



# **A CRITICAL ASSESSMENT OF THE APPLICATION OF ETHIOPIAN VAT ON E-COMMERCE**

**By: Andualem Temesgen**

**February 2018,  
Addis Ababa, Ethiopia.**

**ADDIS ABABA UNIVERSITY  
SCHOOL OF GRADUATE STUDIES  
COLLEGE OF LAW AND GOVERNANCE STUDIES  
BUSINESS LAW STREAM**

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**A Thesis submitted to Addis Ababa University, the school of Graduate Studies, Faculty of Law in Partial fulfillment of the Requirements for the Degree of Master of Laws (LL.M) in Business Law**

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## **Declaration**

I, the undersigned, declare that the thesis comprises my own work, has not been presented for a degree in any other University and that all sources of materials used are aptly acknowledged.

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February, 2018

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## **Acronyms**

**Art.** - Article

**ATM**- Automated Teller Machine

**B2B**- Business-to-Business

**B2C**- Business-to-Consumers

**B2G**- Business-to-Government

**C2C**- Consumer-to-Consumer

**CFA**- Committee on Fiscal Affairs

**EDI**- Electronic Data Interchange

**EFIRA**- Ethiopian Federal Inland Revenue Authority

**ERCA**- Ethiopian Revenues and Customs Authority

**EU**- European Union

**GST**- General Sales Tax

**IP**- Internet Protocol

**OECD**- Organization for Economic Co-operation and Development

**PE**- Permanent Establishment

**TAG**- Technical Assistance Group

**UN**- United Nations

**UNCITRAL**- United Nations Commission on International Trade Law

**UNCTD**- United Nations Conference on Trade and Development

**US**- United States

**VAT**- Value Added Tax

**WTO**- World Trade Organization

## **Abstract**

*This study was intended to assess how the current VAT system of Ethiopia is applicable on e-commerce transactions. The study was guided by the following objectives; analyze the prospects and weaknesses of the existing VAT law in taxation of e-commerce, take lessons from foreign jurisdictions on how to apply VAT on e-commerce transactions, and find out the challenges experienced and possible challenges ahead in the implementation of Ethiopian VAT system on e-commerce transactions.*

*In order to conduct the research, the study uses qualitative method with the belief that it provides the most appropriate way of investigating the research questions. The necessary data to the study were collected from both primary and secondary sources all the way through using a combination of multiple data gathering instruments including interviews, review of relevant literatures and legislative documents.*

*The study findings revealed that there are challenges experienced in the application of the VAT legislations on e-commerce transactions. This includes, the problems of the buyer's identification, establishing his location/residence and its status (business or consumer) in e-commerce transactions, the inadequacy of the VAT Proclamation to define PE for e-commerce purpose, the absence of guidelines on acceptable records where goods are delivered, invoices issued and payments made by electronic means. Add to these is lack of proper and adequate resources, and their usage within the Tax Authority to monitor e-commerce transactions.*

*Using the above findings, it implied that theoretical soundness of the VAT laws would not in itself suffice for the implementation thereof. Given that electronic commercial activity has been evolving with the development of technology, its application should also be technology-based. Accordingly, a clear provision as to what constitute PE for e-commerce purposes should be established, a special scheme, which would require foreign vendors involved in supplying electronic services to Ethiopian consumer to register should be established. What is more, for the sake of effective administration and collection of VAT revenue from e-commerce transactions, the cooperation of the Tax Authority with various stakeholders is advised.*

**Keywords:** *e-commerce, Ethiopia, VAT, permanent establishment*

# CHAPTER ONE

## 1. GENERAL INTRODUCTION

### 1.1. Background of the Study

Taxation is an integral part of human history, past and present, and the virtually continued in the future. Taxes are a portion of private wealth, exacted from individuals, groups of individuals, or other legal entities by the State for the purpose of meeting the expenditure essential to carrying out the functions of Government.<sup>1</sup> It is in effect a contribution designed to reduce private expenditure in favor of public expenditure. Basically it is the coercive contribution by citizens to the State or Government, to enable the Government to obtain funds for the provision of goods and services to its citizens, redistribute income, clear market imperfections and stabilize the economy. It is the main source of revenue to the Government.<sup>2</sup> A Government that cannot tax cannot survive. Taxation must expressly be provided for by law and a good tax policy must incorporate all or some of the canons of taxation or principles of taxation including equity, certainty, convenience, economy, productivity (fiscal adequacy), simplicity, flexibility, and diversity'.<sup>3</sup>

Commonly, taxes can be classified into direct and indirect taxes. VAT is one form of indirect tax in which the tax is typically collected from someone other than the person who actually bears cost of the tax. On the other hand, VAT is a generic term associated with a multistage tax that is levied on the value added by each business firm at every stage of production and distribution of goods and services.<sup>4</sup>

VAT has been the most pervasive tax reform throughout the world during the second half of the twentieth century and into the twenty-first century, and has proved to be a major source of Government revenue. Historically, Americans were the first advocates of VAT.<sup>5</sup> However, the modern notion of VAT to satisfy high demand of revenue on the part of the Government was

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<sup>1</sup> Carl P., *Introduction to Public Finance*, 2<sup>nd</sup> ed., Macmillan Company, New York, 1902, P. 77

<sup>2</sup> *Id.*, P. 6.

<sup>3</sup> Sol P., *International Business Taxation*, A Study in the Internationalization of Business Regulation, Quorum Books, New York, 1992. P. 6.

<sup>4</sup> Taddese L., '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', P. 265, <<http://dx.doi.org/10.4314/mlr.v5i2.4>> (Accessed 1 January 2017)

<sup>5</sup> Yohannes M. & Sisay B., *Tax Law Teaching Material*, Prepared Under the Sponsorship of the Justice and Legal System Research Institute, 2009. P. 63.

introduced by France in 1954.<sup>6</sup> Traditional value added tax concepts are mainly premeditated to operate based on the geographic location of the parties or the transactions. These tax points disappear when business activity is pursued through the internet.<sup>7</sup> Governments therefore are facing the task of defining new tax points capable of catching online transactions if they wish to preserve their revenues.<sup>8</sup>

In Ethiopia VAT is a recent phenomenon which is introduced in 2002 by replacing the then general 'sales tax law'.<sup>9</sup> This law was considered as an essential component of tax reforms of the country to replace the out dated sales tax, which has served for more than four decades and collected at manufacturing or production level and/or while importing. Unlike sales tax, VAT is one variety of taxes imposed on transactions that result in value addition and it is collected from each stage.

It is tough to say that, the VAT law in Ethiopia was written to cater for digital transactions, such as online downloads of movies, music, games or access to content in the cloud (Internet-based storage mechanisms). Ethiopian VAT laws were written with a focus on physical goods and in person services. To date, no amendments have been made to the VAT Proclamation, to ensure that it specifically provides for the imposition of VAT in e-commerce in a comprehensive manner.

Ethiopia differs from other VAT jurisdictions, because it has not yet introduced a considerable guidance on electronic commerce or introduced legislative provisions to deal with electronic commerce efficiently. Traditionally, the current Ethiopian taxing principles must be applied in determining whether electronically supplied services are subject to VAT in Ethiopia. The question therefore arises whether the VAT Proclamation in its current form in fact provides for the imposition of VAT on the supply of digitized products and whether imposing VAT is consistent with the principles formulated by the OECD and other developed countries.

However, it is worth to note that, the Ethiopian VAT legislation provide a definitive statements for the global businesses regarding the importation of e-commerce in Ethiopia. Accordingly, Article 4(7) of the VAT Proclamation envisage an inkling as to the applicability of the Proclamation to the supply of goods and rendering of services carried out by a nonresident in

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<sup>6</sup> *Ibid.*

<sup>7</sup> See, e.g., Kortenaar G. & Spanjersberg C., 'Taxation and E-Commerce: Dutch Tax Policy Implications', *Intertax*, 1999, Vol. 27, P. 180-187.

<sup>8</sup> OECD, *Electronic commerce: The Challenges to Tax Authorities and Tax Payers*, Vol. 4, Nov. 18, 1997, P. 4, <[http://www.oecd.org/daf/fa/e\\_com/turku\\_e.pdf](http://www.oecd.org/daf/fa/e_com/turku_e.pdf)> (Accessed 15 January 2017)

<sup>9</sup> Sales and Excise Tax Proclamation, 1993, *Federal Negarit Gazeta*, Proc. No. 68/1993, 52 year, No. 61.

Ethiopia through a permanent establishment in Ethiopia or through the internet.<sup>10</sup> This is the solitary provision that gives a clue as to the application of Ethiopian VAT law on e-commerce. But, this does not mean that this reference of the Proclamation is sufficient enough to address all the issues of e-commerce with regard to VAT law regime.

Therefore, this study center itself on the examination of whether the application of current VAT legislation of Ethiopia on e-commerce transactions will be adequately cater for the state interests. Besides, assessing the challenges posed in taxation of VAT in e-commerce, together with recommendations for reform will be made. In doing so, the experience of EU and OECD in applying VAT regime to taxation of e-commerce will be put forth as arguably the most advanced in the world and therefore Ethiopia may use its positive experience in regulating the issue.

## **1.2. Statement of the Problem**

As mentioned here in above, VAT is one of the most important systems of taxation for the Government of Ethiopia and the Ethiopian Government continues to be excited at the prospect of VAT's ability to generate large amounts of tax revenue.<sup>11</sup> According to the Ethiopian VAT Proclamation, VAT is levied on the sales of goods and services in the territory of Ethiopia, as well as on imports of goods and services from other countries.<sup>12</sup> In respect to exports, the general rule is that they are not taxed.<sup>13</sup> Hence, the country-of-destination principle of taxation, which is “almost universally employed” for VAT,<sup>14</sup> is typically applied in Ethiopia.<sup>15</sup>

On the other hand, though the present VAT legislation is applicable on e-commerce transactions, the legislation will not be able to achieve a proper functioning of the VAT system as Ethiopia experiences the practical difficulties of compliance and enforcement leading to a misallocation of VAT revenue and the non-taxation of certain transactions. Correspondingly, in practice, the devotion of the Tax Authority to generate revenue from e-commerce transaction is very marginal. Thus, the application of VAT on e-commerce transactions is definitely an area that requires proper

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<sup>10</sup> Value Added Tax Proclamation, 2002, *Federal Negarit Gazeta*, Proc. No. 285/2002, 8<sup>th</sup> year, No. 33, [here in after, VAT Proclamation] Art.7(4).

<sup>11</sup> Markos A., *Value Added Tax (VAT) Administration and Revenue Performance: Challenges and Opportunities in the Mekelle Branch of Ethiopian Revenue and Custom Authorities (ERCA)*, MS Thesis, Mekelle University, Ethiopia, 2010, P. 3.

<sup>12</sup> VAT Proclamation 2002, *Supra note 10*, Art. 3(b), 6(1), 7 (1) (b), (c).

<sup>13</sup> *Id.*, Art. 7(2) (a).

<sup>14</sup> Currently OECD, WTO and the EU are the main advocators of this principle.

<sup>15</sup> VAT Proclamation 2002, *Supra note 10*, Art. 23(3) and Art. 3(7).

attention and regulation by the state. Because, e-commerce concomitant to the vast opportunity brought to the business and the Government, it come up with its own challenges for the tax authorities too. This challenge is intensified by, currently in Ethiopia, it is difficult to find published rulings, tax court decisions, and relevant publications or interpretation notes focusing on the VAT treatment of electronic commerce.

Indeed, several areas of particular concern could be raised as an issue when the traditional VAT rules are applied on e-commerce. The first main issue demonstrated insufficiency of the traditional VAT Proclamation is related with the distinction between goods and services for the purpose of taxation.<sup>16</sup> With appearance of digital products, the query occurred whether to treat them as goods or services. Even though, in the VAT Proclamation both the term goods and services are defined: the term "Goods" means all kinds of corporeal movable or immovable property, thermal or electrical energy, heat, gas, refrigeration, air conditioning, and water, but does not include money<sup>17</sup>; similarly "Services" is provided as a “work done for others which does not result in the transfer of goods.”<sup>18</sup> The attribution of digital products either as goods or service is not clear enough in the Proclamation. For any tax law, however, having a clear definition of terms makes it easy for tax authorities to engage the taxpayers with less ambiguities and possible loopholes.

A further problem related to the application of the existing VAT rules to e-commerce concerns the transaction in which foreign supplier render service to Ethiopian consumers without registration for VAT. Though this problem is not special to Ethiopian only, EU also faces the same problems,<sup>19</sup> it has its own adverse consequence when domestic suppliers who are required to registered and pay VAT found themselves in a disadvantageous position as compared to foreign merchants who are not required to do so.

The anonymity of the internet also increases the challenge of tax authorities to identify the parties of the transaction. As it is acknowledged, identifying the parties to a transaction in order to determine the relevant tax that will be imposed and the relevant tax legislation that will be applicable to the person is important. Unlike the traditional way of transactions which are entered

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<sup>16</sup> Hellerstein W., *Value Added Taxation of Electronic Supply of Services within the European Community*, Jean Monnet Working Paper 13/01 Cecilia Hargitai. ISSN 1087-2221, P. 24.

<sup>17</sup> VAT Proclamation 2002, *Supra note 10*, Art. 2(7).

<sup>18</sup> *Id.*, Art. 2(16).

<sup>19</sup> Pronina T., *Indirect Taxation of Electronic Commerce: The US and European Experience, Lessons for Russia*, LL.M. Short Thesis, Central European University, 2011, P. 44.

into with relevant source documentation, e-commerce transactions have a distinct anonymous character, because the transaction is carried out without papers and pens, offices and warehouses, and even without employees. So, internet will create challenges for the Ethiopian taxing authority to verify the details of the transactions, and this could lead to a tax loss for the Government.

The other issue with e-commerce transactions under the Ethiopian VAT Proclamation is related to permanent establishment in that e-commerce involves non-physical elements and e-commerce transactions are carried out electronically. Permanent establishment is a fixed place of business which generally gives rise to income or value added tax liability in a particular jurisdiction. In Ethiopia, permanent establishment is defined as “*a fixed place of taxable activities through which those activities of a person are wholly or partly carried on...*”<sup>20</sup> This definition excludes places of taxable activity that are mobile. However, websites does not have specific premises, equipment, machinery or the like and the software and data constituting the website does not have the degree of permanency required to be considered to constitute a fixed premises.<sup>21</sup> Website information can be move from one server to another depending on the requirement mostly the internet infrastructure. In this case it is tough to apply the concept of permanent establishment on e-commerce transactions. Likewise, in e-commerce the location of the seller as well as the location of the buyer is often not made known to each other, presenting a degree of anonymity.<sup>22</sup> This allows tax evasion, and creates difficulties to determine which jurisdiction country has the right to tax. Furthermore, e-commerce tax administration and enforcement is another dilemma in realizing the VAT system since business can be conducted across national frontiers and governments’ tax jurisdiction does not extend beyond their countries’ geographical boundaries.

Hence, even though, Ethiopia has taken some steps towards taxation of e-commerce via the VAT regime, as this thesis will seek to demonstrate, it is not as such adequate to address issues that requires a further regulation in taxation of e-commerce.

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<sup>20</sup> VAT Proclamation 2002, *Supra note 10*, Art. 2(10).

<sup>21</sup> Nufrensa W., ‘Permanent Establishment for E-commerce in International Taxation’, 2006, P. 336, <<http://elj.warwick.ac.uk/jilt/04-1/basu.html>> (Accessed 20 January 2017)

<sup>22</sup> Basu S., ‘To Tax or Not To Tax? That is the Question? Overview of Options in Consumption Taxation of E-Commerce’, *The Journal of Information, Law and Technology*, 2004, No. 1, Part 1.

### **1.3. Objective of the Study**

#### **1.3.1. General Objective**

As briefly highlighted above, the overall objective of this thesis is to examine how the existing laws in Ethiopia will apply in enforcing VAT on e-commerce transactions.

#### **1.3.2. Specific Objectives**

The specific aim of this study is in order to

- ) Analyze the prospects and weaknesses in the existing VAT law in taxation of e-commerce.
- ) By obtaining a better understanding of the VAT on e-commerce in foreign jurisdictions, a lesson will be derived on how to apply VAT on e-commerce in Ethiopia.
- ) Research and analyze the challenges experienced and possible challenges ahead in the enforcement of VAT on e-commerce transaction in Ethiopia.
- ) Provide a way forward on how to address challenges of the Ethiopian VAT system in its application on e-commerce transactions for purposes of reform.

### **1.4. Scope of the Study**

This work is central to taxation of e-commerce but it is limited in terms of thematic and geographical area in the sense that the work is restricted to assess the legal regulations of VAT for the taxation of e-commerce in Ethiopia. Hence, even though taxation and e-commerce has different aspects, this research, is not discuss the overall dimensions of e-commerce or all types of taxation which have been dealt with by various scholars and academics. Rather, so as to make the study manageable and comprehensively address the issues by the time, financial and material resource, it focuses mainly on assessment the application of Ethiopian VAT regime in taxation of e-commerce. Therefore, other types of taxes including income taxes within an e-commerce environment in or/and outside Ethiopia will not be inspected as part of the study.

### **1.5. Research Questions**

Owning to the above background body of knowledge, the study has sought to answer the following research questions: -The central question to be answered in this study is

- ) Is the current Ethiopian legal system relating to VAT applicable in e-commerce transactions?

In addition, this research answers the following sub questions that are necessary to answer the main questions:

- ) Should the VAT system of Ethiopia tax e-commerce under the regime of goods or services?
- ) Is there a need to create new definition and meaning of permanent establishment in the VAT Proclamation?
- ) Whether the Ethiopia VAT law is adequate to address the challenges facing the tax aspect of e-commerce?
- ) What real challenges are experienced in the implementation of Ethiopian VAT on e-commerce transactions?
- ) What legal and practical issues should Ethiopia consider when amending the current VAT regime based on other countries' experience of VAT on e-commerce transactions?

## **1.6. Significance of Study**

This study is one of the original works in the Ethiopian context. As a result, it has its own important role in extending the knowledge base in the field of taxation of e-commerce to tax authority, tax officers, and other concerned bodies. The study is also considered to have its own academic and legal significance in that it would help new researchers and academicians to do further studies on the subject matter as it is unexplored area of law. Besides, it is expected that the outcome of this study will be of much use to the legislative and policy makers as it will enable them see the importance of revisiting and proposing possible amendments of the tax legislations in line with the results of the study.

## **1.7 Methodology**

### **1.7.1 Research Method**

In order to ensure that this research achieves its aims and set objectives, the study will consist of qualitative method, as it needs to examine the topic, which mainly focuses on the assessment of the application of Ethiopian VAT law on e-commerce transactions. Qualitative research is advantageous in the case at hand is that it provides a richer and more in-depth understanding of the subject under study. Similarly, it aims at producing factual description that is based on face to face knowledge of individual and social groups in their natural setting that is relevant to this study.

### **7.1.2 Data Source**

In the study, both primary and secondary data will be employed as a source of information to the various issues involved in the paper. As regards primary sources, this study will examine various domestic laws, regulation, and policies on VAT of e-commerce in Ethiopia. With regards to secondary sources, a review of existing literature on VAT law in taxation of electronic commerce, including text books, thesis, journal, articles and internet materials are considered and relied upon. Besides, unstructured interviews with e-commerce website representatives, e-commerce customers and officers of different ranks who have knowledge in this area of study from the ERCA were conducted. Accordingly, the study does not utilize schedules of questions. In obtaining the respondents, this research used Purposive sampling technique. This technique is adopted for the reason that after field investigation on the group, the study involves a deliberate selection of sample units who represents the total population.

### **1.7.3 Data Analysis**

To this end, the study will analyze legal rules of Ethiopia, which mainly focus on VAT law in taxation of e-commerce. To examine books, journals, master's thesis, and other documents in related with taxation of e-commerce in the VAT regime, content analysis technique was employed. A due regard to practical analysis of relevant theoretical concepts and legislations is also carried out.

### **1.8. Limitation of the Study**

The study's main limitation was the apparent lack of local text books and published Articles on the subject under the study. Especially on the case of Ethiopia, it was hardly possible to find a study in this area and hence there was no choice other than relying on the foreign materials that are available on. The other problem encountered was getting the timely responses from respondents; some interviewees did not have time for interview with the researcher and in some areas it was difficult to get the respondents because some of the people feared to provide information believing the researcher was the spy who was sent to acquire certain information. All these mentioned problems in one way or another contributed to the delay of finishing the dissertation.

## **1.9. Structure of the Study**

This thesis is organized into four chapters. Chapter one of this paper is designed to address the introductory part that provides the underlying principles of the study; which specifically encompassed background of the study, statement of the problem, objective of the study, significance of the research, scope, methodology and organization of the paper. Chapter two elucidates an overview of e-commerce by beginning with a discussion on the nature of e-commerce, the historical background, typical, scope and the need for taxation of e-commerce are examined. Equally, the existing international initiatives in regulating e-commerce taxation notably by OECD and EU also examined. Chapter three, assesses how the legislation and VAT system in Ethiopia are currently operating. In doing so, the challenges in enforcement of the VAT regime to e-commerce will be discussed. Finally, the fourth chapter presents the conclusion and possible recommendations of the paper.

## CHAPTER TWO

### 2. LITERATURE REVIEW AND THEORETICAL CONSIDERATIONS

#### 2.1. Introduction

The advent of e-commerce and its' continued growth has produced many changes in the way business is being conducted. Like that of the industrial revolution, e-commerce has a potential to accelerate the rate of growth and development of the world economy. This chapter, hence, commences by examining the meaning of e-commerce. Historical development of e-commerce, typical of e-commerce transaction, and its scope will also be a subject of this discussion. The debate as to the need for e-commerce taxation is the other important focus of this chapter.

#### 2.2. Definitions of E-Commerce

There is no single definition as to the meaning of e-commerce universally yet; nor is there any Ethiopian legislation which sets out a definition. For instance, the OECD has defined an electronic transaction in April 2000 in their Annexure 4 as “the sale or purchase of goods or services, whether between businesses, households, individuals, governments, and other public or private organizations, conducted over computer- mediated networks.”<sup>23</sup> The goods and services are ordered over those networks, but the payment and the ultimate delivery of the good or service may be conducted on or off-line.<sup>24</sup> In this sense the notion of e-commerce transactions can therefore be understood as the application of information and communication technology to any of the activities involved in making commercial transaction.

The U.N. definition explains e-commerce as “a commercial activity conducted through an exchange of information generated, stored or communicated by electronic, optical, or analogous means.”<sup>25</sup> According to XIWT Cross-Industry Working Team, e-commerce is defines as “the ability

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<sup>23</sup> Measuring the Information Economy, ANNEX 4. *The OECD definition of internet and E-commerce transactions*, 2002, P. 89, <[www.oecd.org/sti/ieconomy/2771174.pdf](http://www.oecd.org/sti/ieconomy/2771174.pdf)> (Accessed 17 March 2017)

<sup>24</sup> *Ibid.*

<sup>25</sup> Hill R. & Ian Walden I., *The Draft UNCITRAL Model Law for Electronic commerce: Issues and Solutions*, Computer L.18, 1996, P. 13.

to perform transactions involving the exchange of goods or services between two or more parties using electronic tools and techniques.”<sup>26</sup>

The Work Programme on e-commerce adopted by the General Council of the WTO states that the term “electronic commerce” is understood to mean “the production, distribution, marketing, sale or delivery of goods and services by electronic means.”<sup>27</sup> Similarly, United Nations Commission on International Trade Law (UNCITRAL) defines e-commerce as “exchange of every kind of data message in the scope of commercial activities”.<sup>28</sup> This activity is based on processing and transfer of text, sound, and video data by electronic means. Thus, in this context it can be said that e-commerce includes digital payment of goods and services too.<sup>29</sup> What one can discern from the above definitions is that what distinguishes e-commerce from traditional commercial activity is that it is conducted by electronic means.

### **2.3. Historical Background of E-Commerce**

The introduction of e-commerce is dated back to 1970s and understood as the facilitation of commercial transactions electronically, using technology such as Electronic Data Interchange (EDI) and Electronic Funds Transfer (EFT).<sup>30</sup> This were allowing business to send commercial documents like purchase orders or invoices electronically.<sup>31</sup> Later on, other forms of electronic commerce like automatic teller machines (ATM), credit cards, and telephone banking were introduced.<sup>32</sup> However, the first web browser program was written and the World Wide Web was

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<sup>26</sup> XIWT Cross-Industry Working Team, *Electronic Commerce in the NII*, P. 1., As cited in, The United States, Department of the Treasury, *Selected Tax Policy Implications of Global Electronic Commerce*, Washington, D.C., U.S. Government Printing Office, 1996, P. 18,  
<<https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Global-Electronic-Commerce-1996.pdf>>  
(Accessed 18 March 2017)

<sup>27</sup> WTO General Council, *Work Programme on Electronic Commerce*, Adopted by the General Council on 25 September 1998, 30 September 1998 WT/L/274, P. 1, <[http://www.wto.org/english/tratop\\_e/ecom\\_e/wkprog\\_e.htm](http://www.wto.org/english/tratop_e/ecom_e/wkprog_e.htm)>  
(Accessed 03 March 2017)

<sup>28</sup> The United Nations Commission on International Trade Law, *Model Law on Electronic Commerce*, GA/Res/51/162, 30 January, 1997, Art. 1.

<sup>29</sup> Orhan Y., ‘Development of E-commerce Legislation and Taxation of Revenues from Online Content in Turkey’, <<https://www.hg.org/article.asp?id=7717>> (Accessed 28 March 2017).

<sup>30</sup> <<https://sellitontheweb.com/blog/shipping-fulfillment-resources-ecommerce-business>> (Accessed 23 March 2017)

<sup>31</sup> *Ibid.*

<sup>32</sup> Palmer C., ‘Using IT for Competitive Advantage at Thomson Holidays’, *Institute of Strategic Studies Journal*, 1988, Vol. 21, No. 6, P. 26-29.

invented after 1990, in which internet was opened to commercial use. Then, about seven years later security protocols allowing continual connection to the internet were developed.<sup>33</sup>

By the beginning of the twenty-first century, more and more companies worldwide, especially in U.S. and Western Europe were offering their services over the internet.<sup>34</sup> Currently, the term "e-commerce" is more of associated with the process of purchasing a variety of goods and services over the internet using secure protocols and electronic payment systems.<sup>35</sup> In view of that, the emergence of network organizations helps to establish some of the practice supporting the process of electronic commerce.<sup>36</sup>

## **2.4. Typical E-commerce Transaction**

As a business model, e-commerce can be categorized into four main categories namely: Business-to-Business (B2B), Business-to-Consumer (B2C), Consumer-to-Consumer (C2C), and Business-to-Government (B2G). These classifications of e-commerce business in to several categories is essential, as we will see in chapter three, to determine the preferable methods of tax collection in e-commerce transactions. In the following paragraphs we define these categories.

### **2.4.1. Business-to-Business (B2B) E-commerce**

While relying on modern technologies, especially the internet, B2B e-commerce involves one organization buying products and services from another. Most importantly, B2B means the business between companies such as manufacturers, distributors, wholesalers, and retailers. Most of the e-commerce is B2B type and it greatly occupies more than 80%.<sup>37</sup> There is an expert's prediction that this type of e-commerce is further improved by the ongoing globalization and grow even more in the future.<sup>38</sup> Though B2B e-commerce is high in transaction and volume, since

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<sup>33</sup> 'History of E-commerce' <<http://www.ecommerce-landcom/history-ecommerce.html>> (Accessed on 16 March 2017).

<sup>34</sup> Dauda A., *An examination of The Legal Regulations and Taxation of Telecommunications and Electronic Commerce in Nigeria*, PhD Dissertation, University of Ilorin, Faculty of Law, 2012, P. 110.

<sup>35</sup> Oduntan A., *Taxation of Electronic Commerce: Prospect and Challenges for Nigeria*, LL. B Long Essay, University of Lagos, Faculty of Law, Nigeria, 2010, P. 14.

<sup>36</sup> *Ibid.*

<sup>37</sup> Zorayda A., *E-commerce and E-business*, 2003, P. 9,

<<http://fcitr.kau.edu.sa/GetFile.aspx?id=61164&fn=Ecommerce%20and%20E%20Business.pdf>> (Accessed 17 January 2017)

<sup>38</sup> *Ibid.*

businesses tend to be registered entities and can be easily subjected to an audit, it is not as such problematic for indirect taxation.<sup>39</sup>

#### **2.4.2. Business-to-Consumer (B2C) E-commerce**

A business following a B2C business model sells goods or services to individuals acting outside the scope of their profession.<sup>40</sup> B2C e-commerce involves “marketing and selling to individual consumers online.”<sup>41</sup> The selling of tangible products among others includes books, consumable goods, cosmetics, and clothes or it also covers digitized goods such as downloadable software, music, books, which are intangible. According to Botha et al, B2C can be perceived as ‘the end-point of a business-to-business value chain.’<sup>42</sup> Several websites, such as Rakuten, Amazon, and eBay are characterized as online B2C.<sup>43</sup>

#### **2.4.3. Consumer-to-Consumer (C2C) E-commerce**

C2C e-commerce encompasses a transaction between individuals or consumers whereby they can easily sell; buy through an online auction like eBay.<sup>44</sup> Businesses involved in C2C e-commerce play the role of intermediaries, helping individual consumers to sell or rent their assets (such as residential property, cars, motorcycles, etc.).<sup>45</sup> The amount generated through this auction reaches million dollars a day.<sup>46</sup>

#### **2.4.4. Business-to-Government (B2G) E-commerce**

In addition to business and consumers, governments are active participants of e-commerce. Hence, ‘B2G’ e-commerce means business interactions between business entities and the public sector or governmental institutions,<sup>47</sup> especially where a country has adopted an e-government strategy. In

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<sup>39</sup> Van der Merwe B., ‘VAT and E-commerce’, *SA Mercantile Law Journal*, 2003, Vol. 15, No. 3, P. 373.

<sup>40</sup> Government of India, *Proposal for Equalization Levy on Specified Transactions*, Report of the Committee on Taxation of E-commerce, Department of Revenue, Ministry of Finance, Government of India, 2016, P. 12.

<sup>41</sup> Botha J., Bothma C., & Geldenhuys P., (eds), *Managing E-commerce*, 2004, P. 97.

<sup>42</sup> *Ibid.*

<sup>43</sup> Other websites such as: Travelocity.com (<http://travelocity.com>); Expedia.com (<http://www.expedia.com>); Dell.com, (<http://www.dell.com>); Netbank.com (<http://www.netbank.com>); EthioGift.com (<http://www.EthioGift.com>) are a good examples of B2C.

<sup>44</sup> Botha J., (eds), *Supra note 41*, P. 97.

<sup>45</sup> Government of India, *Supra note 37*, P. 12.

<sup>46</sup> Zorayda A., *Supra note 37*, P. 12.

<sup>47</sup> *Ibid.*

B2G model, the procedure of business registration, licensing, advertising, web-based communications and government-related operations can be executed electronically.<sup>48</sup>

## 2.5. Scope of E-commerce

Based on the extent to which the internet is utilized in the course of a transaction, e-commerce can be “indirect e-commerce” and “direct e-commerce”.<sup>49</sup>

### 2.5.1. Indirect E-commerce

In indirect electronic commerce, sometimes referred to as offline-business, internet is only used to conclude the contract.<sup>50</sup> The European Commission defines indirect commerce as follows: “Indirect electronic commerce is the electronic ordering of tangible goods, which must be physically delivered using traditional channels such as postal services or commercial couriers.”<sup>51</sup> In offline transactions, the internet is used instead of telephone, fax or letter. From a tax point of view the offline business is just a new form of ordering system.<sup>52</sup>

### 2.5.2. Direct E-commerce

In direct electronic commerce, also known as online-business,<sup>53</sup> on the other hand, the internet is used to fulfil contractual obligation, e.g., to deliver ordered software, music or videos.<sup>54</sup> Thus, in online business, the goods and services in digitized form, are acquired directly from the internet. Even if, not all services or goods can be delivered electronically, there are several applications in place on the internet. For instance, downloading of e-books, magazines, newspapers, music, standard-software, individualized software and using online information services.<sup>55</sup> Therefore, one can say that tangible goods are considered as indirect e-commerce, in contrast, intangible goods, and data information is the type of direct e-commerce.

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<sup>48</sup> *Ibid.*

<sup>49</sup> Elani F., *The VAT Implications of E-commerce Goods and Services Imported to South Africa*, Mini Dissertation, North-West University, 2014, P. 43.

<sup>50</sup> *Ibid.*

<sup>51</sup> European Commission, *A European Initiative in Electronic Commerce*, 1997, COM (97) 157, P. 3. <<http://aei.pitt.edu/id/eprint/5461>> (Accessed 03 March 2017)

<sup>52</sup> Andreas K., *VAT Taxation of E-Commerce -Under Special Consideration of the 6<sup>th</sup> EU VAT Directive-*, LL.M Dissertation, University of Cape Town. P. 6.

<sup>53</sup> The European Commission defines direct commerce as follows: “*direct e-commerce is the online ordering, payment and delivery of intangible goods and services such as computer software, entertainment content, or information services on a global scale.*”, European Commission, *Supra note 51.*

<sup>54</sup> *Id.*, P. 7.

<sup>55</sup> *Ibid.*

## 2.6. Need for Taxation of E-Commerce

With regard to e-commerce be subjected to tax just like regular commerce, is a debatable issue among scholars. The first approach, the pro-taxation, contends that e-commerce, just like regular commerce, should be taxed. Arguments for taxing e-commerce are based on equity, economic neutrality, and revenue considerations.<sup>56</sup> *First*, “failure to impose the tax on online purchases would cause significant revenue losses for state and local governments”.<sup>57</sup> *Second*, allowing tax exemption for electronic goods and services that are identical to goods and services purchased in traditional stores is not fair, e.g., not taxing an e-book that is downloaded directly online while taxing the hardcopy of the same book sold in a store.<sup>58</sup> *Third*, a basic principle of taxation is economic neutrality. Taxation should be economically neutral that is, it should not influence the form or location of economic activity.<sup>59</sup> *Fourth*, tax free e-commerce gives these sellers an unfair advantage over traditional bricks-and-mortar retailers. Means, by comparison, much of e-commerce does compete with vendors who would be disadvantaged by preferential tax treatment of e-commerce.<sup>60</sup>

On the other hand, proponents of anti-taxation argue that “the e-commerce business is an emerging industry and that taxing online activities would negate its future development; hence, at least a delay on taxation of e-commerce would be advisable.”<sup>61</sup> Moreover, the opponents of e-commerce taxation argue that due to the electronic and border-spanning nature of the internet, the existing tax laws are inappropriate for the internet. Hence, in order for these laws to work for electronic marketplace, serious modifications and different enforcement mechanisms are required.<sup>62</sup> Complexity of taxation is the other argument raised by opponents of e-commerce taxation. With multiple taxing jurisdictions, it becomes difficult for individual and businesses to know their respective tax liabilities and the confusion so generated result in avoidance or double taxation.

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<sup>56</sup> Basu S., ‘Relevance of E-Commerce for Taxation: an Overview’, *Global Jurist Topics*, 2003, Vol. 3, No. 3, P. 18, <<http://www.bepress.com/gj/topics/vol3/iss3/art2>> (Accessed 23 February 2017)

<sup>57</sup> *Ibid.*

<sup>58</sup> Oduntan A., *Supra note 35*, P. 39.

<sup>59</sup> *Ibid.*

<sup>60</sup> *Ibid.*

<sup>61</sup> Austan G. *et al*, ‘Evaluating the Costs and Benefits of Taxing Internet Commerce’, *National Tax Journal*, 1999, Vol. 52, P. 413-428.

<sup>62</sup> Annette N., ‘E-Commerce: To Tax or Not to Tax? That Is the Question ... or Is It?’, *The Computer and Technology Law Conference*, San Francisco, June 29, 2001, P. 32.

However, this does not mean that e-commerce vendors should not collect a tax that is dramatically simplified.<sup>63</sup>

Therefore, from the cursory reading of the above two arguments it can be said that there is no consensus as to whether e-commerce should be made subject to taxation or, if so, to what extent. As a result of this, examine the arguments for and against taxation of e-commerce in a systematic way in order to provide proper guidance for policy-makers on this important issue has a paramount importance. In the Ethiopian context, though e-commerce is subjected to tax as a normal business transaction, due to various legal, infrastructural and other technological reasons the practice is defective.

As there is now a clear understanding as to the overall notions of e-commerce and taxation of e-commerce, the following section will address how different jurisdictions are applying VAT on e-commerce in their systems.

## **2.7. International Initiatives on Applying VAT on E- Commerce Transactions**

### **2.7.1. OECD and Taxation of E-Commerce VAT**

The OECD is one of the leading and very significant organization that shows its efforts to the tax issues arising from electronic transactions.<sup>64</sup> The OECD was originally established to promote and assist policies with the design to achieve the highest sustainable economic growth and rising standard of living in ‘member countries’<sup>65</sup> so that contributing to the development of the world economy as well.<sup>66</sup> The OECD was the first to establish a framework for the taxation of e-commerce. This was because the OECD realized that electronic commerce has an enormous potential to change the way people work, play and organize their lives. “If this potential is to be fully realized, the OECD decided they must provide a taxation framework that provides neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility and that precludes the establishment of new tax obstacles for this new form of doing business.”<sup>67</sup>

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<sup>63</sup> Oduntan A., *Supra note 35*, P. 39-39.

<sup>64</sup> Silafis k., *Consumption Taxation & Electronic Commerce: Issues, Approaches and A Way Forward*, PhD Dissertation, University Aberystwyth, Department of Law & Criminology, 2015, P. 155.

<sup>65</sup> The members of the sub-group include: Australia, Canada, France, Germany, Ireland, Italy, Japan, Korea, Norway, the Netherlands, Sweden, Switzerland, United Kingdom, United States, European Commission and Singapore.

<sup>66</sup> OECD, *Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions*, 2001, <<http://www.oecd.org/ctp/consumption/Taxation%20and%20eCommerce%202001.pdf>> (Accessed 25 March 2017).

<sup>67</sup> *Ibid.*

Accordingly, on 8<sup>th</sup> October 1998, the Ottawa taxation framework conditions was adopted. Since 1998, the work of the OECD's Committee on Fiscal Affairs (CFA) has continued to develop these principles into practical guidance for international application.<sup>68</sup> In particular, the OECD has established working parties in an attempt to craft an international tax policy.

These and several other attempts have paved the way for a statement of broad taxation principles that should apply to e-commerce:<sup>69</sup> The taxation principles, which guide governments in relation to conventional commerce should also apply equally to e-commerce, namely:

A. Neutrality – taxation is expected to be neutral and equitable between different forms of e-commerce and between conventional and electronic commerce,<sup>70</sup> thus avoiding double taxation or unintentional non-taxation. Business decisions should be motivated by economic, rather than by tax, considerations;

B. Efficiency – this principle underlines that the compliance costs for businesses and administration costs for governments should be as low as possible so that a large fraction of what is taken from the tax-payer's pocket is not used up in collecting the tax.

C. Certainty and Simplicity – in order to promote certainty and simplicity, the tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance, including knowing when, where and how the tax is to be accounted for.<sup>71</sup>

D. Effectiveness and Fairness – taxation should produce the right amount of tax at the right time, and fairness may also indicate horizontal equity, where individuals under equal circumstances are taxed equally or equal transactions are taxed equally.<sup>72</sup> Accordingly, the potential for evasion and avoidance should be minimized.

E. Flexibility – the systems for taxation should be flexible and dynamic to make sure that they keep pace with technological advancement and commercial expansions.

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<sup>68</sup> OECD, *The Economic and Social Impact of Electronic Commerce: Preliminary Findings and Research Agenda*, OECD Digital Economy Papers No. 40, OECD Publishing, Paris, 1999, <<http://dx.doi.org/10.1787/236588526334>> (Accessed 16 March 2017)

<sup>69</sup> OECD, *Electronic Commerce: Taxation Framework Conditions. A Borderless World: Realizing the Potential of Electronic Commerce*, 1998, <<http://www.oecd.org/dataoecd/46/3/1923256.pdf>> (Accessed 8 February 2017)

<sup>70</sup> Elani F., *Supra note 49*, P. 50.

<sup>71</sup> OECD, *Implementation Issues for Taxation of Electronic Commerce*, 2003c, <<http://www.oecd.org/tax/consumption/5594899.pdf>> (Accessed 8 February 2017)

<sup>72</sup> Sol P., *Supra note 3*, P. 82.

These principles can be applied through existing tax rules, and any new or revised administrative measures in the framework of those rules should be directed towards the application of existing taxation principles. There should be no discriminatory tax treatment on e-commerce.

Subsequently, the CFA of the OECD proceeded to implement these taxation framework by establishing five Technical Assistance Groups (TAGs).<sup>73</sup> Among those five TAGs, one of the groups, the Consumption Tax TAG, scrutinized consumption taxes especially VAT and electronic commerce transactions in three areas, these are the rules for consumption taxation of cross-border trade, whether the supply of digitized products must be treated as a supply of services, and mechanisms that can be used to provide immediate protection to the revenue base.<sup>74</sup>

Thus, the framework conditions of OECD recommends that, firstly, the rules for consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place.<sup>75</sup> As a consequence the OECD suggests that the place of consumption entitles the state to impose tax. The main purpose of this rule is to prevent double taxation, or unintentional non-taxation.<sup>76</sup> Secondly, for the purpose of consumption taxes, the supply of digitized products should not be considered as a supply of goods.<sup>77</sup> Accordingly, the OECD proposes that the supply of digitized products, so pure online-business, should be treated as the supply of services.<sup>78</sup> Lastly, a reverse-charge, self-assessment mechanism should be used where businesses and other organizations within a country acquire services and intangible property from outside the country.<sup>79</sup>

The OECD countries also agreed that for business to business (B2B) supplies tax should apply in the jurisdiction in which the recipient is located and for business to consumer (B2C) supplies, the place of consumption should be the jurisdiction in which the recipient has his or her usual residence.<sup>80</sup> Generally, the OECD has played a significant role in facilitating discussions,

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<sup>73</sup> The five TAGs created were the Treaty Characterization TAG, the Business Profits TAG, the Consumption Tax TAG, the Technology TAG and the Professional Data Assessment TAG.

<sup>74</sup> Jones R. & Basu S., 'Taxation of Electronic Commerce: A Developing Problem', *International Review of Law Computers & Technology*, 2002, Vol. 16, No.1, P. 35-52, <<http://www.bileta.ac.uk/01papers/rjones.htm>> (Accessed 1 January 2017)

<sup>75</sup> OECD, *International VAT/GST Guidelines*, 2006, P. 10, <<http://www.oecd.org/ctp/consumptiontax/36177871.pdf>> (Accessed 12 March 2017).

<sup>76</sup> *Id.*, P. 4

<sup>77</sup> *Ibid.*

<sup>78</sup> *Ibid.*

<sup>79</sup> *Id.*, P. 6.

<sup>80</sup> OECD, *Consumption Taxation of Cross-Border Services and Intangible Property in the Context of E-commerce, A. Guidelines on the Definition of the Place of Consumption*, 2001, P. 1-2,

developing guidelines and possible solutions to the task of indirectly taxing e-commerce by tax authorities.<sup>81</sup> Nonetheless, it is good to note that, though OECD members apply consumption taxes, there are no model treaties or bilateral international agreements that cover VAT especially for e-commerce transactions.<sup>82</sup> Hence, the OECD is anticipated to lead efforts towards a model tax treaty on taxation of VAT arising from e-commerce.<sup>83</sup>

### **2.7.2. European Union VAT Regime in Taxation of E-commerce**

European Union is one of the most prominent tax jurisdictions in the world to develop and implement a simplified framework for consumption taxes on e-commerce. This framework of EU is in compliance with the principles agreed within the framework of the OECD.<sup>84</sup> Accordingly, in June 1999, the European Commission issued a Working Paper to revise the current tax rules of the VAT Directives for both goods and services, irrespective of the medium through which these items are vended.<sup>85</sup> By acknowledging the complexity of the VAT procedures and the delays in obtaining refunds of VAT paid in other member states are major disincentive to cross-border trade, the paper also recognized the need to apply existing taxation rules effectively.<sup>86</sup> Besides, it underlines the improvement of the existing rules based on the evolution of business, and particularly e-commerce.

In 2000, the European Commission issued a proposal for a directive to modify the rules for applying VAT to certain services supplied by electronic means as well as subscription-based and pay-per-view radio and television broadcasting. The objective of the proposal is to create a level playing field for the taxation of digital e-commerce in accordance with the OECD principles. The proposal mainly concerns the supply over electronic networks of software and computer services generally. The proposal would ensure that when these services are supplied for consumption within

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<<https://www.oecd.org/ctp/consumption/5594831.pdf>> (Accessed 13 February 2017).

<sup>81</sup> Reimar P., *Application of the EU Value Added Tax to E-Commerce Transaction*,

<[http://www.tahghigh.net/tarjomeha/series/645300\\_en.htm](http://www.tahghigh.net/tarjomeha/series/645300_en.htm)> (Accessed 20 February 2017).

<sup>82</sup> Watako M., *Application of Kenyan VAT Law to E-Commerce*, LL.M Thesis, University of Nairobi, 2012, P. 52.

<sup>83</sup> *Id.*, P. 44.

<sup>84</sup> VAT on Electronic Services,

<[http://ec.europa.eu/taxation\\_customs/taxation/vat/traders/ecommerce/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/vat/traders/ecommerce/index_en.htm)> (Accessed 20 February 2011), as cited by, Dauda A., *Supra note 34*, P. cclxxiii.

<sup>85</sup> European Commission, *Harmonization of Turnover Taxes*, Directorate General XXI, Working Paper, 1999, No. 1, <[www.europa.eu.int](http://www.europa.eu.int)> (Accessed 13 February 2017).

<sup>86</sup> Jones R. & Basu S., *Supra note 74*.

the European Union, they are subject to EU VAT, but when these services are supplied for consumption outside the European Union, they are exempted from VAT.<sup>87</sup>

Later, Council Directive 2002/38/EC which entered in to effect on 1<sup>st</sup> July 2003, was adopted on 7<sup>th</sup> May 2002. Following the effective date, the European Union's directive on electronic communications obliges all non-EU companies selling digital goods and services online to consumers within the EU to register with an EU tax authority and charge, collect and remit VAT.<sup>88</sup> The registration of non-resident businesses, hence, can be made in an interim "special scheme" arrangement with one EU member state, which will operate a form of clearinghouse to ensure each EU member state receives its appropriate amount of VAT due to it.<sup>89</sup> After remittance, the appropriate EU countries in which the digital goods and services were sold, will redistribute the VAT.<sup>90</sup> Based on this Directive, therefore, the place of taxation was changed from the origin principle to the destination principle for B2B transactions; and, for B2C transactions, the origin principle was still applicable. There was also a list of items supplied that were considered to be electronic services supplied.

In 2006, Council Directive 2006/58/EC was adopted on 27<sup>th</sup> 2006 June 2006, Council Directive 2006 /138/EC was adopted on 19<sup>th</sup> December 2006 and Council Directive 2008/8/EC was adopted on 12<sup>th</sup> February 2008. These VAT arrangements were extended until 31 December 2009. As far as electronically supplied services are concerned, Council Regulation (EC) 792/2002 temporarily amending Regulation (EEC) 218/92 on administrative co-operation in the field of indirect taxation (VAT) subsequently included in Regulation (EC) 1798/2003, "introduces additional measures necessary for registering for VAT purposes of e-service traders not established within the Community and where the services were actually used, for distributing the VAT receipts to the Member States".<sup>91</sup> As per these new rules, when selling on markets outside the EU, suppliers of

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<sup>87</sup> McLure C., 'The Value Added Tax on Electronic Commerce in the European Union', *International Tax and Public Finance*, 2003, Vol. 10, No. 6, P. 753.

<sup>88</sup> European Commission, Council Directive 2002/38/EC: Amending and amending temporarily directive 77/388/EEC as regards the Value Added Tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services, 2002, <<http://eur-lex.europa.eu/legal-content/GA/TXT/?uri=CELEX:32002L0038>> (Accessed 2 February 2017)

<sup>89</sup> Commission Proposal for a Council Directive Amending Directive 77/388/EE, as cited by, Oduntan A., *Supra note* 35, P. 53.

<sup>90</sup> Oduntan A., *Ibid.*

<sup>91</sup> Dauda A., *Supra note* 34, P. clxxv.

EU are no longer obliged to levy VAT. Previously under tax rules drawn up before, EU suppliers had to charge VAT when supplying digital products even in countries outside the EU.<sup>92</sup>

The reform, by obliging non-EU suppliers to charge VAT as EU suppliers when they are providing electronic services to EU non-taxable persons, it tries to bring to an end the existing competitive distortion.<sup>93</sup> This is something which EU businesses had been actively pursuing for some time.<sup>94</sup> However, the VAT rules for non-EU suppliers selling to customers in the Union remain applicable. In doing so, the VAT is supposed to be paid by the importing company under reverse charge mechanisms.

Council Directive 2008/8/EC was adopted on 12 February 2008.<sup>95</sup> The aim of the Directive was to combat tax evasion connected to intra-community transactions.<sup>96</sup> In this Directive, the reverse charge mechanism was introduced on B2B transactions in the European Union. According to reverse charge arrangement, the liability to pay VAT is shifted from the supplier to the recipient of the supply.<sup>97</sup> However, the reverse charge mechanism that was supposed to be applied on B2B transaction was not taken as an effective option for B2C transactions. Because, in B2C transactions, consumers are not registered and have neither the skills to voluntarily proceed to the remittance of the tax nor any incentive to do so given that they have to bear the economic burden of the tax without any possibility of recovering it.<sup>98</sup> Thus, “the registration of European suppliers in one of the member states and pay VAT at that state for all supplies to European consumers based on the tax rates of the countries of consumption is required”.<sup>99</sup> Regulation 2011/282 is the other EU Directive that was issued on 15 March 2011 to supply a definition of electronically supplied services for VAT purposes.<sup>100</sup> Consequently, “electronically supplied services shall include services which are delivered over the internet or an electronic network and the nature of

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<sup>92</sup> VAT on Electronic Services, as cited by, Dauda A., *Supra note 34*, P. cclxxv.

<sup>93</sup> Dauda A., *Supra note 34*, P. cclxxv.

<sup>94</sup> *Ibid.*

<sup>95</sup> Council Directive 2008/8/EC of 12 February 2008 Amending Directive 2006/112/EC as Regards the Place of Supply of Services, Official Journal of the European Union, <<http://data.europa.eu/eli/dir/2008/8/oj>> (Accessed 23 March 2017)

<sup>96</sup> Dauda A., *Supra note 34*, P. cclxxiv.

<sup>97</sup> *Ibid.*

<sup>98</sup> *Ibid.*

<sup>99</sup> Pronina T., *Supra note 19*, P. 35.

<sup>100</sup> European Commission, Council Implementing Regulation (EU) No 282/2011, *Official Journal of the European Union*, <<http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:077:0001:0022:EN:PDF>> (Accessed 17 March 2017)

which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology.”<sup>101</sup>

To conclude, it can be said that the European Union has done considerable work in adjusting the existing VAT rules to the realities of e-commerce.<sup>102</sup> But, it does not mean that the European Union does have a perfect legal framework which tries to tackle all the problems related with taxation of e-commerce. So, the EU is still in the transitional period of establishing concrete rules to deal with the phenomenon of e-commerce taxation.<sup>103</sup> Developments and amendments implemented by the EU in their application of VAT on e-commerce may form lessons for Ethiopia in coming up with appropriate policy and legislation.

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<sup>101</sup> *Ibid*, Art. 7.

<sup>102</sup> Rajiv R., *India: Country Report on E-Commerce Initiatives*, Department of Information and Technology Ministry of Information and Technology India, 2005, P. 133-145.

<[http://www.unescap.org/tid/publication/part\\_three2261\\_ind.pdf](http://www.unescap.org/tid/publication/part_three2261_ind.pdf)> (Accessed 14 February 2017)

<sup>103</sup> Watako M., *Supra note 82*, P. 60.

## CHAPTER THREE

### 3. ETHIOPIAN VAT REGIME IN TAXATION OF E-COMMERCE

#### 3.1. Introduction

Ethiopia is one of the least developed countries, which has recently experienced a tremendous growth in the number of internet users.<sup>104</sup> As report shows, individual purchasers and business buy more and more goods and services online both from local and foreign suppliers.<sup>105</sup> According to the 2015 UN report, in the years of 2009 B2C e-commerce sales in Ethiopia is 0.02 \$billions, in the years of 2010 is 0.03 \$billions and increase year by year in 2011 the business of e-commerce is 0.04 \$billions and end the year of 2012 business of e-commerce growth is 0.06 \$billions.<sup>106</sup> Taking the expansion of online transactions in to consideration, the VAT system of Ethiopia has taken some steps in adapting the existing VAT rules to the realities of e-commerce. However, due to the absence of proper regulation and enforcement problems, most online transactions simply escape taxation. In this chapter, the VAT systems that Ethiopia currently has mainly the issues related to the application of the VAT legislations on e-commerce transaction will be examined.

#### 3.2. Overview of E-Commerce in Ethiopia

Over the past couple of years, e-commerce in Ethiopia has shifted the gear on how business is done; as a result, people have started doing online business just like traditional transactions.<sup>107</sup> Most companies, associations, chambers and government offices have set up websites. These sites mainly provide information about an organization, and its products and services. There are very few sites where financial transactions can be completed. As reports show, the main reasons for low e-commerce transactions are due to the absence of legal framework for completing an electronic business or financial payment system, stringent exchange control regulations, low

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<sup>104</sup> Digital In 2017: Global Overview, <<https://wearesocial.com/special-reports/digital-in-2017-global-overview>> (Accessed 29 June 2017)

<sup>105</sup> UNCTAD, *E-commerce in the Least Developed Countries E-commerce and Development Report*, New York and Geneva, 2001, Part Four, P. 192, <<http://unctad.org/en/Docs/ecdr01p4.en.pdf>> (Accessed 30 March 2017)

<sup>106</sup> UNCTAD, *Information Economy Report 2015: Unlock the Potential of E-Commerce for Developing Countries*, New York and Geneva, Sales No. E.15. II.D.1, 2015, P. 25, <[http://unctad.org/en/PublicationsLibrary/ier2015\\_en.pdf](http://unctad.org/en/PublicationsLibrary/ier2015_en.pdf)> (Accessed 11 October 2017)

<sup>107</sup> Eden S., *AfricaBusiness.com*. <<http://africabusiness.com/2016/05/18/e-commerce-paving-its-way-in-the-untapped-ethiopian-market/>> (Accessed 22 March 2017); Addis Fortune (Addis Ababa), Ethiopia: *Can We Afford the Internet Shutdown in Ethiopia?*, <<http://allafrica.com/stories/201706060615.html>> (Accessed 19 October 2017)

internet usage due to lack of adequate telecom facilities, and overall lack of confidence in the security and reliability of e-commerce transactions.<sup>108</sup>

E-commerce models are either an extension or revision of traditional business models, such as advertising and auction models, or a new type of business model that is suitable for the Web implementation, such as intermediary, selling information collected over the Web about individuals and businesses to other businesses.<sup>109</sup> Despite the fact that there are various e-commerce models, the most common e-commerce models in Ethiopia are The Merchant model and The Advertising model. The Merchant model is a simple extension of the usual offline retail model to the online world by using the internet. Hence, except that it sells goods and services over the Web, the most common type of merchant model is similar to a traditional business model.<sup>110</sup> Amazon.com is one of the online retail store that can be cited as a good example of this category in the international arena.<sup>111</sup> Local merchant model websites are emerging in Ethiopia. One example-shopping platform in Ethiopia is Jumia.com, which allows members to purchase various items sold on the website.<sup>112</sup> The website offers various products like dresses, shoes, mobiles, laptops etc.

The other most popular e-commerce model in Ethiopia is advertising model. This business model uses the internet as a medium to target and deliver marketing messages to customers and takes a number of forms.<sup>113</sup> “The most prominent of online advertising is display adverts, in which an advertiser pays to display adverts linked to particular content or user behavior, and search engine adverts, in which an advertiser pays to appear among internet search results.”<sup>114</sup> Search engines and directories such as Google, Yahoo! and AltaVista and social media such as Facebook provide content and allow the users to access this content for free while selling advertising.<sup>115</sup> Google for example sells advertising space by letting advertisers to bid on the price of keywords and then charging based on the number of users who clicked the adverts. Delala.com is one of the few online advertising in Ethiopia, which promotes and markets car as well as other goods and services

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<sup>108</sup> Bultum A., ‘Factors Affecting Adoption of Electronic Banking System in Ethiopian Banking Industry’, *Journal of Management Information System and E-commerce*, 2014, Vol. 1, No. 1, P. 3.

<sup>109</sup> Hossein B., *Electronic Commerce: Principles and Practice*, Academic Press, USA, 2002, P. 44.

<sup>110</sup> *Ibid.*

<sup>111</sup> <<https://www.amazon.com/gp/help/customer/display.html?nodeId=596186>> ( Accessed 30 June 2017)

<sup>112</sup> <<https://www.jumia.com.et>> (Accessed 30 June 2017)

<sup>113</sup> OECD, *Addressing the Tax Challenges of the Digital Economy*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, P. 28, <<http://dx.doi.org/10.1787/9789264218789-en>> (Accessed 28 June 2017)

<sup>114</sup> *Ibid.*

<sup>115</sup> Hossein B., *Supra note 109.*

including real estate in Ethiopia.<sup>116</sup> This website is established to overcome distance barrier between both the potential buyers and the sellers and save the valuable resource devote to buy and/or sell various products and services with a click of mouse and sellers to advertise the item they want to sale.<sup>117</sup> Another online marketing business popular in Ethiopia is Kaymu.com. This website is an online marketplace in Ethiopia where by buyers and sellers can meet and make awesome business deals.<sup>118</sup> Kaymu offers a wide variety of used and new items including Clothes, accessories, electrical goods, gadgets, gifts, and jewelries to the buyers.<sup>119</sup> Similarly, Qefira is an online and mobile web based advertisement platform that offers buyers and sellers an opportunity to effectively reach their target audience.<sup>120</sup>

### 3.3. VAT in Ethiopia

In Ethiopia, VAT applies as an indirect tax is applicable at different levels of production and distribution, then ultimately paid by the consumers on classified consumer products. As will be discussed in this chapter, VAT is a consumption tax charged on both local sales and importation of taxable goods and services.

VAT in Ethiopia was administered by the “EFIRA, Ethiopian Customs Authority”<sup>121</sup> and the Regional Government’s Finance Bureaux.<sup>122</sup> The ECA administers VAT on imports of goods and services into the country.<sup>123</sup> In the fiscal year 2009, VAT on import items generated revenue of 4.2 billion birr that accounted 34.54 percent of the total revenue collected by the ERCA from taxes imposed on imported items.<sup>124</sup> The EFIRA with its VAT department, large taxpayers’ office and branch offices (Addis Ababa branch and regional branch offices) administers federal and joint

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<sup>116</sup> <<https://www.delala.com>> (Accessed 16 June 2017)

<sup>117</sup> *Ibid*; in the same fashion, Mekina.net offers a similar service in Ethiopia. Hence, if people want to market their cars using Mekina.net, they have to pay ETB 250 per car.

<sup>118</sup> <<https://www.kaymu.com>> (Accessed 16 June 2017)

<sup>119</sup> *Ibid*.

<sup>120</sup> *Ibid*.

<sup>121</sup> The EFIRA and ECA have merged since the year 2008; Yeneakal T., ‘Melaku to Remain Head at the New Revenue Authority’, *Capital Newspaper*, Addis Ababa, 20 July 2008,

<[http://www.capitalethiopia.com/archive/2008/july/week3/local\\_news.htm#6](http://www.capitalethiopia.com/archive/2008/july/week3/local_news.htm#6)> (Accessed 22 October 2017)

<sup>122</sup> Ethiopia is a federal country with nine regional governments and two self-administering cities (Addis Ababa and Dire Dawa cities).

<sup>123</sup> VAT Proclamation, *Supra note 10*, Art. 26(4).

<sup>124</sup> Abebe H., *Imports and taxes in Ethiopia, Taxpayers Education and Communication Senior Expert*, P.7, <<http://www.erca.gov.et/images/Documents/Customs/Others/1457.pdf>> (Accessed 19 September 2017)

VAT on local transactions, while regional governments' finance bureaus administer their own VAT revenues.<sup>125</sup>

As seen throughout in the discussion above, the main Ethiopian VAT regime is enshrined in the 2002 VAT Proclamation. The proclamation stipulates that VAT shall be charged in accordance with the provisions of the proclamation on the supply of goods and services in Ethiopia and on the importation of goods and services into Ethiopia. Correspondingly, the Proclamation applies to the supply of goods and rendering of services conducted by a non-resident in Ethiopia through a permanent establishment in Ethiopia or through the internet.<sup>126</sup> Therefore, as per Article 4(7) of the VAT proclamation, if a non-resident engage in the supply of goods and rendering of service via internet then the VAT Proclamation will be applied. This is true even if a non-resident do not have a permanent establishment in Ethiopia.

### **3.4. Taxable Transactions**

Taxable transaction is defined in the VAT Proclamation expansively as “[a] supply of goods or a rendition of services in Ethiopia in the course or furtherance of a taxable activity other than an exempt supply under Article 8.”<sup>127</sup> Here, The VAT Proclamation of Ethiopia specifies that VAT shall be charged on any supply of goods or services in Ethiopia where it is a taxable supply made by a taxable person in the course of or in furtherance of any business carried on by him. There are, however, lists of exempted goods and services from VAT by the Proclamation.<sup>128</sup> In this sense, it can be stated that the notion of taxable transaction is related with supply of goods or rendition of services.

When referring to the VAT Proclamation for the definition of goods and services, the term good is defined broadly. It includes all corporeal movable or immovable property.<sup>129</sup> The definition is confined to corporeal property. Hence, incorporeal property (such as intellectual or industrial property (copyrights, patents, trademarks and the like), shares, stocks and securities) and other intangible properties are not considered as goods.<sup>130</sup> However, incorporeal property may be treated

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<sup>125</sup> Wolela A., ‘Value Added Tax Administration in Ethiopia: A Reflection of Problems’, *e Journal of Tax Research*, 2008, Vol. 6, No. 2, PP. 145-168.

<sup>126</sup> VAT Proclamation 2002, *Supra note* 10, Art. 4(7).

<sup>127</sup> *Id.*, Art. 7(3).

<sup>128</sup> *Ibid*; In addition, Article 8 (4) of the Proclamation empower Ministry of Finance to add its own exemption lists of goods and services not listed in the Proclamation.

<sup>129</sup> *Id.*, Art. 2(7).

<sup>130</sup> Art. 2(7) define “goods” as, “all kind of corporeal movable or immovable property, thermal or electric energy, heat, gas, refrigeration, air conditioning and water energy, but does not include money.”

as services for the purposes of VAT. The definition expressly includes thermal or electrical energy, heat, gas, refrigeration, air conditioning and water. Thus, the transfer or provision of these utilities is treated as a supply of goods (not services) for the purposes of the VAT.

The other term that is central to the operation of the VAT is service. As provided under Article 2(16), services is defined as “work done for others which doesn’t result in the transfer of goods.” This catchall definition has a vital role to prevent sales from escaping tax by not falling within either the definition of goods or services. What we have to understand here is that the terms “goods” and “services” shall be treated separately and something cannot be goods and services at time.<sup>131</sup>

With respect to the classification of digitized items, the VAT Proclamation does not contain a specific clear provision that determines how digitized items will be characterized as goods or services. Nonetheless, the definition of services is broadly formulated and includes everything that does not constitute goods. Accordingly, the supply of digital content or electronic services would have been classified as a service. It follows that intangible property does not constitute goods, therefore falls within the definition of services.<sup>132</sup> This corresponds to an EU proposal that for VAT purposes trade in digital goods be treated as a supply of services.<sup>133</sup> Here, the VAT Proclamation of Ethiopia says nothing as to what electronically supplied services include. In South Africa, for example, the VAT Regulation lists the services that meet the definition of electronic services per the VAT Act. Consequently, educational services, games and games of chance, internet based auction services, miscellaneous services and subscription services are electronic services where such services are supplied by means of any electronic agent, electronic communication or the internet for any consideration.<sup>134</sup> The list provided in the Regulation are not exhaustive and include all electronic services that the VAT rules would apply to however it provides a level of guidance as to what the definition encompasses.<sup>135</sup> Yet, in Ethiopia, there is no legislative definition of electronically supplied services for VAT purposes. Thus to clear up some misunderstanding

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<sup>131</sup> Yohannes M. & Sisay B., *Supra note 5*, P. 73.

<sup>132</sup> Johnston, ‘Value Added Tax on Virtual World Transaction: A South Africa Perspective’, *International Business and Economics Research Journal*, 2013, Vol. 12, No. 1, P. 76.

<sup>133</sup> Jones R. & Basu S., *Supra note 74*.

<sup>134</sup> South African Value-Added Tax Act, 1999, Regulations Prescribing Services for the purpose of the definition of “Electronic Services”, Government Gazette, Act No. 89/1999, No. 37489, Section 1. The Regulation is similar to that of the European Union (EU) per Annexure 1 to the council Regulation of 17 October 2005.

<sup>135</sup> Tsogo R., *An Evaluation of The Practical Application of The South African VAT Legislation on Electronic Services: A Case Study*, LL.M Dissertation, North-West University, 2015. P. 24.

concerning what is included in the definition of electronic services it became necessary that the law be clarified.

Besides all that is discussed above, for practical purposes a distinction must be drawn between supplies that are ordered and delivered on the Internet by electronic means, and commodities that are ordered on the Internet and delivered by traditional means.<sup>136</sup> In the latter case, administrative procedures already in place for traditional cross-border trade continue to apply.<sup>137</sup> The supply of tangible goods ordered over the Internet is fairly easy to monitor because tangible corporeal goods must be cleared through customs at a border post before entering the country.<sup>138</sup> Goods delivered by airmail are monitored by the Ethiopian post office, where the value for VAT purposes is determined, and where VAT is levied at the appropriate rate.<sup>139</sup> These goods, accompanied by a VAT declaration, are posted to the recipient. The recipient must pay VAT (as indicated on the VAT declaration form) at the post office where the package is collected. The fact that tangible goods, which are ordered electronically, are delivered to a designated physical address simplifies the task of ensuring that appropriate VAT is levied and collected.<sup>140</sup>

In the case of Internet deliveries of incorporeal items such as software, music, and videos, it is often difficult to determine whether or not a transaction has occurred.<sup>141</sup> Since electronic deliveries do not go through the mails or customs, it is difficult to track and trace the occurrence of these transactions.<sup>142</sup> Meaning, in electronically delivered digitized products, delivery cannot be intercepted as in the case of corporeal goods that must enter a customs area; this would essentially avoid import VAT.

As we will discuss here in below, a person is a taxable person if he makes taxable sales above a threshold amount and such sales are made in connection with certain economic or taxable activity. In the following section we are going to see the kind of e-commerce activity that gives rise to sales subject to tax.

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<sup>136</sup> Ebrill L, et al, *The Modern VAT*, International Monetary Fund, Washington, D.C. 2001, P. 186.

<sup>137</sup> *Ibid*; OECD, *International VAT/GST Guidelines on Neutrality*, 2011, P. 5, <http://www.oecd.org/tax/consumptiontax/48331948.pdf> (Accessed 11 October 2017).

<sup>138</sup> Steyn T., 'VAT and E-commerce: Still Looking for Answers?', *SA Mercantile Law Journal*, 2010, Vol. 22, No. 2, P. 233; Van der Merwe B., *Supra note 39*, P. 382, Naicker K., 'The VAT Implications of E-commerce', *Taxtalk*, 2010, P. 8.

<sup>139</sup> Steyn T., *Supra note 138*.

<sup>140</sup> *Id.*, P. 234; Naicker K., *Supra note 138*.

<sup>141</sup> Ebrill L, et al, *Supra note 135*; OECD, *Supra note 74*, P. 188.

<sup>142</sup> *Ibid*, P. 5.

### 3.5. Taxable Activity

The VAT Proclamation under Art 6 clearly envisages what kind of activity or transaction is subject to imposition of VAT. Accordingly, Taxable activity is;

*“[A]n activity which is carried on continuously or regularly by any person. (1) In Ethiopia, or (2) partly in Ethiopia whether or not for pecuniary benefit that involves or is intended to involve in whole or in part, the supply of goods or services to another person for consideration.”<sup>143</sup>*

On the basis of the above definition, irrespective of the profit accrued, as far as there is regular or continuous supply for consideration, it is a taxable activity. In other words, an activity may be a taxable activity within paragraph (2), whether or not it is carried on for pecuniary profit. The terms regularly and continuously here indicate the frequency of the transaction. Hence, an activity carried on continuously or regularly by any person wholly or partly in Ethiopia that involves or is intended to involve the supply of taxable goods or services to a person for consideration is a taxable activity. However, as per the Value Added Tax (Amendment) Proclamation, the phrase “any person” under Article 6 is replaced by “any registered person”.<sup>144</sup> Similarly, the requirement of “activity which is carried on continuously or regularly” is also changed by “activity whether or not carried on continuously or regularly”.<sup>145</sup> Hence, to be taxable, the activity does not have to be carried on continuously or regularly. Meaning, as far as the activity is carried out by a registered person, an activity is a taxable activity even if it is not carried on continuously or regularly (assuming the other necessary conditions are met).

When looking at taxable activities regarding e-commerce transactions, businesses can advertise and sell products through their own websites and cyber malls and delivering the products via internet and courier services and information databases that can be subscribed to at a fee.<sup>146</sup> For example, Delala.com, Mercato.com and Qefira, are an online and mobile web based advertisement platforms that sells advertising space to the advertisers by letting them to promote and market their products and reach their target audiences. Similarly, Jumia sales various used and new products including clothes, shoes, accessories, mobiles, jewelries and other similar products to the buyers.<sup>147</sup> Another potential taxable activity in e-commerce transaction is the sale of intangible property such

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<sup>143</sup> VAT Proclamation 2002, *Supra note* 10, Art. 6.

<sup>144</sup> Value Added Tax (Amendment) Proclamation, 2008, *Federal Negarit Gazeta*, Proc. No. 609/2008, 15<sup>th</sup> year, No. 6, Art. 2(3).

<sup>145</sup> *Ibid.*

<sup>146</sup> Sijbren C., ‘VAT Treatment of Immovable Property’, *Tax Law Design and Drafting*, 1996, No. 1, P. 421.

<sup>147</sup> *Ibid.*

as software and related purchases. Other services include brokerage services.<sup>148</sup> Consequently, where those and similar e-commerce activities are carried on by any registered person either in Ethiopia or partly in Ethiopia for consideration then the activity is subject to VAT. This is true whether or not the activity is being carried on continuously or regularly.

The other most important point we need to bear in mind here is that in the Ethiopian VAT proclamation, the place of supply is included in the definition of taxable activity, as the taxable activity must be conducted “in Ethiopia” or partly in Ethiopia”.<sup>149</sup> This is, however, not clear when e-commerce transactions will be considered to be conducted in Ethiopia and yet no guidelines are issued in this regard.

### **3.6. The Rate of VAT**

Ethiopia has two VAT rates upon which tax is calculated, which include the standard rate of 15% and zero-rate, both computed on taxable supplies.<sup>150</sup> This standard rate of 15% is payable upon importation of goods and services irrespective of whether the importer is a VAT registered taxpayer or not.<sup>151</sup> Conversely, the supply of goods that are exported is zero-rated. Likewise, services rendered outside Ethiopia and services rendered to a non-resident who is outside Ethiopia when the services are rendered are zero-rated. However, regarding e-commerce it is not clear what will constitute proof where these services are delivered over internet and apply the applicable VAT rate provided in the Proclamation.

### **3.7. Regulation of VAT on E-commerce Under the Current VAT system**

The other important point worth to discuss at this stage relates to the notion of tax collection mechanisms. This is important because, inadequate and inappropriate VAT collection mechanisms in cross-border e-commerce transactions are the main sources of VAT fraud and the erosion of the tax base.<sup>152</sup> As far as online consumption taxes is concerned, there are various approaches already existing and new ones discussed. These mechanisms are self-assessment/reverse charge;

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<sup>148</sup> Delala.com is a good example of brokerage service provider in Ethiopia.

<sup>149</sup> See VAT Proclamation 2002, *Supra note* 10, Art. 10(1) in tandem with Art. 6.

<sup>150</sup> *Ibid*, Art. 7(1) (2).

<sup>151</sup> However, unlike individual consumer, VAT registered importers are entitled to claim credit for VAT paid on imports in their monthly VAT returns.

<sup>152</sup> Alfredo J., *Applying VAT to International Trade-The Challenge of Economic Globalization: The Challenge for Tax Administrations*, First Meeting of the OECD Global Forum on VAT, 2012, P. 54, <<http://www.oecd.org/ctp/consumptiontax/PptpresentationssessionmaterialGFonVAT.pdf>> (Accessed 6 April 2017)

registration of non-residents; tax at source and transfer; collection by trusted third parties, and Technology based solutions.<sup>153</sup>

Under a self-assessment or reverse charge systems, recipients would be required to determine a tax owing on imports of services and intangible property, and to remit this amount to the domestic Tax Authority.<sup>154</sup> This system is currently in place in most OECD countries and in Ethiopia as well.<sup>155</sup> Especially, where the transaction is B2B, the recipient business is a registered VAT person in the country of consumption, it has proven feasible, effective and carries a low compliance and administrative burden.<sup>156</sup> This is because authorities can verify and enforce compliance without difficulty.

In terms of the registration system, non-resident businesses shall be obliged to register in a jurisdiction and to charge, collect and remit the consumption tax to this country of registration.<sup>157</sup> This approach is deemed to be feasible, effective and would promote tax neutrality.<sup>158</sup> The effectiveness of a registration system is, however, greatly affected by registration and other hidden costs; difficulties of identifying the suppliers, and enforcing the obligation of registration on non-suppliers.<sup>159</sup>

Rather than registering in each jurisdiction where supplies are made, other option is there in which the suppliers are taxed at source and transfer the revenue to the jurisdiction of consumption.<sup>160</sup> This alternative is considered to be unfeasible in the near future.<sup>161</sup> Because, in addition to the increase cost of administration, it needs an international agreements regarding enforcement, collection and revenue transfers.<sup>162</sup>

The collection of consumption taxes by third parties is also another approach. In this method, the responsibility of collecting the taxes is not on the revenue authorities, rather financial institutions

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<sup>153</sup> Andreas K., *Supra note 52*.

<sup>154</sup> *Ibid.*

<sup>155</sup> For more discussion see section 3.7.

<sup>156</sup> *Emerging Concepts for Defining Place of Consumption*, P. 4,  
<<http://www.oecd.org/tax/consumptiontax/39874228.pdf>> (Accessed 7 April 2017)

<sup>157</sup> OECD, *Supra note 74*.

<sup>158</sup> Andreas K., *Supra note 52*.

<sup>159</sup> OECD, *Consumption Tax Aspects of Electronic Commerce*, A report from Working Party No. 9, 2001, P. 15,  
<<http://www.oecd.org/tax/consumption/2673667.pdf>> (Accessed 7 April 2017)

<sup>159</sup> *Ibid.*

<sup>160</sup> *Ibid.*

<sup>161</sup> *Id.*, P. 16,

<sup>162</sup> *Ibid.*

might have to bear that task.<sup>163</sup> This system could be effective. Nonetheless, the feasibility of shifting the onus of collection onto trusted third parties is questionable.<sup>164</sup>

Lastly, inventing a new technology that simplify the tax collection system might be an alternative feasible approach. This method of tax collection involve the use of software, which would automatically calculate the tax due on a transaction and remit (through a financial intermediary) the tax to the jurisdiction of consumption.<sup>165</sup> However, this might not be realized in a short term, rather a medium to long term option.<sup>166</sup>

### **3.7.1. Registration for VAT**

At the outset, it is worth noting that registration is one of the basic element of VAT. The VAT Proclamation of Ethiopia provides for both mandatory and voluntary registration of tax payers. Thus, persons are required to register as a taxpayer if they anticipate to or make taxable supplies with a total value that exceeds the stipulated threshold value (500,000 Ethiopian birr) for a twelve month period, in the month that this occurs.<sup>167</sup> Meaning, as per the VAT Proclamation, if the total value exceeds 500,000 birr, registration is compulsory. When the threshold has been reached, the person liable to be registered as a taxpayer is required to take the necessary steps to apply for registration within the day specified under Article 16(3) of the VAT Proclamation.

Registration may occur voluntarily, provided that the applicant person shall supply goods or render services at least 75% of his/her goods and services to a person registered for VAT in a regular manner.<sup>168</sup> A direct consequence of voluntary registration is that the registered person will have to account for output tax and will be able to claim credit or refund,<sup>169</sup> as an agent of ERCA.

In practice, though online transactions have become one of the growing commerce models in Ethiopia, there is a little exercise for which stores on e-commerce websites are registered or report their incomes to the tax authority. Having this in mind, the study was conducted by asking the e-commerce website representatives whether they are registered for VAT or not. Out of the 5 e-commerce websites, 3(60%) of them are registered for VAT and 2(40%) of them are not registered

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<sup>163</sup> *Ibid.*

<sup>164</sup> *Ibid.*

<sup>165</sup> *Ibid.* For instance, in US several tax compliance software such as ‘Taxware’, ‘Certitax’ and ‘Corptax’ are available to internet vendors in order to determine their taxability of sales.

<sup>166</sup> Andreas K., *Supra note 52*, P. 23.

<sup>167</sup> VAT Proclamation 2002, *Supra note 10*, Art. 16(1).

<sup>168</sup> *Id.*, Art. 17.

<sup>169</sup> Yohannes M. & Sisay B., *Supra note 5*, P. 75; see also VAT Proclamation 2002, *Supra note 10*, Art. 27.

for VAT.<sup>170</sup> The main reasons why those e-commerce websites are reluctant for registration are lack of knowledge (awareness) about the time, ways and reasons of registering for VAT, the absence of strong control by the authority, the need of the society to buy goods and services without VAT. Likewise, the tax authority does not device an effective online system for the registration of e-commerce websites for VAT purpose. These pitfalls in the existing tax system will result in reduced the potential tax revenues.

### **3.7.2. Reverse Charge Mechanism**

As described above, under the reverse charge mechanism, “the person liable for the payment of the VAT on the particular transaction is the recipient/ buyer.”<sup>171</sup> In other words, in this mechanism the liability to pay VAT is shifted from the seller to the buyer. “The supplier/service provider would be solely responsible for indicating the transaction to the Revenue service.”<sup>172</sup> The following discussion is devoted to discuss the reverse tax rules of Ethiopia and its application in B2B and B2C transactions.

#### **3.7.2.1. Business to Business E-commerce (B2B) Transactions**

When we see the case of reverse charge mechanism in the Ethiopian context, the VAT Proclamation provides that if a non-resident person who is not registered for VAT in Ethiopia renders services in Ethiopia for a person registered in Ethiopia for VAT or any legal person, the rendering service is subject to taxation.<sup>173</sup> Therefore, in the case of B2B e-commerce transactions for purposes other than exempted supplies, the recipients of electronic services, the imported service, are required to make use of the reverse-charge mechanism.<sup>174</sup> As provided under Article 23(3) of the VAT Proclamation, the amount of tax imposed is determined by a method of calculation to be determined by Regulations issued by the Council of Ministers.

Consequently, if a consumer who is registered for VAT receives the imported service, he/she is required to pay VAT at the time for filing of the VAT return for the accounting period in which

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<sup>170</sup> From those 3 VAT registered e-commerce websites, none of them are a Foreign-based website. On the other hand, among those two unregistered websites, one of them is a foreign-based website that makes supplies of goods and services in Ethiopia.

<sup>171</sup> International VAT Association, *Combating Fraud in the EU: The Way Forward*, Report Presented to the European Commission, 2007. P. 22.

<sup>172</sup> *Ibid.*

<sup>173</sup> VAT Proclamation 2002, *Supra note 10*, Art. 23(1) and (2).

<sup>174</sup> *Id.*, Art. 23(3) and Art. 3(7).

the transaction took place.<sup>175</sup> Nonetheless, where the customer is not registered for VAT, the period of payment is different and the withheld tax is payable within 30 days of payment to the non-resident.<sup>176</sup> It must be noted that a person who receives imported services still has to acknowledge receipt of the non-taxed imported service to ERCA and later declare it as input tax. Accordingly, if a businessperson does not issue receipts then it cannot claim a refund of the corresponding amount on taxes it paid on inputs it purchased.

In these circumstances, the reverse charge mechanism adopted by the Government of Ethiopia has a number of key advantages. To mention them; firstly, the Ethiopian Tax Authority have the opportunity to verify and enforce compliance since that authority has jurisdiction over the customer. Secondly, the compliance burden is shifted from the supplier to the customer and is minimized since the customer has full access to the details of the supply. Thirdly, the compliance costs for the Tax Authority are also low because the supplier is not required to meet tax obligations in Ethiopia (e.g. VAT identification, audits, which would otherwise have to be administered). Finally, it reduces the revenue risks associated with the collection of tax by non-resident suppliers, whether or not that supplier's customers are entitled to deduct the tax or recover it through input tax credits.

However, it is worth to note that in Ethiopia there is no effective online payment system currently working in the international level.<sup>177</sup> The most common means of payment used for import trades are Letter of Credit, Cash against Document and other similar trade instruments.<sup>178</sup> A study conducted by Belaynew point out that vast majority of the importers in Ethiopia are dependent on Letter of Credit and 77% of the importers use Cash Against Document as a means of payment.<sup>179</sup> But, this payment system is traditional, compared to the new e-commerce payment system like credit card and debit card. In Ethiopia, the reality shows that the infrastructure for the latter two payment modalities for foreign trade payment is almost not exist,<sup>180</sup>

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<sup>175</sup> *Id.*, Art. 23(4).

<sup>176</sup> *Id.*, Art. 23(5).

<sup>177</sup> Belaynew A., *Electronic Commerce: Opportunities and Challenges of general importers in Addis Ababa*, MBA Thesis, Addis Ababa University, 2012. P. 69.

<sup>178</sup> *Ibid.*

<sup>179</sup> *Ibid.*

<sup>180</sup> *Ibid.* If credit card and debit card ownership cannot be increased; some other electronic forms of payment need to be developed. Because, without electronic payments, much of e-commerce transactions will be difficult to effective. Without electronic payment facilities, websites will remain to be information tools rather becoming venues where business transactions are consummated.

Above and beyond, it is illegal for individuals to casually trade on foreign exchange. Those foreign exchange restrictions on payments and transfers are not consistent with international standards, as determined by the IMF.<sup>181</sup> For example, the Ethiopian currency (birr) is not freely convertible because the exchange rates are set by the government.<sup>182</sup> Similarly, Ethiopia limits foreign currency inflows, **outflows**, and the amounts that local and foreign individuals and companies can hold.<sup>183</sup> These restrictions have a negative impact on the growth of those e-commerce ventures currently operating and turning away possible foreign investment in new initiatives.<sup>184</sup> Equally, it increase money laundering and underground market for Ethiopia when individuals and businesses seeking to operate internationally need to find alternative means of managing their foreign exchange needs. These alternative means are difficult for the authority to monitor and track.<sup>185</sup> At a more individual level, due to these foreign exchange restriction problems, taxpayers will not report the details of transactions that are carried out electronically to the authority; this ultimately limits the ability of the government to collect VAT from those transactions.

### **3.7.2.2. Business to Consumer E-commerce (B2C) Transactions**

The method of collection under the cross-national e-commerce transaction is in large part dependent upon whether a transaction involves the delivery of a good or of a service. When, for example, a final consumer orders a taxable tangible goods (a DVD, CD, clothing, etc.) over the Internet, but the good is physically shipped to the consumer in Ethiopia, this is considered "indirect e-commerce," and the rules governing the collection of VAT is similar to that of goods ordered by traditional means.

Here, the VAT proclamation of Ethiopian under Article 23(1) (2), without any distinctions of the types of the transaction, extends the application of reverse charge mechanism on B2C e-commerce transactions. However, reverse-mechanism suits well for B2B transactions, when business customer self-assesses VAT; the application of self-declaration to B2C transactions is connected with some complexities of enforcement.<sup>186</sup> This is because, firstly, since reverse-mechanism is

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<sup>181</sup> IMF, "The Federal Democratic Republic of Ethiopia: 2013 Article IV Consultation," *IMF Country Report*, No. 13/308, October 2013, P. 27

<sup>182</sup> For full details, see National Bank of Ethiopia, "Foreign Exchange Directives," <<http://www.nbe.gov.et/pdf/Consolidated%20Forex.pdf>. > (Accessed 16 June 2017)

<sup>183</sup> *Ibid.*

<sup>184</sup> Interview with Teninet Yibeltie, Customer Service officer at Commercial Bank of Ethiopia, *on e-commerce transactions*, July 6, 2017.

<sup>185</sup> Interview with Tesfu Techane, Investigation Team Coordinator at ERCA, *on e-commerce taxation*, July 1, 2017

<sup>186</sup> OECD, *Report by the Technology Technical Advisory Group (TAG)*, 2000, P. 52, <<http://www.oecd.org/dataoecd/46/2/1923248.pdf>. > (Accessed 28 April 2017)

reliant mostly on the honesty of the recipient, private customers (legal person) probably have stronger incentive to avoid tax collection than business customers.<sup>187</sup> Especially, when a consumer purchases a good or service over the Internet and accepts electronic delivery of that good or service by downloading it onto his PC, it do not go through the mails or customs, as a result they essentially avoid import VAT.<sup>188</sup> The situation is further aggravated by the fact that, the Tax Authority of Ethiopia does not have effective mechanism to detect and control supplies of electronically supplied services, hence, customers' tax avoidance will substantially increase.<sup>189</sup> Secondly, the VAT proclamation provides, by adducing the invoices, an incentive for businesses to compute input VAT credit for their purchases or expenses. Nonetheless, the incentive is not present in purchases by final consumers as the latter generally do not have the option to deduct their expenses for tax purposes or claim input VAT credit. Moreover, while business are better aware about tax obligations and often have educated manpower for carrying out tax tasks, some customers stay ignorant in this respect.<sup>190</sup> This has the effect that Ethiopian consumers can buy imported digital goods or services without paying VAT. Thus, despite the advantages of simplicity in realization, for B2C e-commerce private customers' self-assessment is not supported as the reliable method of tax collection neither by the EU, nor by the OECD as well.

When looking at the current practice, it is revealed that the main problem against an effective VAT system for international e-commerce transactions in Ethiopia is the lack of attention to the taxation of e-commerce transactions as a unique concept and the lack of unique policies to regulate the sector.<sup>191</sup> From questions posed to the ERCA officers, it emerged that there was a lack of proper and adequate resources, specialized human resource and institutional setup within the Tax Authority to monitor the taxation of e-commerce.<sup>192</sup> The problem for enforcement in e-commerce taxation were also raised due to the absence of tough integrated efforts of ERCA with the major stakeholders such as Information Network Security Agency (INSA), Ethio-telecom and Banks in tracing the requisite e-commerce transactions. Consequently, with regard to the practical side of the problematic VAT issues the study established that theoretical soundness of the prospective

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<sup>187</sup> Interview with Endaleign Asrat, Tax Payers Education and Support Team Coordinator at ERCA, *on e-commerce taxation*, July 1, 2017.

<sup>188</sup> *Ibid.*; Interview with Getachew Dilu, Law Enforcement Process Coordinator of ERCA, *on the enforceability of Ethiopian VAT law on e-commerce*, July 1, 2017.

<sup>189</sup> *Ibid.*; Interview with Tesfu Techane, *Supra note 185*. There is also no existing process to accurately verify ownership or the location of the beneficial owner of the website. Therefore, the potential for tax evasion through e-commerce in Ethiopia is very high.

<sup>190</sup> Interview with Endaleign Asrat, *Supra note 187*.

<sup>191</sup> Interview with Tesfu Techane, *Supra note 185*.

<sup>192</sup> Interview with Endaleign Asrat, *Supra note 187*, Interview with Getachew Dilu, *Supra note 188*.

proposals would not in itself suffice for the implementation thereof. Given that electronic commercial activity has been evolving with the development of technology, its regulation and implementation should also be technology-based.

### **3.7.3. VAT Invoice**

The invoice is the crucial control document of the usual VAT system.<sup>193</sup> It helps the tax authority to establish the tax liability of the supplier and the entitlement of the purchaser to a deduction for the VAT charged.<sup>194</sup> Invoices must be carefully completed and kept as records. In Ethiopia, the VAT proclamation under Article 22(1) specifies that a person registered for VAT is required to issue a VAT invoice for a taxable transactions, but a person who is not registered for a VAT does not have the right to issue a tax invoice.<sup>195</sup> Hence, each VAT registered e-commerce businesses is required retains their copy of the invoice at their offices to be inspected by a VAT auditor. However, in practice, contrary to the VAT proclamation, as (7)46.6% of the e-commerce customer's respondents declares e-commerce websites do not issue a tax invoice. Whereas, (8) 53.4% of the respondents replied that during their transaction VAT invoices are issued by e-commerce websites.

On this basis, it could be argued that in practice some of the e-commerce websites are not comply with the laws and regulations of the VAT proclamation. This is due to the fact that several number of e-commerce websites in Ethiopia do not issue VAT invoices for all taxable e-commerce transactions. This means that the tax collected by taxpayers is not paid to the Tax Authority which result in the loss of tax revenue for the government.<sup>196</sup> The situation is further aggravated by the fact that the authority is incapable to identify and control e-commerce business that are non-compliance with the VAT laws. On the other hand, an electronic invoice system that could form the basis of claiming an input tax credit for VAT paid in e-commerce transaction is not indorsed in Ethiopia, thus hindering the opportunities for businesses to reduce their costs of transactions conducted via internet.<sup>197</sup>

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<sup>193</sup> Tait A., Value Added Tax: Administrative and Policy Issues, International Monetary Fund, Washington, D.C. 1991, P. 279.

<sup>194</sup> *Ibid.*

<sup>195</sup> VAT Proclamation 2002, *Supra note* 10, Art. 22(1).

<sup>196</sup> But, it is good to note that the actual revenue losses associated with e-commerce transactions are difficult to estimate as there are currently no empirical studies that attempt to measure these losses.

<sup>197</sup> Interview with Fisha Assefa, General Manager of Mercato.Com, *on the application of Ethiopian VAT law on e-commerce transactions*, November 23, 2017.

#### **2.7.4. Non-compliance to VAT Proclamation**

As per Articles 45 and 46 of the VAT proclamation, failure to register for VAT as per the registration requirement, failure to issue a tax invoice, failure to maintain recorder such as original tax invoices received and a copy of tax invoices issued and failure to file timely return shall be liable to administrative penalties ranging from a fine 100 percent of the amount of tax payable and a fine of up to 50,000 Birr.

Apart from administrative penalties tax offenders such as tax evasion, making false or misleading statement and failure to notify are all criminal offences under Ethiopian law. Accordingly, tax fraud - making false or misleading statements is punishable with a fine ranging from 1000 Birr to 100,000 Birr and an imprisonment ranging from 3 years to five years where the making of false or misleading statement is made knowingly or recklessly such an offence is punishable by a fine of up to 200,000 Birr of an imprisonment of up to 15 years.<sup>198</sup>

Taking into account the above rules, in practice measures taken by the ERCA to control and punish e-commerce business for their non-compliance is minimal. Some of the reasons for taxpayer's compliance problems are: less attention given to taxation of e-commerce; the absence of strong controlling system against the frauds and evasions performed by some non-compliance e-commerce websites; the deliberate evasion and unlawfulness of e-commerce websites.<sup>199</sup>

### **3.8. Possible Problems and Challenges Ahead in the Application Ethiopian VAT System on E-commerce Transactions**

From the above discussion, an understanding as to the current VAT system of Ethiopia in the context of its applicability on e-commerce transactions was obtained. Nonetheless, it is important to note that applying VAT on e-commerce transactions is not without any flaws. In the following section, the possible challenges posed in taxation of VAT on e-commerce under the Ethiopian VAT system will be analyzed. This could indicate for Ethiopia what problems and challenges should be considered when adjusting the current VAT system in the context of e-commerce.

#### **3.7.1. Verifying the Details of a Transaction**

Unlike the traditional ways of commerce, e-commerce transactions have a more anonymous character, because it can be carried out without papers and pens, offices and warehouses, and even

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<sup>198</sup> See section 12, VAT Proclamation

<sup>199</sup> Interview with Endalelign Asrat, *Supra note 187*; Interview with Getachew Dilu, *Supra note 188*.

without employees. In such environment, Tax Authorities may not easily verify the products and services delivered and other details of a transaction concluded over the internet.<sup>200</sup> This will create the most tax favourable condition for the customer to alter or change the documentation in such a way to pay minimum tax and VAT to the authorities. Besides, e-commerce leaves less of a ‘paper trail’, such as invoices and receipts, which tax authorities often use to track down and verify conventional transactions, and even when electronic records are available, they are more subject to tampering than paper records are.<sup>201</sup> Therefore, e-commerce might pose a challenge for the Ethiopian taxing authorities to verify the details of the transactions and this could lead to a tax loss for the Government.

However, the issue of inability of tax authorities to verify the details of electronic transactions is yet to be resolved not only in Ethiopia, but in the U.S. and the EU as well. Absence of reliable technologies creates the situation when “the opportunities for tax evasion seem endless”<sup>202</sup> and ensuring tax compliances appears to be a challenging task. Therefore, the development of new technologies should be conducted, which would allow the Ethiopian tax authority to identify transactions taking place in internet and guarantee a higher level of tax compliance.

### **3.7.2. Identifying the Parties to a Transaction**

It is important to identify the parties to a transaction in order to determine the relevant tax authorities and tax legislation that will be applicable. Nevertheless, one of the key attributes of online transactions is that the identification of the consumer is not easily ascertainable. The decentralized and global aspect of the internet makes it difficult to discover the identity or geographic location of economic participants, especially in the B2C type of e-commerce.<sup>203</sup> The anonymous nature of the network, hence, allows taxpayers to leave little evidence of their participation in economic activity and frustrate attempts by tax authorities to track and audit taxpayers.

In Ethiopia, neither the VAT Proclamation nor its regulation regulate how the supplier or the tax authority is supposed to discover the residence of the consumers, which is necessary for the

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<sup>200</sup> Akçaoglu E., ‘International Taxation of Electronic Commerce: A Focus on the Permanent Establishment Concept’, 2002, P. 127, <<http://dergiler.ankara.edu.tr/dergiler/38/287/2615.pdf>> (Accessed 26 April 2017)

<sup>201</sup> National Electronic Commerce Coordinating Council (NECCC). *Challenges in Managing Records in the 21<sup>st</sup> Century*, 2004, P. 9-13.

<sup>202</sup> Basu S., *Global Perspectives On E-commerce Taxation Law*, Queen’s University Belfast, UK, 2007, P. 104.

<sup>203</sup> Cockfield A., ‘Balancing National Interests in the Taxation of Electronic Commerce Business Profits’, *Tulane Law Review*, 1999, Vol. 74, P. 180- 83.

application of the VAT rules. This problem is more aggravated, as Mr. Birhanu stated, mostly because, the parties' aspiration to provide false details for the transactions that makes the identification of the details of the transaction and parties by the Tax Authority more difficult.<sup>204</sup> In this regard, the Australian Tax Authority adopted a registration system whereby internet businesses would have to register their online address (i.e., their Internet Protocol ("IP") address) as well as the physical location for their main office.<sup>205</sup> Similarly, the OECD made substantial findings in this field. Specifically, it is considered consumer self-declaration, credit card billing address, IP traces and digital certificates as possible methods to identify the buyer in e-commerce transaction.<sup>206</sup> Accordingly, though none of the above methods of identifying the buyer is found to be absolutely reliable, until a proper solution is found, all those available means, should be used as a temporary solution to address this problem.

### 3.7.3. Permanent Establishment

A further problem that relates to the taxation of e-commerce in Ethiopia concerns the notion of permanent establishment. As noted above, in order to be taxable in a specific jurisdiction, certain connecting factors need to be present. Accordingly, the VAT Proclamation provides that the supply of goods and rendering of services is taxable, if it is carried out by a nonresident through a permanent establishment in Ethiopia or through the internet.<sup>207</sup> Article 2(10) of the Proclamation defines "permanent establishment" as;

*"[F]ixed place of business through which the business of an enterprise is wholly or partly carried on. The following shall, in particular, be considered to be a permanent establishment, an administrative office, branch, factory, workshop, mine, quarry or any other place for the exploitation of natural resources, and a building site or place where construction and/or assembly works are carried out."*<sup>208</sup>

The PE concept refers to substantial physical presence in the country where services are rendered and goods are supplied. As per Article 2(10) of the Proclamation, a permanent establishment exists

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<sup>204</sup> Interview with Birhanu Nigussie, officer of ERCA, *on the identification of the details of e-commerce transaction*, May 9, 2017; unfortunately, even if the VAT Proclamation offered acceptable sanctions, practical implementation thereof would still be impossible. Namely, the Tax Authorities, in order to enforce VAT laws, need to identify the infringing persons. In practice, there are a circumstance where the online platform acts as a trading platform rather than a trader. In this case the online platform's clients are various sellers who own the inventory of goods and advertise their goods on the online platform. However, the ultimate sale of the goods is completed between the third party seller and the end consumer.

<sup>205</sup> Australian Tax Office, *Tax and The Internet*, Discussion Report of the ATO Electronic Commerce Project, 1997, <[http://downloads.ato.gov.au/content/business/downloads/ECOM\\_PL.rtf](http://downloads.ato.gov.au/content/business/downloads/ECOM_PL.rtf)> (Accessed 24 March 2017)

<sup>206</sup> OECD, *Supra note 75*, P. 5-7

<sup>207</sup> VAT Proclamation 2002, *Supra note 10*, Art. 4(7).

<sup>208</sup> *Id.*, Art. 2(10).

where an enterprise has a fixed place of business located in Ethiopia. Hence, the enterprise must carry on business in Ethiopia through a fixed place. Here, the term “fixed” implies a certain degree of permanence as opposed to temporary. In other words, the place of business is 'fixed' such that it is established at a distinct place with a certain degree of permanence.

In the conventional type of commerce, the PE concept provided by the VAT Proclamation can easily be applied but not in the case of e-commerce where the function of e-commerce is based on the application like web page, server, computers and cable.<sup>209</sup> Because, in e-commerce, traders can sell their products or services in a non-resident state even without the physical presence or establish a permanent establishment. Therefore, the premise of the permanent-establishment rule-that is, to conduct business in a country, you need a presence there-does not always necessary to e-commerce transactions. Besides, the concept of “fixed place” in PE is difficult to apply in e-commerce because companies can be located anywhere and can conduct business everywhere.<sup>210</sup>

The question this raises is whether a website or a server, owned or used by a foreign company alone can constitute a permanent establishment. As per the revised commentary to Art. 5 of the OECD Model Tax Convention, a non-resident enterprise with an internet web site alone would not be regarded as having a PE in the jurisdiction of its consumers.<sup>211</sup> This is based on the premise that a place of business test requires some physical existence in the source country. However, a website is not a tangible object, and therefore it cannot be a place of business.<sup>212</sup> Conversely, the server, being a physical object, can constitute a place of business.<sup>213</sup> Apart from the possibility that a server may be a place of substantial equipment, the room where the server is located would satisfy the concept of place of business.

In a nutshell, in the Ethiopian VAT Proclamation, the traditional concepts contained in the definition of a permanent establishment are inadequate to deal with the ever-increasing growth of e-commerce in the digital era. In this context, it is therefore of utmost importance that a solution

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<sup>209</sup> Barrett S., 'International Taxation of Electronic Commerce Income: A Proposal to Utilize Software Agents for Source-Based Taxation', *Santa Clara High Technology journal*, 2000, Vol. 16, Issue 1, P. 117.

<sup>210</sup> Rifat A., 'E-Commerce Taxation and Cyberspace Law: The Integrative Adaptation Model', *Virginia Journal of Law & Technology*, 2007, Vol. 12, No. 5, P. 9. This may also have a devastating effect in applying the provisions of the Proclamation like Art. 18(8) (a) that requires fixed place of abode or business.

<sup>211</sup> OECD, *Clarification on The Application of The Permanent Establishment Definition In E-Commerce: Changes To The Commentary On The Model Tax Convention on Article 5*, 2000, P. 3, <<http://www.oecd.org/dataoecd/46/32/1923380.pdf>> (Accessed 8 May 2017)

<sup>212</sup> *Id.*, P. 5, Para. 42.2.

<sup>213</sup> Arvid S., 'Erosion of the Concept of Permanent Establishment: Electronic Commerce', *Intertax*, 2000, Vol. 28, No. 5, P. 189.

is developed to address the limitations of the present construction of the permanent establishment principle.

#### **3.7.4. Deficiency of VAT Treaties**

The fact that lack of uniform global legislation for regulating cross-border e-commerce taxation is a big impediment in itself. This means that different countries apply different standards when applying e-commerce tax law rules.<sup>214</sup> This may result in double taxation. ‘Double taxation’ has been defined as “the imposition of comparable taxes in two (or more) states on the same taxpayer in respect of the same subject matter and for identical periods.”<sup>215</sup> This therefore implies that double taxation treaties have an importance role to avoid double taxation. In Ethiopia, most tax treaties were created for income tax purposes. Indirect taxes such as VAT are usually left out of the multilateral and bilateral treaties between Ethiopia and other countries and this will create challenges to apply the existing VAT rules on e-commerce. In this respect, OECD, to minimize the risk of double taxation or under-taxation, develops international VAT guidelines as an international standard for cross-border trade. These guidelines are based on the principles of a “good tax” namely neutrality, efficiency, legal security, simplicity, equity, and flexibility.<sup>216</sup> Consequently, in order to avoid issues of double taxation or non-taxation, the future tax treaties should be created for VAT purpose and take account of changes relating to taxation of e-commerce transactions.

Moreover, enforcement measures and penalties for non-compliance granting ERCA extra-territorial powers, would have to be developed. These powers will not be enforceable unless tax treaties are in place between Ethiopia and the country in which the enforcement measures are to be imposed. Bilateral and multilateral treaties to realize the application of Ethiopian VAT law on cross border e-commerce transaction would, therefore, have to be negotiated.

#### **3.7.5. Keeping Records**

In business, traders are expected to maintain proper accounts and records as may be prescribed by the Tax Authority, so that they can have the required material as needed. Otherwise, it is difficult to properly manage the incomes and expenses of the business operation. To put it in a context, “Jurisdictions are encouraged to allow the use of electronic record keeping systems, as business

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<sup>214</sup> Vann R., ‘International Aspects of Income Tax’, *International Monetary Fund*, 1998, Vol. 2, <<https://www.imf.org/external/pubs/nft/1998/tlaw/eng/ch18.pdf>> (Accessed 23 April 2017)

<sup>215</sup> *Ibid.*

<sup>216</sup> Van der Merwe B., *Supra note 39*, P. 389.

processes have become increasingly automated and paper documents generally have been replaced by documents in an electronic format.”<sup>217</sup> Accordingly, Article 37 of the VAT Proclamation requires every taxable person to keep records and books of account (which must be retained for up to ten years) in order to fulfill the requirements of the Proclamation.<sup>218</sup> However, in e-commerce transactions or when the taxable person engaged in the sale of electronic goods or services, no paper records are likely to be created. In such cases, the only record that exists could be an electronic one. This creates the possibility for taxpayers to engage in tax evasion and fraud because computerized records can be altered without a trace. Correspondingly, in Ethiopia, guidelines regarding acceptable records or documents where goods are delivered, invoices issued and payments made electronically are not issued.

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<sup>217</sup> OECD, International VAT/GST Guidelines, 2015, P. 53,  
<<http://www.oecd.org/ctp/consumption/international-vat-gst-guidelines.pdf>> (Accessed 12 May 2017)

<sup>218</sup> VAT Proclamation 2002, *Supra* note 10, Art. 37.

# CHAPTER FOUR

## 4. CONCLUSION AND RECOMMENDATIONS

### 4.1. Conclusion

The thesis discussed the various aspects of taxation of electronic commerce. In doing so, it tried to show how the existing legal regime relating to VAT in Ethiopia will be applicable for taxation of e-commerce. Accordingly, it is demonstrated that the legislation currently in place in Ethiopia is applicable to e-commerce transactions. Nonetheless, it has seen that there are many practical questions that do not find answers in the current VAT structure. In practice, e-commerce taxation especially for VAT purpose is not given due attention. Correspondingly, it emerged that there was a lack of proper and adequate resources, and their usage, within the Tax Authority to monitor the business. Similarly, including the absence of legal framework for completing an electronic business, lack of effective online payment system currently working in the international level, and stringent foreign exchange regulations are important barriers to the development of e-commerce in Ethiopia. As a result of that, the state continues to lose potential tax revenues from this sector.

Moreover, the paper revealed the possible challenges posed in taxation of VAT on e-commerce under the Ethiopian VAT system. In view of that, the tax collection method of reverse-charge mechanism is inefficient to address situations where digital content was supplied to customers in Ethiopia. Because, it is mostly reliant on the honesty of the taxpayer to declare all imported e-commerce transactions that were incurred. This is challenging to control for the Ethiopian Tax Authority, and this may lead to tax evasion and the erosion of the tax base. Moreover, the research has shown that, the VAT system of Ethiopia does not have an effective mechanism to solve the problem of the buyer's identification, establishing his location/residence and its status (business or consumer). Similarly, it remains unclear how merchants could ascertain information about the buyers and how Tax Authority could trace electronic transactions. The traditional definition of PE which is provided in the VAT Proclamation is also inadequate to deal with the ever-increasing growth of e-commerce transactions. Accordingly, the criteria of 'fixed place of businesses', appears impractical since in e-commerce business can be placed and conducted anywhere without having any fixed place. It is correspondingly established that the VAT Proclamation does not give a clear provision as of whether websites or server is a permanent establishment that is subjected to tax. Another setback identified in this paper is that Ethiopian tax treaties which address the problem

of double taxation does not give much concern for VAT. There is also no guidelines developed by Ethiopian Government as to acceptable records where goods are delivered, invoices issued and payments made by electronic means.

In general, it is found that the current Ethiopian legal system is not effective enough for the application of VAT on e-commerce transactions. Thus, the government of Ethiopia might need to take into account those problems that are experienced and adjustments implemented by the other jurisdictions and how the existing VAT legislation is lacking in realizing VAT on e-commerce transactions.

## 4.2. Recommendation

Following the above conclusion, the study has forwarded the following major recommendations, which, if implemented, may ameliorate the gaps of the existing VAT regime on the realities of e-commerce. Thus,

- ) The tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction. Hence, it is endorsed to extend the definition of “rendition of services” contained in Article 4(1) (b) of the VAT Proclamation by including a statement that the term “services” includes “electronically supplied services”. Furthermore, it is better to provide for the list of services covered by the term “electronic supplied services” taking the indicative list contained in the EU Council directive 2006/112/EC/ as the guidance.
- ) A clear provision on whether web sites and/or servers will be considered to be permanent establishment should be issued.
- ) As for B2C transactions, rules need to be established, which would prevent foreign suppliers from escaping taxation in Ethiopia. It is advisable to establish a special scheme, which would require foreign vendors involved in supplying electronic services to Ethiopian consumer to register (a simplified registration process accompanies this new requirement) and report in the Ethiopian Tax Authority for the purpose of remitting VAT.
- ) To resolve the problems of identification of the identity and location of the parties, certain methods should be designed. Hence, the Ethiopian Tax Authority should investigate ways to verify and obtain accurate information as to the party’s identity and location. Particularly, the use of technologies for tax administration and collection should be used towards identifying not just the parties but also other details of the e-commerce transactions thereto.
- ) Better collaboration and networking between government departments like INSA, Telecommunication, and ERCA is required so that the presence of online businesses can be monitored. This cautious step of the Tax Authority should be made to work together with such group of actors in order to disclose e-commerce transactions that take place within their networks. In doing so, there is need to develop a comprehensive human resource development programme and create an awareness to all stakeholders including ERCA officers and taxpayers on conception of e-commerce taxation. This should be done in different conferences and trainings.

- J The Government of Ethiopia should have inked bilateral agreements to address the challenges on the international taxation of VAT arising from e-commerce. This will have its own positive impact on the revenue potential of VAT and to realize enforcement of the VAT legislation.
- J An efficient international cooperation that assist the administration of VAT is key aspect in e-commerce situation. Unless such cooperation is forthcoming, e-commerce will cause a potential erosion of tax base for the government. To ensure such co-operation it will be necessary to create separate unit within the Tax Authority for information exchange. Broad consensus on the type of information to be exchanged and compatibility in laws relating to banking secrecy would assist in preventing erosion of tax base.
- J To modernize the existing VAT system, it is important to ensure the principles of taxation which include neutrality; efficiency; certainty & simplicity, effective & fairness; as well as flexibility are adhered to, so as to avoid distortion in the economy. Yet, in realizing the above suggestions, having a holistic approach with a sound assessment and enforcement procedure is very imperative.
- J What is more, this research has attempted to provide a baseline on the application of the current VAT system on e-commerce transactions. Taxation of e-commerce through income tax law regime was not exploited in this research. Therefore, studies should be carried out on the application of Ethiopian income tax laws on e-commerce transactions.

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