate of manufacturing in Ethiopia and the rest of the developing world is increasingly tied to emerging technologies, particularly 3D Printing, which the Economist called 'the third industrial revolution'. In order to remain economically competitive, Ethiopia should accelerate the transition to high-value manufacturing by acquiring and developing capabilities in 3D printing technology.[119]

Ethiopia already uses 3D printers for various purposes, mainly in the aerospace and automotive industries. For example, the Boeing 787 Dreamliner Ethiopian owns has thirty 3D printed parts, but Boeing plans to use more 3D printed features in its aircraft. As of 2014, it has printed over 22,000 parts for its various products.[120]

However, Boeing's 737 Max suffered two fatal crashes, in 2018 and 2019, that was shown to be caused by a design flaw and led to a global grounding of the aircraft. The 737 MAX suffered a recurring failure in the Maneuvering Characteristics Augmentation System (MCAS), causing two fatal crashes, Lion Air Flight 610 and Ethiopian Airlines Flight 302, in which 346 people

[118] Samuel Alemu, 3D Printing and how it can revolutionize manufacturing, the reporter, January 26, 2019, accessible at https://www.thereporterethiopia.com/7328/.

[119] https://www.acts-net.org/events/past-events/39-3d-printing-africa-s-development-the-3d-printing-revolution-and-ethiopia-s-unfinished-agenda-on-manufacturing

[120] The other aircraft owned by Ethiopian, the Airbus A350 XWB, has one thousand 3D printed features. Airbus designers aim to print the entire plane in one go at the press of the print button. See Hailemichael T. Demissie: From manufacturing service: Ethiopian Airlines verging towards 3D Printing, the Reporter, August 13, 2016, p.1.

died in total.[121] Boeing has already paid substantial amounts ***voluntarily*** to compensate the families of the Lion Air 610 and Ethiopian Airlines 302 passengers. In addition, it may have contractual agreements with purchasers, including airlines and leasing companies, entitling them to compensation for losses due to product defects.[122] Let us suppose that Boing company refused to compensate the victim voluntarily. Then, would the company be held responsible as per tort law? The following section tries to address such kind of issues.

### *(iii) Ethiopian Tort Law vis-à-vis 3D Printing: Who is a Liable Person?*

3D Printing will impact many legal fields, including regulatory, intellectual property, insurance, environmental, transportation, contracts, and imports/exports.[123] However, this article is limited to examining the legal

[121] Agence France Presse(AFP), Inquiry Into 2019 Ethiopian Air Crash Confirms Software Failure, December 23, 2022, accessible at https://www.barrons.com/news/inquiry-into-2019-ethiopian-air-crash-confirms-software-failure-01671821708; see also Fasika Tadesse and Alan Levin, Ethiopia Reiterates Boeing Max Crash Due to Unfit Safety Feature, Blomberg, December 23 2022, accessible at https://www.bloomberg.com/news/articles/2022-12-23/ethiopia-reiterates-boeing-max-crash-due-to-unfit-safety-feature?leadSource=uverify%20wall.

As part of a settlement in a civil lawsuit brought on behalf of the Ethiopian Airlines crash victims, Boeing in 2021 declared that it alone was liable for the ET302 accident and that neither the pilots nor the airline were at fault.

[122] See Dominic Gates & Steve Miletich, Boeing's $100 Million Pledge for 737 MAX Crash Victims Sparks Criticism and Questions, SEATTLE TIMES (July 3, 2019), https://www.seattletimes.com/business/boeing-aerospace/boeing-will-give-100-million to-max-crash-victims-families-and-communities. [https://perma.cc/KQ29-G9KS].

[123] Possible scenarios in which "defects" in 3D-printed products might include:

*(1) The original Product used to create the initial digital design was defective;*
*(2) The original CAD file digital design was defectively created;*
*(3) A defect was introduced into the CAD file as it was uploaded to a file-sharer;*
*(4) The CAD file was corrupted during the process of downloading from a file sharer;*
*(5) The defect was caused by some problem or "defect" in the 3D printer;*
*(6) The defect was caused by some problem or "defect" in the bulk of raw material used in the 3D printer to create the product;*

considerations of 3D Printing in the tort law system. For example, who should be potentially liable for a defective 3D-printed product? Who is responsible for an injury resulting from using a defective 3D Product?

In traditional mass production, tort liability targets producers. Since producers are considered the party who can reduce accidents at the lowest cost and spread the losses, they must bear the residual liability and are thus exposed to strict liability. In the context of 3D Printing, where digital designing and physical fabrication are accomplished by a single entity (i.e., under the so-called "one-stop business model"), applying strict liability might still be desirable. However, for production organized in the so-called "separation models[124], accidents are not unilateral, and it is difficult to define the most appropriate party who can efficiently reduce accidents and spread losses.[125]

Therefore, who should be liable for a defective 3D-printed product? Who is responsible for an injury resulting from using a defective 3D Product? should the digital designer, manufacturer, or hobbyist printer be liable for the injured?

i. **Digital Designer**

Establishing the liability of the **digital designer** is problematic because it is difficult to identify whether the "code" is a product or not.[126] A physical

*(7) Human error in implementing the digital design caused the defect; and*
*(8) Human error in using the 3D printer or materials caused the defect.*
*For further information, see* James M. Beck & Matthew D. Jacobson: *supra* note 116.

[124].This means that CAD file designers, fabricators, and consumers may contribute to the damage.

125 Shu Li, The Quest for Product Safety in the Context of 3D Printing: A Law and Economics Analysis, PhD. Dissertation, 2021, for further information, see https://www.eur.nl/en/events/phd-defence-s-shu-li-2021-02-12.

[126]In the U.S., the Restatement (Third) of Torts defines a product as "*tangible* personal property distributed commercially for use or consumption." See the RESTATEMENT

object produced through 3D Printing fits within traditional product concepts. However, 3D Printing requires CAD files and Code to operate the printer, and whether this software would also be considered a product is questionable.[127]

ii. **Manufacturers**

Concerning **manufacturers**, the purpose of imposing strict liability on a commercial seller, manufacturer, or distributor of products is to create "safety incentives" for manufacturers that encourage more significant investment in product safety.[128] Under a strict liability theory, product users seeking to recover for injuries resulting from a 3D-printed product face the additional hurdle of proving that a commercial manufacturer or seller placed the product on the market. Moreover, holding the printer manufacturer liable is unlikely because it must show that the 3D printer was already defective at delivery.

**iii. A hobbyist Printer**

An entity that regularly makes, markets, distributes, and sells 3D printed products as part of its ongoing business activities will be strict liability. On the contrary, a **hobbyist** printer, who occasionally uses 3D Printing to make, for example, a hard-to-obtain spare part, which then injures a consumer, will not be subjected to strict liability.[129]

(THIRD) OF TORTS: PRODS. LIAB. *§* 19 (Am. LAW INST. 1998), cited by James M. Beck & Matthew D. Jacobson: supari note 116, pp.163.

[127] Courts in the USA have yet to extend product liability theories to lousy software, computer viruses, or websites with inadequate security or defective design. However, purely electronic data, such as Code, does not constitute a product. See James M. Beck & Matthew D. Jacobson: 3D Printing: What Could Happen to Products Liability When Users (and Everyone Else in between) Become Manufacturers." Minnesota Journal of Law, Science, and Technology, Vol. 18, no. 1, p.163.

[128] James M. Beck & Matthew D. Jacobson: *supra* note 116.

[129] Id..

### iv. Joint and Several Liability of Manufacturer, Importer, Wholesaler & Retailer as per Consumer Protection Laws

As we have seen earlier, in case of product defects, as per Art. 14 (5) of the Trade Competition and Consumers Protection Proclamation the injured party can claim compensation *jointly or severally from the manufacturer, importer, wholesaler & retailer*.[130] Therefore, in case of product defects related to 3D Printing, the injured party can claim compensation jointly or severally from the manufacturer, importer, wholesaler & retailer.

## Concluding Remarks

In conclusion, the study analyzes the compatibility of the Ethiopian tort law with newly emerging cyberspace and product defect tort liability.

The current Ethiopian civil code cannot regulate cyberspace torts such as theft of personal data, online defamation, cyberattacks, and tort problems arising from bitcoin and cryptocurrency. As a result, damages caused by the cyberattack and dismantling of personal data, cyber security, and the crypto platform will not be redressed. Therefore, the Ethiopian government should expedite the passage of the cyber security and personal data protection regulations to minimize the losses associated with database security breaches and redress any tort liability associated with database security.

Moreover, the Ethiopian civil code governing tort liability is unresponsive to regulating tort cases arising from 3D printers or 3D printable products.

[130] Art. 14 (5) of the Trade Competition and Consumers Protection Proclamation provides as follows:

*Every consumer shall have the right to: claim compensation or related either jointly or severally from persons who have participated in the supply of goods or services as manufacturer, importer, wholesaler, retailer, or in any other way for damages he has suffered because of purchase or use of the goods or services.*

Mainly, it is challenging to identify the liability of the printer's manufacturer and the writer of the program code, and sometimes even the liability of the hobbyist printer who might occasionally be sold the 3D printable product. Likewise, let us be optimistic that autonomous driving, mainly high-driving automation (level 4), will soon start its operation in Ethiopia. In the case of an autonomous driving accident, it would be difficult to identify the liability of the user, owner, producer, fleet operator, and injured party. Therefore, the Ethiopian civil code governing product defects may need to be updated to keep up with this emerging technology. The finding does not call for a wholesale reform of tort principles, but they do demand careful application by judges who are sufficiently well-informed about the limits of machine and human performance.