



ADDIS ABABA UNIVERSITY  
COLLEGE OF LAW AND GOVERNANCE STUDIES  
SCHOOL OF LAW

Income Taxation of the Digital Economy: BEPS and  
Ethiopian Tax Administration in Focus

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## **Abstract**

The unprecedented pace of digitalization of the economy wreaked havoc on income tax rules designed for bricks-and-mortar economy. The source-residence and PE rules that are predicated upon fixed place requirements are getting obsolete in the face of virtual economic presence. As a result the OECD's BEPS project has been a rallying point for the developed and developing countries alike. In view of this, it is important to look into the legal and administrative challenges of income taxation of the digital economy in Ethiopia.

After critically assessing the legal and practical challenges in taxing the digital economy in Ethiopia, the research finds that the income tax rules are riddled with gaps and the tax administration has many challenges. The research in this regard mainly recommends that Ethiopia should join the BEPS project and modify its income tax rules and modernize its tax administration in the process.

## **Lists of Abbreviations**

- ATAF African Tax Administration Forum
- BEPS Base Erosion and Profit Shifting
- CBE Commercial Bank of Ethiopia
- CBR Country by Country Reporting
- CCSI Columbia Center on Sustainable Investment
- DSTV Digital Satellite Television
- DTAs Double Taxation Avoidance Agreements
- ECRA Ethiopian Communication Regulatory Authority
- E-payment Electronic Payment
- FITP Federal Income Tax Proclamation
- FITR Federal Income Tax Regulation
- LOB limitation-on-benefits
- LRDs Limited Risk Distributors
- MAP Mutual Agreement Procedure
- MLI Multilateral Convention to Implement Tax Related Measures
- MNCs Multinational Companies
- MNEs Multinational Enterprises
- MOFEC Ministry of Finance and Economic Cooperation
- MOIT Ministry of Information and Technology
- MOR Ministry of Revenue
- OECD Organization for Economic Cooperation and Development
- PE Permanent Establishment
- POS Point of Sale
- PPT Principle Purpose Test
- SIGTAS Standardized Integrated Government Tax Administration System
- UN United Nations
- VAT Value Added Tax

# Chapter One

## 1. Introduction

### 1.1. Background

For years, tax has been a matter of domestic jurisdiction where states choose their own tax policy paradigm. This situation created a fertile ground for MNEs to shift their profit from the jurisdiction where the value is created.<sup>1</sup> Thus, due to this uncoordinated tax rules and policies, MNEs were able to play national taxation rules off against each other to achieve non-taxation or low taxation of their income.<sup>2</sup>

Even though the design of tax policy is at the heart of states' sovereign affair, the ever increase of the integration and interconnectedness of domestic economies<sup>3</sup> necessitates the need to complement the gaps created by domestic tax rules through multinational fora. The international effort to bring domestic tax laws together was culminated in 2013 in the OECD's 15 Action Plans dubbed as Base Erosion and Profit Shifting (BEPS). The Action Plan was taken as a 'collective international effort to assist both developed and developing countries'.<sup>4</sup>

In the OECD's initiative, the taxation of the digital economy became a center of attention culminating in the 2015 Action 1 Report. The report concluded that since the whole economy was digitalizing, 'it would be difficult, if not impossible to ring-fence the digital economy.'<sup>5</sup>

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<sup>1</sup> OECD, 'Two-Part Report to G20 Developing Working Group on the Impact of BEPS in Low Income Countries', (OECD 2014) 7 <<https://www.oecd.org/tax/tax-global/report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf>> accessed 30 August 2019

<sup>2</sup> Francesco Boccia and Robert Leonardi, *The Challenge of the Digital Economy: Markets, Taxation and Appropriate Economic Models*, (Palgrave Macmillan 2016) 56

<sup>3</sup> OECD, *Action Plan on Base Erosion and Profit Shifting*, (OECD Publishing 2013) 15

<sup>4</sup> OECD (n 1) 7

<sup>5</sup> OECD, 'Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy', (OECD/G20 Inclusive Framework on BEPS, 2019) 5

<<https://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf>> accessed 30 August 2019

Thus, the ubiquitous nature of the digitalization poses challenge to segregate the digital economy from the rest of the economy for tax purposes.<sup>6</sup>

The OECD'S BEPS initiative is meant to bring coherence, transparency, and substance to the international tax rules in general and to overcome the tax challenges posed by digitalization on tax rules developed a century ago.<sup>7</sup>

In Ethiopia, though many might have a jaundiced view on the internet penetration, the country's internet users are increasing exponentially. The number of internet users in the country showed a great leap from what were 10 thousand users at the beginning of the millennia to 20 million in 2019.<sup>8</sup> This shows the tremendous amount of potential that the country is going digital. There are also growing internet startups in our country. Search engines and social media platforms collect huge amount of many from Ethiopian user participations on the internet.

What is more, there are many instances that show the digitalization of the Ethiopia's economy: online banking, digital taxis, online betting, etc., are just some of the illustrations that show the digitalization of the country's economy. The Ethiopian government also has a policy to encourage electronic commerce in the country.<sup>9</sup> Thus, it is important to find out how our Tax Authority is trying to tax these online industries and how is the BEPS initiative helps the Ministry of Revenue in this endeavor.

Even though the 2016 tax reform is braised for responding to some of the much criticized hurdles, the Ethiopian tax system is still a problem fraught area, this is even more so when it comes to income inequities due to loopholes in the tax rules and tax administration issues. Thus, if the ministry does not have proper rules for taxing the digital economy and devise appropriate

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<sup>6</sup> OECD, 'OECD/G20 Inclusive Framework on BEPS Progress Report July 2018-May 2019' (OECD 2019) 5  
<<https://www.oecd.org/tax/beps/inclusive-framework-on-beps-progress-report-july-2018-may-2019.pdf>> accessed 30 August 2019

<sup>7</sup> Ibid 2

<sup>8</sup> Internets Users Stats, <<https://www.internetworldstats.com/stats1.htm>> accessed 14 January 2020

<sup>9</sup> See paragraph 1 of the preamble of the Electronic Signature Proclamation No. 1072/2018, *Fed. Neg. Gaz.* Year 24, No. 25

tax administration that suit the purpose, inequities and discriminations<sup>10</sup> will continue to haunt the country's tax system.

Therefore, it is high time to test the country's income tax laws and administration with the new developments in the BEPS era and assess how the Ethiopia's tax administration system fares with the fast changing ways of doing business.

## **1.2. Research Problem**

Many developing countries are joining the BEPS initiative and participate on the ongoing discussion on the tax issues and change their tax rules and share vital information on tax administration challenges. Moreover, the MLI, which is meant to prevent BEPS now covers 88 jurisdictions<sup>11</sup> and ratified by over 20 signatories. As a result, over 50 tax treaties have been modified and reinforced against abuse<sup>12</sup> and many jurisdictions are expected to join the ratification process.

However, though many developing African countries are joining this initiative, Ethiopia is yet to be part of it. In an interview with Mr. Ataklti Weldeabzgi,<sup>13</sup> the researcher learned that the country does not have a near future plan to join BEPS and ratify the MLI because of absence of research in the area at institutional level which is mainly attributed to lack of expertise.

There are also perplexing legal and administrative challenges in taxing income from the digital economy in Ethiopia. In this regard, the source, residence and PE rules are predicated on requiring some level of physical presence in the country.<sup>14</sup> These rules are getting obsolete in the face of virtual economic presence of online based businesses including search engines and social media platforms. Similarly, there are tax administrative challenges in taxing domestic online

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<sup>10</sup> Taddese Lencho Gemechu, 'The Ethiopian Income Tax System, Policy, Design and Practice', (A PhD Dissertation, University of Alabama 2014) 515  
<[http://acumen.lib.ua.edu/content/u0015/0000001/0001504/u0015\\_0000001\\_0001504.pdf](http://acumen.lib.ua.edu/content/u0015/0000001/0001504/u0015_0000001_0001504.pdf)> accessed 1 January 2020

<sup>11</sup> OECD (n 6) 3

<sup>12</sup> Ibid

<sup>13</sup> Interview with Mr. Ataklti Weldeabzgi, Domestic Taxes Policy Research Team Leader, Ministry of Finance and Economic Cooperation, 16 December 2019

<sup>14</sup> Federal Income Tax Proclamation No. 979/2016 *Fed. Neg. Gaz.* Extra Ordinary Issue, Year 22, No. 104

based businesses and those businesses that use e-payment products since there is no system integration between the tax administration system and commercial banks. Thus, taxing the digital economy, as it is a complicated staff, needs detailed rules, strong tax administration system and a tremendous shift of policy paradigm.

The challenge arising from the income taxation of the digital economy in Ethiopia is not just limited to the difficulties of imposing income taxation but it is related to the whole way of tax administration as the country still uses the old tax administration system, SIGTAS, which is riddled with technical and functional problems and it is a manual system unsuitable for the digital era.<sup>15</sup>

Thus, this research will try to dissect and bisect the legal and practical challenges posed by the digitalization of the economy on income taxation in Ethiopia and try to recommend some policy measures in the process.

### **1.3. Research Questions**

This research raises one fundamental research question and “sub questions” built around it. Hence, the central question that this research will try to grapple with is how should Ethiopia try to tax income sourced from the digital economy in the face of legal and administrative challenges?

And the specific questions include:

- I) What are the relevant OECD recommendations under the income taxation of the digital economy and tax administration and how these recommendations help Ethiopia design its tax policy and modernize its tax system?
- II) Why is Ethiopia not joining the BEPS initiative?
- III) Should Ethiopia ratify the MLI?
- IV) What are the works undertaken to tax the digital economy in Ethiopia?
- V) What are the legal and practical challenges of the income taxation of the digital economy in Ethiopia?

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<sup>15</sup> Interview with Mr. Birhanu Mamo, Strategic Partnership Directorate Director, Ministry of Revenue, 16 December 2019

#### **1.4. Research Objective**

The main objective of this research is to explore and study the recommendations from the BEPS initiative on the Action 1 of the income taxation of the digital economy and tax administration with a view of studying and analyzing the Ethiopian tax system on the issue. The research will also try to examine the practical challenges of the tax administration in taxing the digital economy in Ethiopia.

Taxation of the digital economy requires robust and comprehensive tax rules that enable the tax authorities to capture the digital economy. Equally important is the need to have modern tax administration system that can respond to the business sophistication. Thus, this study will try to inquire into the legal and practical challenges posed by the digitalization of the economy.

#### **1.5. Research methods and Methodology**

As per the topic of the study the following methods and methodologies will be employed in this research.

##### **1.5.1. Research Design**

This is an empirical research that encompasses the doctrinal and non-doctrinal approach to study. Empirical work is chosen since it will be more useful to policy makers as focus is made on the factual reality from where policy decisions originate. In relation to the doctrinal aspect, the researcher tried to identify and analyze tax and non-tax legislations that are relevant to the taxation of digital economy in Ethiopia. Moreover, the research used OECD's reports and recommendations and other authoritative works to build the theoretical framework of the study. With regard to the non-doctrinal aspect, the study used interview to gather information on the topic of the research.

##### **1.5.2. Methods of Data Gathering**

In its design, this is a qualitative study employing the primary and secondary methods of data gathering. In relation to the primary data, the researcher used interview to gather information from different departments of the Ministry of Revenue, Ministry of Finance and Economic Cooperation, National Bank of Ethiopia, Ethio-Telecom and 5 commercial banks in order to solicit a response on the research topic. The research also tried to include the views of tax practitioners and researchers. Interview is chosen since it is suitable to the topic of the research as it needs raising condensed technical queries requiring an in-depth response.

With regard to the secondary method of data gathering, the research explored the different OECD reports, standards and recommendations on taxation of the digital economy and tax administration under the BEPS initiative and other authoritative literatures on the topic. Moreover, the study tried to look at the gaps in income tax and tax administration laws in taxing and administering the digital economy in Ethiopia. And some non-tax legislations relating to taxing the digital economy in Ethiopia are also consulted.

### **1.5.3. Population**

As the topic of the research indicates, the theme of the study revolves around the income taxation of the digital economy and tax administration issues. Thus, institutions which are directly or indirectly connected to the research topic will be the respondent of the research. Accordingly, the Ministry of Revenue will be the center of attention. The Ministry will be required to respond to tax administration challenges in taxing the digital economy. Ministry of Finance and Economic Cooperation will also be consulted on the issue of joining the BEPS initiative and in facilitating the ratification of the MLI. The National Bank of Ethiopia (NBE) is also important in creating conducive environment in the online payments without which digital transaction is unthinkable. Thus, questions on the facilitating of the online payment system in the country were thrown to the NBE. And the researcher also tried to gather information regarding payment systems from 5 commercial banks that are selected based on their extensive experience on digital transactions and willingness to provide information.<sup>16</sup> Finally, the researcher tried to knock the door of the Ethio-telecom with questions relating to the works done in creating good internet connections in facilitating the digital economy.

### **1.5.4. Research Procedure**

As mentioned before, this is a qualitative research based on interview. The interview was made based on structured questionnaire where the researcher delivered personally the interview questions to the respondents. Then, the researcher gave time to the respondent to get a well thought response. And during the interview session, the researcher clarified some of the questions to the respondents. The researcher used mainly face to face interview but very few phone call interview was used where meeting in person was not possible.

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<sup>16</sup> The willingness to provide information criterion is set as there are commercial banks that 'outlawed' information sharing to researcher through their own management decisions.

## **1.6. Scope of the Research**

In substance, this study is limited to income taxation and tax administration issues related to the income taxation. As such, the research does not cover the other areas of taxation. Thus, it is limited mainly to the FITP, FTAP and FITR.

Geographically too, the study is limited to the federal taxation. That is, regional study is not considered here. This is mainly because of the fact that the taxation of the digital economy is dependent on the tax system or policy of the country which is applicable to the regional governments and city administrations as well. It is important to mention here the tax system of the country, the SIGTAS, which is still applicable in the country as a whole. Moreover, the taxation of the digital economy involves the study and recommendation of the Ministry of Finance and Economic Cooperation whose work can influence both federal and regional government. In fact, the Federal Tax Administration Proclamation<sup>17</sup> imposes on the regional states governments and their agencies a duty to cooperate in administering the tax laws as can be gathered from Art. 7 of the proclamation. Hence, because of the above mentioned reasons the research limits itself to federal income taxation and tax administration.

## **1.7. Limitations of the Study**

So far, little has been done in assessing our income taxation and tax administration in relation to the challenge posed by the digitalization. Thus, this absence of prior research on the topic is a bottleneck for the study. Coronavirus also affected data gathering from interview.

## **1.7. Literature Review**

Even though we are closer to a decade since the inception of the BEPS movement, literatures that discuss BEPS issues in light of the Ethiopian tax system are scanty. However, a study titled ‘Should Ethiopia Sign the MLI? Prospects and Challenges with Spotlight on Treaty Abuse and PE’ is worth mentioning.<sup>18</sup> As the title indicates, this work focuses on issues related to the MLI which is part of the G20/OECD BEPS project. The writer began his work with the objective of understanding and assessing what he called ‘foreseeable implication’ of signing the MLI in Ethiopian context. Then, the writer concluded that Ethiopia should not rush to signing the MLI

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<sup>17</sup> Federal Tax Administration Proclamation No. 983/2016, *Fed. Neg. Gaz.* Year 22, No. 103

<sup>18</sup> Birhanu Tadesse Daba, ‘Should Ethiopia Sign the MLI? Prospects and Challenges with Spotlight on Treaty Abuse and PE’ (LLM Thesis, University of Amsterdam July 2018)

before having in-depth look at the comparative tax and non-tax policy factors. The writer generally recommends Ethiopia to adopt a wait and see approach regarding the signing of the MLI.

However, the current study is very different from Mr. Birhanu's work, in that the focus is made on assessing and discussing income taxation of the digital economy. Even though a paragraph or two might be devoted to the discussion of issues related to the MLI, the signing or otherwise of the treaty is not a central idea that this study ponders on. If this study could be considered as a dragon, MLI would be its tail.

This research is inspired by the BEPS initiative in the OECD fora. Thus, the study used the different OECD reports and recommendations made under Action 1 of the digital economy and tax administration. The steps taken by individual countries, comments and recommendations under the Action1 of the BEPS project is made part and parcel of the literature review. The study also benefited from different articles by authorities on the topic from reputable journals. The OECD's and other websites and data bases searched to look for updated information on the research topic.

As mentioned before, little or no study made on the income taxation of the digital economy in the context of Ethiopia. Thus, this research will be an eye breaker for subsequent studies and serve as a catalyst for other studies to sprout.

### **1.8. Structure of the Research**

The study is organized into four chapters. Accordingly, chapter one provides the prelude of the research where the background, statement of the problem, objective, research questions and methods and methodology of the study are made the part. Chapter two deals with some concepts and issues related to the BEPS project. Accordingly, this chapter tries to decipher some issues related to the meaning of BEPS, tax challenges posed by digitalization, rationales that led to the BEPS initiative, criticisms forwarded against the BEPS and the issue of BEPS and developing countries. Chapter three will hold discussions on the gaps of the Ethiopian international income tax rules. Thus, under this chapter, in the main, the source, residence and PE rules will be discussed in light of the OECD's BEPS reports and recommendations, the UN and OECD Model tax treaties. A modest discussion is made on the new developments in the nexus and profit

allocation rules. A few paragraphs are also devoted to the discussion of some issues on the MLI and Ethiopia's treaty network. Under chapter four, the legal and practical challenges in taxing the digital economy will be discussed based mainly on the data collected from the field work. And finally, conclusions and recommendations on the finding of the research will be the finale of the thesis.

## Chapter Two

### 2. Concepts and Issues on BEPS

Tax law has never been void of conceptual and theoretical perspectives. It is an interesting blend of history and political rhetoric. Contrary to other areas of law, where researchers struggle to find controversial and challenging issues, tax law is filled with ‘fat and juicy’ issues.<sup>19</sup> Thus, under this chapter, some of the conceptual and intriguing issues of BEPS and the digital economy would be discussed to shed light on some introductory points before delving to the crux of the matter.

#### 2.1. BEPS as a Concept

The acronym BEPS stands for Base Erosion and Profit Shifting. However, as a concept it is not much discussed. And this part is devoted to some of the discussion around that in order to give some conceptual context to it.

The shifting of income or profit shifting by MNEs using tax rate differential of jurisdictions is one of the most perplexing issues of international taxation.<sup>20</sup> MNEs through their aggressive tax planning would end up eroding tax base of a jurisdiction. Tax base is considered as the amount of income or presence which can be levied.<sup>21</sup> In a broader sense of the term, tax base can be understood as ‘the thing, transaction or the amount on which the tax is raised.’<sup>22</sup> Thus, in the context of the OECD base erosion refers to the practice of MNEs, who maneuver tax rules of different jurisdictions to shift profit and cost and achieve non-taxation of their income.<sup>23</sup> Generally, the concept of Base Erosion and Profit Shifting denotes tax planning scheme where MNEs exploit gaps and mismatches of tax rules of countries in order to hide (shift) their profits to locations where little or no tax is paid.<sup>24</sup>

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<sup>19</sup> Peter Harris and David Oliver, *International Commercial Tax*, (Cambridge Tax Law Series, CUP 2010) 1

<sup>20</sup> Alan Auerbach and Kent Smetters (eds.), *The Economics of Tax Policy*, (CUP 2017), 235

<sup>21</sup> Mehran Amirli, ‘How to Deal with BEPS’, (2015) 96 106 2 BAKU ST U.L. REV 99

<sup>22</sup> Ibid

<sup>23</sup> Francesco and Robert (n 2) 56

<sup>24</sup> Ibid 39

In a sense, the term profit or income shifting can be understood to contain both ‘strategic transfer pricing (charging relatively low prices from goods and services transferred from high tax to low tax affiliates) and the strategic use of inter-affiliate debt (financing the activities of high-tax affiliates using debt issued by low-tax affiliates)’.<sup>25</sup>

## **2.2. Tax Challenges Posed by the Digital Economy**

Digital transformation is praised for encouraging innovation, generating efficiency, improving services and bringing economic growth.<sup>26</sup> However, the unprecedented breadth and speed of the digital transformation poses challenges in many policy areas, including taxation.<sup>27</sup> As identified in the 2015 Action 1 Report of the OECD, scientific innovations continue to drive the digital economy, where the internet of things, crypto currencies, the sharing economy, 3-D printing, advanced robotics and open government data are important and new innovative ways that transform the digitalization of businesses.<sup>28</sup>

Tax policy wise, the growing digitalization of the economy has been a source of headache for many jurisdictions. Relying on highly ‘mobile intangibles’ (tremendous use of data, in particular, personal data)<sup>29</sup> and ‘multisided business models’, the digital economy has been difficult for tax systems to trace.<sup>30</sup> The digital economy becomes so elusive for tax purpose because of its multisided business model. Thus, it is hard for jurisdictions to determine the source of the value creation. Digitalization brought about the increase of the commercial reach of businesses irrespective of their location and the location of their customers or users.<sup>31</sup> Thus, the direct repercussion of this is that ‘businesses might have an economic presence in a jurisdiction without having a physical presence’.<sup>32</sup> Hence, it becomes difficult to relate the digital economy to the

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<sup>25</sup> Alan and Kent (n 20) 235

<sup>26</sup> OECD (n 5) 5

<sup>27</sup> Ibid

<sup>28</sup> OECD, *Tax Challenges Arising from Digitalization—Interim Report 2018: Inclusive Framework on BEPS*, (OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing 2018) 15

<sup>29</sup> OECD (n 3)10

<sup>30</sup> Francesco and Robert (n 2) 55

<sup>31</sup> OECD (n 28) 51

<sup>32</sup> Ibid

concepts of source and residence and characterization of income for tax purposes.<sup>33</sup> For example, in an Electronic Commerce or E-commerce, parties transact digitally through the internet, as it happens in virtual world, it is tough to determine taxable presence.<sup>34</sup> Thus, it is arduous to apply rules including residence, PE etc.<sup>35</sup> in sum, so long as tax rules and tax administration do not keep up the pace, digitalization of the economy will continue to put a strain on the existing international tax rules which currently founded on ‘bricks-and-mortar’ system.<sup>36</sup>

### **2.3. Rationale for the BEPS Initiative**

BEPS is an international movement that galvanizes support from different jurisdictions on tax policy issues. Thus, in order to have a little bit deeper knowledge regarding the movement, it is essential to inquire into the *raison d'être* of the initiative. Hence, some modest paragraphs are devoted to the brief discussion of the causes or reasons that led to the BEPS initiative.

Traditionally, taxation has never been pure from public controversy. The internationally coordinated fiscal policy was preceded by tremendous amount of pressure from media and public discourse regarding the low taxation paid by MNCs through the use of ‘hybrid mismatch’ arrangement.<sup>37</sup> Thus, at the request of the G20, the OECD shouldered the task of designing action plan to address BEPS.<sup>38</sup> As a result, the OECD, in 2012 carried out the ‘Internet Economy Outlook Analysis’ in which up to 13% of the revenue generated by enterprises is attributed to their participation in the web.<sup>39</sup> And the research also found out that the internet contributes to the Growth Domestic Product (GDP) albeit indirectly, in particular, the contribution of what is known as the ROPO (Research online Purchase Offline) effect is incredibly high.<sup>40</sup> The ROPO effect transforms many traditional sectors, in 2010, 46% of real state contracts, 10% of

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<sup>33</sup> OECD (n 3) 10

<sup>34</sup> Mehran (n 21) 101

<sup>35</sup> Ibid

<sup>36</sup> Francesco and Robert (n 2) 39

<sup>37</sup> Ibid 56

<sup>38</sup> Ibid 55

<sup>39</sup> Ibid 86

<sup>40</sup> Ibid

mortgages and many tourism and travel services were bought and sold with some level of support from the internet.<sup>41</sup>

Thus, in addition to the shifting of profit by MNCs, the idea is that accessing and surfing the internet coupled with selling goods and services produces ‘earning capacity’ and subject to different types of existing or new taxes.<sup>42</sup>

According to the estimation made by the OECD in 2015, the global Corporate Income Tax (CIT) losses were between 4% and 10% (100 to 240 billion US dollars).<sup>43</sup> This is a huge amount of money that would undoubtedly affect individual countries budget. The other argument raised in relation to this is that non-taxation of giant corporations affects societal trust on the tax system.<sup>44</sup> This argument is tilted towards inquiry of the equity and fairness issues in the tax system.

Authorities agree that the major reasons that led to the eruption of the BEPS include loopholes in international tax rules resulting from jurisdictional differences, lack of regulation of international tax rules and misunderstanding among jurisdictions because of ‘tax competition’.<sup>45</sup> Tax competition occurs because states try to attract MNEs by providing preferential tax or tax incentives and MNEs use this opportunity to shift their profits to tax heavens.<sup>46</sup>

Thus, in response to the above mentioned tax challenges, the G20/OECD movement began in earnest with the mission to bring together the location of taxable profits with the economic activities and value creation.<sup>47</sup> In this regard, it is important to note that some of the widely acclaimed principles of taxation are in play in the G20/OECD’s BEPS initiative including the benefit principle, the single tax principle and the transparency principle.<sup>48</sup> As the BEPS

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<sup>41</sup> *ibid*

<sup>42</sup> *Ibid* 87

<sup>43</sup> OECD, *BEPS Project Explanatory Statement: 2015 Final Report*, (OECD/G20 BEPS Project, OECD Publishing 2016) 10

<sup>44</sup> Maarten Floris de Wilde, ‘Taxing Multinationals Post BEPS- What is Next’, (2017) 10 ERASMUS L REV 1 2

<sup>45</sup> Mehran (n 21) 98

<sup>46</sup> *Ibid* 99

<sup>47</sup> Reuven S. Avi-Yonah and Haiyan Xu, ‘Evaluating BEPS’, (2017) 10 ERASMUS L REV 3 5

<sup>48</sup> *Ibid*

initiatives encourages coordination rather than competition in taxation,<sup>49</sup> the transparency principle looms large where the movement will not achieve its targets unless jurisdictions are willing to share information on their tax related issues.

#### **2.4. Criticism against BEPS Project**

Even though the BEPS project praised as the substantial renovation of international taxation in a century,<sup>50</sup> it has never been pure from academic distaste. In this regard, some try to dismiss the connection of aggressive tax planning of the MNEs and the resultant profit shifting on the ground that there is no actual base erosion since evidence shows that the existing corporate tax across the OECD region is stable.<sup>51</sup>

The other assumption of the BEPS project that became a center of attack is the OECD's presumption that internet or E-Commerce led to the exacerbation of profit shifting. The argument against this assumption is that there is no causal relationship between the recent hike in digitalization or E-Commerce and corporate income tax.<sup>52</sup> Thus, it has been argued that the internet and E-Commerce do not pose tax challenge to governments 'contrary to popular belief and media report'.<sup>53</sup> Furthermore, the OECD itself was criticized as unfit to be representative in undertaking this task since it views itself as representative of its members interest which is the rich country's club.<sup>54</sup>

Even though it is hard to say that the arguments raised against the BEPS project and the OECD are baseless, it is equally unwise to dismiss the challenge that digitalization of the economy poses on the levying and administering tax. And whatever inclination that the OECD might have towards the developed countries (members), the participation of the great number of individual

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<sup>49</sup> Mehran (n 21) 98

<sup>50</sup> Francesco and Robert (n 2) 54

<sup>51</sup> Ibid 57

<sup>52</sup> Ibid 59

<sup>53</sup> Francesco and Robert (n 2) 60 and 61

<sup>54</sup> Dimitrios D. Thomakos and Konstantinos I. Nikolopoulos (eds.), *Taxation in Crisis Tax Policy and the Quest for Economic Growth* (Springer International Publishing 2017)116

countries is testimonial to the representative nature of the project. In fact, there is ample evidence as to the huge shift of profits by MNEs and the resultant base erosion.<sup>55</sup>

## **2.5. BEPS and Developing Countries**

Despite the degree, there seems to be consensus on the effect of the BEPS on developed and developing countries alike. Some argue that developed countries are the most hard hit by the BEPS since they are the one that were affected most by the global financial crisis; they are expected to finance programs; since they are democratic, they are the ‘most politically fragile and the least nimble’.<sup>56</sup> The premise that the developed world suffered large by the base erosion and profit shifting might be true but the underline reasoning is weak. In financing projects, the governments of emerging countries have great responsibility on their shoulder to finance projects as the private sector is weak and it is also hard to assume that democratic states are politically fragile.

Emerging or developing countries suffer great deal from the BEPS for hosts of reasons: they lack policy and legislative measures to fight BEPS;<sup>57</sup> their effort to address BEPS is often hindered by lack of information; they suffer from lack of capacity to implement complex rules to go against well advised and experienced MNEs; the legislative and gaps in capacity building regarding tax administration will leave developing countries more vulnerable to aggressive tax planning by MNEs than the developed ones.<sup>58</sup>

Even though many considered the BEPS project as a ‘Washington consensus’ serving the interests of developed countries, the project fell under critical scrutiny in the face of internationalization of market, changing technologies, aggressive tax planning and problems associated with equitable allocation of worldwide income among the developed capital exporting and the developing capital importing countries.<sup>59</sup>

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<sup>55</sup> see Dharmapala, in Alan and Kent (n 20) the Economics of Tax Policy, (OUP 2017) 235

<sup>56</sup> Yariv Brauner, ‘What the BEPS’(2014) 16 FLA TAX REV 55 64

<sup>57</sup> OECD (n 1) 7

<sup>58</sup> Ibid 8

<sup>59</sup> Subhjit Basu, ‘Direct Taxation and E-Commerce: Possibility and desirability’, (2010) 1 International Journal of Innovation in the Digital Economy 39

### 2.5.1. Benefits of the BEPS Project to Developing Countries that Joined the Initiative

For starter, it is important to shed light on experience of developing countries that are participating in the BEPS project in order to appreciate the relevance of BEPS for the developing world. However, there is a paucity of research on the actual experience of developing countries that joined the BEPS project. Thus, a forward looking analysis characterizes most of BEPS related literatures on developing countries.

With the establishment of the Inclusive Framework on BEPS in 2016, many developing countries are participating in the BEPS project.<sup>60</sup> Out of the 15 Action Plans, developing countries that joined the BEPS Inclusive Framework are required to implement the minimum standards: Action 5 on countering harmful tax practices; Action 6 on preventing treaty abuse; Action 13 on issues of improving transparency through CBCR and Action 14 on effective dispute resolution.<sup>61</sup> However, developing countries face tax administration challenges to implement these minimum standards including: lack of knowledge; lack of staff capacity and lack of infrastructure.<sup>62</sup> As a result some tax administrations of developing countries do not even know whether their countries joined the BEPS initiative.<sup>63</sup> Lack of participation is also observed in African countries despite joining BEPS due to ‘gaps between standards and reality’.<sup>64</sup>

Despite the challenges of implementing BEPS standards, there are developing countries benefiting from the initiative. In this regard, it is important to mention African countries that are trying to translate BEPS outcomes into legislations through guidance of ATAF.<sup>65</sup> As a result, in 2017/18, a new transfer pricing rules was enacted by Nigeria, Zambia etc.<sup>66</sup> And a new interest deductibility rule instrument is also enacted by countries such as Senegal and Zambia.<sup>67</sup> This is

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<sup>60</sup> German Cooperation, *Implementing OECD/G20 BEPS Package in Developing Countries: An Assessment of Priorities, Experiences and Needs of Developing Countries*, (Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH 2018) 3

<sup>61</sup> Ibid

<sup>62</sup> Ibid 42 and 43

<sup>63</sup> Ibid 39

<sup>64</sup> ATAF, ‘the Place of Africa in the Shift Towards Global Tax Governance: Can the Taxation of Digitalized Economy be an Opportunity for More Inclusiveness?’, (ATAF Paper 2019)16 <<https://irp-cdn.multiscreensite.com/a521d626/files/uploaded/ATAF%20PAPER%5B1%5D.pdf>> Accessed 9 June 2020

<sup>65</sup> Ibid 17

<sup>66</sup> Ibid

<sup>67</sup> Ibid

an interesting legislative measure that aimed at converting BEPS standards into legal instruments.<sup>68</sup>

Moreover, Nigeria, after participating in the Automatic Exchange of Financial Account Information (AEOI), it launched Voluntary Asset and Income Declaration Scheme (VAIDS) in 2017 which enabled the country to collect 82.6 million USD.<sup>69</sup> Similarly, in South Africa, the Special Voluntary Disclosure Program produced 225 million USD in revenue.<sup>70</sup> Thus, it is very important to see that developing countries are benefiting from the BEPS project in spite of their tax administration challenges that inhibit them to fully realize their revenue raising potential in tax.

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<sup>68</sup> Ibid

<sup>69</sup> Ibid 21

<sup>70</sup> Ibid

## Chapter Three

### 3. Legal Gaps in Taxing the Digital Economy in Ethiopia

It has often been remarked that the current international tax rules were not designed to tackle the wide spectrum of challenges that arise from the digitalization.<sup>71</sup> In order to tackle the problems associated with digitalization, a number of questions need to be addressed in the tax bills of jurisdictions. These include, but not limited to, questions regarding how certain income from the digital economy should be attributed to jurisdictions? How such income should be characterized? And how should tax authorities go about taxing the income?<sup>72</sup> These are some of the core international taxation issues to worry about.

Thus, under this chapter, some of the legal problems related to residence/source taxation and permanent establishment (PE) concept in Ethiopia will be discussed in light of the G20/OECD BEPS reports and recommendations, the UN model tax treaty, the OECD Model Tax Treaty and the MLI. This is not article by article analysis; it is rather a general overview that focuses on the gaps of the most important pillars of taxation and testing them against the newly posed tax challenges of the digital economy. finally, a brief overview on Ethiopia's treaty network is made part of the discussion.

#### 3.1. Source Based Taxation

To start with, even though tremendous change has been observed in the areas of international commerce and trade beginning from the 1920s, determining the competing claim of a source and resident jurisdiction to avoid double taxation, tax avoidance and tax evasion remains unsettled international tax issue.<sup>73</sup> Preventing double taxation between the source and residence jurisdiction is the major goal of tax treaties. However, the apportionment of taxing rights between source/residence countries result in winners and losers, this is because of the fact that

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<sup>71</sup> Yariv (n 56) 70

<sup>72</sup> Subhajit (n 59) 39

<sup>73</sup> Michael Kobetsky, *International Taxation of Permanent Establishments: Principles and Policy*, (CUP 2011)

the capital importing developing countries prefer source taxation, whereas, the capital exporting developed countries choose the residence jurisdiction.<sup>74</sup>

Taxation based on the source principle indicates that all income generated in a country is finally taxed in the source country.<sup>75</sup> To make source taxation effective, the tax attributes in the source country should be clearly determined. But the problem is that due to the digitalization of the economy, it is problematic to delineate the amount and location of income.<sup>76</sup> In the digital era, since the transaction of the international enterprise is fungible and complex, it is hard for the tax authorities to ascertain the kind of profits made in its border.<sup>77</sup> In the digital business, the major asset of the MNEs is the intangible assets that constitute mainly patent, know-how, copyrights and trademark. These intangible assets do not have single geographical location.<sup>78</sup>

Thus, in the globalized, digitalized and interconnected economies, applying the traditional concept of source taxation to link income with specific geographical location will be difficult if not impossible.<sup>79</sup> Hence, the difficulty of attributing source income in the internet or E-commerce will seriously inhibit the significance of the century old principle.

### **3.2. Residence Based Taxation**

At the face value, the principle of residence taxation seems straight forward as the geographical location where a tax payer has the closest link is taken to determine residence for tax purposes.<sup>80</sup> However, the issue will be much more complicated when it comes to the digital economy where difficulties arise since place of registration, incorporation and place of effective management tests are irrelevant because of the digitalization of the economy. For example, the effective management test will be rendered obsolete since directors sitting in different countries can communicate and pass management decisions without being physically present in certain fixed

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<sup>74</sup> Ibid 107

<sup>75</sup> Subhajit (n 59) 43

<sup>76</sup> Ibid

<sup>77</sup> Bird, 'Shaping a New International Tax Order', in Michael (n 73) 31

<sup>78</sup> Michael (n 73) 32

<sup>79</sup> Subhajit (n 59) 43

<sup>80</sup> Ibid 40

place or country through video conferencing.<sup>81</sup> In order to access a market of a certain country, it is not necessary to be registered or incorporated in that state because of the existence of E-commerce.

The adoption of the residence based taxation to tax income from the electronic commerce leads to many challenges. One of these challenges is that the fast change in the communication technology and the ease with which business is made online makes it easy for companies to establish a corporate residence without having or performing tangible activities<sup>82</sup> thereby rendering a country's residence based taxation irrelevant. The other challenge is that residence based taxation is not favored by capital importing developing countries.<sup>83</sup> Thus, unless modification is made, it is difficult to apply the residence principle to taxing income from the digital world.

In many countries, both the source and residence principle are used to claim taxation though more inclination to one than the other may be observed based on the nature of their economy. The adoption of both the source and residence taxation might lead to either double or no taxation. For example, many countries law requires that a company should pay tax in residence state even if the operation of the residence company is located elsewhere.<sup>84</sup> This situation might result in a scenario where a company pays tax in both the place of residence and where it operates (source country).<sup>85</sup> On the other way round, beginning from the 1980s, source jurisdictions, driven by tax competition, tried to offer tax holidays to MNEs, and their residence jurisdictions also chose not to impose tax on their global income not to leave them at competitive disadvantage.<sup>86</sup> The direct repercussion of this is that MNEs remain untaxed in both source and

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<sup>81</sup> Ibid

<sup>82</sup> Ibid 44

<sup>83</sup> Ibid

<sup>84</sup> Luis M. Almeida and Perrine Toledano, 'Optimizing the PE Clause for Resource Rich Source State', (CCSI Briefing Note, CCSI 2018) 7 <<http://ccsi.columbia.edu/files/2018/03/Optimizing-the-PE-clause-for-resource-riche-source-state-CCSI-2018-2.pdf>> accessed 21 February 2020

<sup>85</sup> Ibid

<sup>86</sup> Avi-Yonah and Haiyan (n 47) 3

residence jurisdictions.<sup>87</sup> This latter scenario triggered tremendous amount of public outcry that led to the inception of the BEPS project.<sup>88</sup>

In sum, since the digital economy involves multifaceted commerce covering tangible and intangible goods and multifarious jurisdictions, taxation of these humongous economic activities becomes elusive for tax authorities to assert their power of taxation.<sup>89</sup> The question is not whether these MNEs or the digital economy should be taxed or not, it is how to tax. In order to tax the digital economy, it is important to look into the source and residence principle and modify them to respond to the challenges posed by digitalization. The old principles of source and residence taxation are not to be thrown away. In fact, the OECD BEPS project is built on these principles where the unitary or destination principles are not contemplated in the OECD fora.<sup>90</sup> According to the OECD, ‘actions to address BEPS will restore both source and residence taxation... these actions are not directly aim at changing the existing international standard on the allocation of taxing rights on cross border income’.<sup>91</sup> But there is still difference in the preference of the principles, while the UN Model Tax Convention gives more weight to the source principle than its OECD counterpart.<sup>92</sup>

### **3.3. Source and Residence Principle in Ethiopia**

The preceding discussion reveals the inherent problems on the rules of international taxation devised to deal with the physical economy making them obsolete in the face of the new world of digital commerce. Thus, it is important to discuss the Ethiopian international tax rules in this regard to look into whether they are crafted in such a way to withstand the storm of digitalization.

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<sup>87</sup> Ibid

<sup>88</sup> Dimitrios and Nikolopoulos (n 54) 75

<sup>89</sup> Mehran (n 21) 101

<sup>90</sup> KPMG International, ‘OECD BEPS Action Plan Moving from Talk to Action in the Asia Pacific Region’, (KPMG International 2017) 5 <<https://assets.kpmg/content/dam/kpmg/xx/pdf/2017/10/2017-beps-aspac.pdf>> accessed July 23 2019

<sup>91</sup> OECD (n 3) 11

<sup>92</sup> United Nations Model Double Taxation Convention between Developed and Developing Countries, (UN 2017) 6 <[https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT\\_2017.pdf](https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf)> accessed 24 February 2020

### **3.3.1. Residence Based Taxation Principle in Ethiopia**

In order to determine the residence of entities (bodies), the law employs two alternative tests. Thus, for a body to be considered as Ethiopian resident, the body should either be incorporated or formed in Ethiopia or it's the place of its effective management should be in Ethiopia.<sup>93</sup> Although the test of formation or incorporation is fairly easy, the problem arises in the determination of the place of 'effective management'. The effective management test is said to include a place where the high level management, commercial and financial decisions necessary for the operation of the business as a whole is taken.<sup>94</sup> For example, in determining the residence of a company, the 'effective management' test should be considered in light of the place of the meeting of its board members, since the management of a company is made through its board of directors.<sup>95</sup> However, in a digital world where a board of directors can meet through video conferencing and other online platforms, it is difficult to determine the place of the residence of a company.

### **3.3.2. Source Based Taxation in Ethiopia**

The Federal Income Tax law contains a fairly detailed Ethiopian source income for taxation purposes.<sup>96</sup> In this regard it is interesting to see how business income is sourced to Ethiopian jurisdiction. Income from business can be attributed to Ethiopian source from both resident and nonresident persons.<sup>97</sup> It may not be that much difficult to attribute Ethiopian source income ones the residence of the person is determined. However, the difficulty arises in appropriating Ethiopian source income when the person is Ethiopian nonresident. This is because of the fact that the law, to attribute Ethiopian source income requires that the business should be undertaken or transacted through 'permanent establishment' located in Ethiopia.<sup>98</sup> And the concept of permanent establishment is defined as 'a fixed place of business through which the business of a person is wholly or partly conducted'.<sup>99</sup>

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<sup>93</sup> See generally Art. 5 (5) (a) and (b) of the FITP

<sup>94</sup> Federal Income Tax Proclamation Technical Notes, 17

<sup>95</sup> Ibid

<sup>96</sup> See generally Art. 6 of the FITP

<sup>97</sup> See generally Art. 6 (2) and (3) of the FITP

<sup>98</sup> See generally Art. 6 (3) (a), (b) and (c) of the FITP

<sup>99</sup> See generally Art. 4 (1) of the FITP

In a digital economy, where businesses are conducted through online based platforms by having intangible assets, it is difficult to ascertain the source of such income. Through internet, a company can access Ethiopian market without having transaction with fixed business entities in the country, a case in point is the search engines and social media and other online based markets. In sum, both the residence and source based taxation are not meant to tax the traditional businesses based on physical presence.

### **3.4. Permanent Establishment in General**

In international taxation, the issue of permanent establishment is very important in allocating taxing rights to countries. The income that countries resort to collect from foreign investment in their country depends basically on policy rules they adopt in relation to PE. This is to mean that a broader definition of the concept of PE will likely to provide more taxing right.<sup>100</sup> On the contrary, a narrow definition of PE, limiting the number of cases where PE is triggered, will have the possibility of dwindling effect in tax income of a state.<sup>101</sup> Thus, against this back drop, it is important to observe the PE system and the challenge posed by the digitalization of the economy. Thus, a few paragraphs are devoted to the discussion of some of the issues associated with permanent establishment.

It has been recognized long ago that the notion of permanent establishment denotes a substantial physical presence and nonresident entities conducting business through a dependent agent in a given state.<sup>102</sup> Thus, 'permanent establishment' refers to 'a fixed place of business through which the business of an enterprise is wholly or partly carried on'.<sup>103</sup> And the fixed place of the PE definition is said to include, a place of management, and office, branch, factory, workshop, etc.<sup>104</sup>

Even though the OECD and the UN Models adopt the same definition of PE, there are observable differences in some of the elements constituting the existence of PE. For example, the

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<sup>100</sup> Luis and Perrine (n 84) 7

<sup>101</sup> Ibid

<sup>102</sup> OECD, *Preventing the Artificial Avoidance of Permanent Establishment Status: Action 7 Final Report*, (OECD/G20 BEPS Project, OECD Publishing 2015 ) 13

<sup>103</sup> See generally common Art. 5 (1) of the OECD and UN Model Tax Conventions.

<sup>104</sup> See generally common Art. 5 (2) (a) to (f) of the OECD and UN Model Tax Conventions.

OECD requires twelve months for a building site, construction, installation project to determine the existence of PE, but only six months are required to claim PE for the said activities under the UN Model.<sup>105</sup> The UN Model also adds assembly, supervisory activities and provision of services in the lists of activities for instigating PE when performed for 183 days in any 12 months period and there are many other important differences in models.<sup>106</sup> It can easily be comprehended that the UN Model is trying to favor developing or capital importing countries contrary to the OECD Model.

PE is inserted into tax treaties in order to determine profits attributable to foreign enterprises. As a result, the definition of PE is essential in many DTAs.<sup>107</sup> Tax obligation of a foreign enterprise is triggered to the extent that the entity has a permanent establishment in a taxing state.<sup>108</sup> Thus, the definition of PE is crucial in deciding whether a nonresident enterprise should pay income tax in another state.<sup>109</sup> Therefore, as tax income from foreign enterprises depend largely on the definition of the concept of PE; narrowing or expanding its meaning will have a direct repercussion on income of a state. Particularly, resourceful developing countries will incur revenue loss due to the adoption of narrow PE definition or incorrect interpretation.<sup>110</sup>

#### **3.4.1. Limitation of the PE Definition in Taxing the Digital Economy**

The PE concept was developed by the League of Nation; in particular, the organization was behind the PE threshold tests which are to date reflected in the OECD and UN Model Taxes.<sup>111</sup> However, despite changes in the business environment, the PE rule remains the same.<sup>112</sup> The PE principle developed in a world economy when there was low international communication and international trade was mainly composed of tangible items.<sup>113</sup> The concept of PE worked then

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<sup>105</sup> See generally Art. 5 (3) of the OECD and UN Model Tax Conventions.

<sup>106</sup> See generally Art. 5 (3) (a) and (b) of the UN Model Tax Conventions (n 90) 143 and 144 for comparison between the OECD and the UN models.

<sup>107</sup> WTS, 'Taxation of Permanent Establishment in China', (WTS 2016) 2 <[https://wts.com/wts.com/publications/pe-in-china/wts\\_pe\\_china\\_china.pdf](https://wts.com/wts.com/publications/pe-in-china/wts_pe_china_china.pdf)> accessed 21 February 2020

<sup>108</sup> OECD (102) 9

<sup>109</sup> Ibid

<sup>110</sup> Luis and Perrine (n 84) 6

<sup>111</sup> Michael (n 73)151

<sup>112</sup> Ibid 106

<sup>113</sup> Ibid 106

due to the merger between physical presence and market access. But in the digitalized economy, neutrality between E-commerce and physical presence dictates the business environment.<sup>114</sup>

In addition, there are new ways of doing business causing relocation of core business function resulting in a different distribution of taxing rights which might lead to a low taxation.<sup>115</sup> As discussed before, the digital economy is characterized largely by reliance on intangible assets and massive use of data which complicates the determination of a jurisdiction where value creation occurs.<sup>116</sup> Thus, the existing PE rule is criticized for its fixation on relating value creation with territory.

#### **3.4.2. Allocating Taxing Rights in a Digital Era (Revising Nexus and Profit Allocation Rules)**

As shortly discussed above, digitalization of the economy poses many challenges on the world's tax system that rely mainly on the permanent establishment concept defined in terms of having a fixed place to determine the presence of taxation. As rightly noted in the recent OECD public consultation document, the existing tax rules which are dated back to the 1920s 'are not sufficient to ensure a fair allocation of taxing rights...' in this digital age.<sup>117</sup> In order to solve the tax allocation challenges, a number of proposals have been put forward by different countries at the OECD, these are: the user participation proposal, the marketing intangible and the significance economic presence proposal. These are different rules that try to address tax allocation in a digital economy. Despite their differences, these rules try to provide taxing right to a market jurisdiction (jurisdiction of a customer or user).<sup>118</sup> Thus, this topic tries to discuss these rules and their current status briefly.

##### **3.4.2.1. User Participation Rule**

This rule tries to create a nexus between value creation and user participation. It comes from the premise that user participation goes beyond the mere consumption of a service.<sup>119</sup> As noted in the

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<sup>114</sup> Subhajit (n 59) 46

<sup>115</sup> OECD (n 3) 10

<sup>116</sup> Ibid

<sup>117</sup> OECD, 'Public consultation document Secretariat Proposal for a Unified Approach under Pillar One', (2019) 6 <<https://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf>> accessed 1 March 2020

<sup>118</sup> OECD (n 5) 11

<sup>119</sup> OECD (n 28) 25

OECD public consultation document, the activities and participation of users is essential ‘to the creation of the brand, the generation of valuable data, and the development of a critical mass of users that help to establish market power.’<sup>120</sup> The idea here is that user participation helps digital businesses to build the trust and reputation, contribute to their brand and the growth of their networks.<sup>121</sup> It is even difficult to assume the development of the business of social networks without data, network effect and user participation.<sup>122</sup> The point behind the user participation rule is that a jurisdiction where there is active participation can claim taxing rights without the physical presence of an enterprise. Digital businesses collect large amount of data and monetize the same which is collected from through intensive monitoring of users’ active contribution and behavior.<sup>123</sup>

The user participation rule is important for business models such as social media platforms, search engines and online marketplaces.<sup>124</sup> The value generated through user participation is not amenable to tax under the existing international tax system which is based on the physical activities of enterprises. Thus, businesses generate value from active user base (user jurisdiction) without paying tax to the local jurisdiction despite collecting juicy profits.<sup>125</sup> Hence, the user participation rules calls for the revision of the nexus rule so that the user jurisdiction will have a right to tax.<sup>126</sup>

#### **3.4.2.2. Marketing Intangibles**

Marketing intangible is something which is short of a physical or financial asset but capable of being owned or controlled for commercial activity.<sup>127</sup> And it ‘relates to marketing activities, aids in the commercial exploitation of a product or service and/or has an important promotional value

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<sup>120</sup> OECD, ‘Addressing the Tax Challenges of the Digitalization of the Economy: Public Consultation Document’, (OECD Base Erosion and Profit Shifting Project) 9 <<https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf>> accessed 12 March 2020

<sup>121</sup> OECD (n 28) 25

<sup>122</sup> Ibid 24

<sup>123</sup> Ibid 25

<sup>124</sup> OECD (n 120) 9 and 10

<sup>125</sup> Ibid 10

<sup>126</sup> Ibid

<sup>127</sup> OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD Publishing 2017) 249

for the product concerned.<sup>128</sup> Trademarks, trade names, customer lists, customer relationships and proprietary market and customer data used or aided in marketing and selling goods and services are listed as examples constituting marketing intangibles.<sup>129</sup> Thus, unlike user participation rule, the marketing intangible proposal has a wider scope as it applies to both digital and non-digital entities.<sup>130</sup>

Allocation of taxing rights through marketing intangibles rule is based on the premise that intangible assets contribute immensely towards value creation.<sup>131</sup> This rule will allocate taxing rights to a jurisdiction where MNEs reach into that jurisdiction remotely or via a limited local presence through LRDs in order to establish user or customer and other marketing intangibles.<sup>132</sup> And it modifies the existing transfer pricing and treaty rules to allocate marketing intangibles and risks associated with such intangibles to a market jurisdiction.<sup>133</sup>

#### **3.4.2.3. Significant Economic Presence Rule**

Technological advancements enabled businesses to participate in economic activity of a jurisdiction without having a physical presence. Thus, according to the advocates of the significance economic presence approach, technological developments made the existing nexus and profit allocation rules utterly ineffective.<sup>134</sup> Hence, in order to fight this, this rule kicks in when a nonresident foreign enterprise has a significant economic presence in a jurisdiction via digital technologies and other automated means and has a purposeful and sustained interaction with such jurisdiction.<sup>135</sup>

In order to establish ‘significance economic presence’, a number of factors are used as indicators; including: having user base coupled with data input; the size of digital content acquired; billing and collection in local currency; keeping website in a local language; having an obligation for the final delivery of goods to customers and rendering after sale services (repair

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<sup>128</sup> Ibid 27

<sup>129</sup> Ibid

<sup>130</sup> OECD (n 120) 11

<sup>131</sup> OECD (n 28) 52

<sup>132</sup> OECD (n 120) 12

<sup>133</sup> Ibid

<sup>134</sup> Ibid 16

<sup>135</sup> Ibid

and maintenance) and promotion activities to attract customers.<sup>136</sup> One or more of these factors are important in determining the presence of significant economic presence and protect the taxing rights of a jurisdiction where such factors loom large.<sup>137</sup>

Even though the three rules or approaches have certain differences in their approach in tackling the broader taxing challenges of the digitalization, they all call for changes to a nexus and profit allocation rules and they go beyond a traditional taxing right based on physical presence.<sup>138</sup> All the proposals also provide taxing rights to user or market jurisdictions.<sup>139</sup>

However, there is lots of criticism regarding the approach. One of these criticisms is directed towards the user participation that the rule is limited only to digital businesses largely social Medias and search engines. It does not cover other businesses outside the digitalized ones. Similarly, the marketing intangibles' approach is criticized for its heavy reliance on the intrinsic link between intangibles and market jurisdiction as it is difficult to determine the link particularly when market activities are undertaken outside a certain jurisdiction and not largely directed towards local customer habits and preferences.<sup>140</sup> As the user participation is criticized for solely dealing with digital businesses, the marketing intangible is questioned for being broad and not focusing on digital businesses specifically.<sup>141</sup>

Thus, there is no consensus among jurisdiction at the OECD on the new nexus and profit allocation rules. Thus, the OECD tried to come up with what it called the 'Unified Approach'<sup>142</sup> in order to create consensus among jurisdictions. Thus, there is still an ongoing discussion at the OECD to adopt unified rules that would modify the PE, source and residence rules in order to tax income from the digital economy.

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<sup>136</sup> Ibid

<sup>137</sup> Ibid

<sup>138</sup> Ibid 17

<sup>139</sup> OECD (n 117) 4

<sup>140</sup> OECD (n 120) 18

<sup>141</sup> OECD (n 117) 5

<sup>142</sup> See generally OECD (n 117) where the whole document is about the discussion of the new and revised nexus and profit allocation rules.

### 3.5. Permanent Establishment in Ethiopia

The preceding topic provided some of the international issues regarding PE in general, particularly the challenges associated with taxing the digital economy. This topic tries to unravel some prominent issues related to PE as put in place under the Ethiopian tax system. The PE rule is said to be significant in determining the source income under Art. 6; taxation of certain payment made to non-residence under Art. 51; transfer pricing rules under Art. 79 and the withholding tax under Arts. 89, 90 and 93 of the FITP.<sup>143</sup> It is important to note that the most important principles of taxation (source, residence and PE) are drawn from the OECD and UN model tax convention or by blending the two. Thus, this topic, as its predecessors, will try to comparatively observe the lessons learned from the international tax conventions mentioned.

To begin with, the income tax proclamation defines the term ‘permanent establishment’ as ‘a fixed place of business through which the business of a person is wholly or partly conducted’.<sup>144</sup> The definition is the same with what is provided under the OECD Model Tax Convention and the same definition is adopted in the UN Model. Despite changes and modifications to close gaps in some areas of PE from time to time, it is rare to observe alteration or modification in the general definition of PE both under the OECD and the UN model. Thus, it is unwise to expect changes in the Ethiopian tax law regarding the general definition of PE. Moreover, it has been noted that the Ethiopian PE definition got its inspiration from the OECD Model Tax Convention.<sup>145</sup>

Thus, the above discussion is indicative of the fact that the PE definition as adopted in the FITP does not capture transactions made through the digital economy. Since the law requires a fixed place to constitute PE in Ethiopia, it does not capture economic activities made through virtual world. However, unlike the FITP, the VAT Proclamation captures the supply of goods and services via the internet.<sup>146</sup> But there is no guideline as to how it works.

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<sup>143</sup> FITP Technical Note (n 92) 14

<sup>144</sup> See generally Art. 4 (1) of the FITP

<sup>145</sup> FITP Technical Note (n 92) 14

<sup>146</sup> See Art. 4 (7) of the Value Added Tax Proclamation No. 285/2002, *Fed. Neg. Gaz.* Year 8, No. 33

### 3.6. General Overview Regarding the MLI

The MLI marked a unique development in the area of international taxation. Before the MLI, international taxation was built largely on DTAs.<sup>147</sup> The plan to develop a multilateral instrument was set under Action 15 of the 2013 OECD project.<sup>148</sup> Under the Action 15, it was asserted that it is important to come up with a multilateral instrument designed to provide an innovative approach to the ever changing global economy.<sup>149</sup> To this end, the MLI is prepared with a vision to fight non-taxation or reduced taxation through tax evasion or avoidance and treaty shopping arrangements; address artificial avoidance of PE status and improve dispute resolution.<sup>150</sup>

Even though the plan to develop multilateral instrument has already been envisaged under action 15 of the 2013 BEPS project, the later development of the MLI was to give a binding force or to implement BEPS issues identified in the course of the BEPS initiative.<sup>151</sup> However, the implementation of the BEPS package would require modifying more than 3000 DTAs and changing model tax conventions from where those DTAs are drawn.<sup>152</sup> Other than going through an arduous and time consuming task of changing thousands of DTAs and model tax conventions, developing a multilateral instrument was conceived as panacea. Thus, coming up with multilateral instrument that automatically updates all the DTAs of its signatories is taken as an ‘ingenious solution’ to the problem.<sup>153</sup>

With regard to its design, the MLI works as a tool to modify tax treaties between two or more parties to the convention. Thus, the corollary is that the MLI does not serve as an amending protocol to a single existing treaty which automatically amends the text of the cover tax

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<sup>147</sup> Reuven S. Avi-Yonah and Haiyan Xu, ‘A Global Treaty Override? The New OECD Multilateral Tax Instrument and Its Limits’, (2018) 39 MICH J INTL L 216

<<https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1929&context=mjil>> accessed 21 February 2019

<sup>148</sup> OECD (n 3) 24

<sup>149</sup> Ibid

<sup>150</sup> See generally paragraph 5 and 7 of the preamble of the Multilateral Convention to Implement Tax Related Measures to Prevent Base Erosion and Profit Shifting, (OECD 2016)

<sup>151</sup> Explanatory Statement to the Multilateral Convention to Implement Tax Related Measures to Prevent Base Erosion and Profit Shifting, (OECD 2016) 1 and 2

<sup>152</sup> Ibid 1

<sup>153</sup> Avi-Yonah and Haiyan (n 147) 216

agreement.<sup>154</sup> The MLI applies side by side with existing treaties modifying their application to implement the BEPS measures.<sup>155</sup>

### **3.6.1. Criticism against the MLI**

Even though the MLI is praised for its mega effort in introducing strong international tax system, it is not without its detractors. Hence, this sub topic will analyze some of those criticism forwarded against the MLI.

The MLI is designed to be flexible taking into account the enormity of jurisdictions participating in the project in order to accommodate the positions of different countries and jurisdictions.<sup>156</sup> However, the policy of adopting flexibility is criticized for creating a possible gap in the effective implementation of rules that might be important in fighting BEPS.<sup>157</sup> Thus, due to the selective and optional nature of many of its provisions, the MLI is said to lack significant impact on international taxation.<sup>158</sup> Even though flexibility could be a challenge in implementing the BEPS measures, introducing mandatory or non-flexible international taxation rules may fail to attract many jurisdictions defeating the purpose of international effort to counter BEPS.

With regard to its preparation, the short period of time given to develop the MLI was criticized at the OECD for focusing mainly on ‘bare bone’ of structural issues neglecting important details in its content.<sup>159</sup> What is more, the consultation process in the MLI was also said to be minimal.<sup>160</sup>

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<sup>154</sup> Ibid 3

<sup>155</sup> Ibid

<sup>156</sup> Ibid

<sup>157</sup> Nathalie Bravo, ‘The Multilateral Tax Instrument and Its Relationship with Tax Treaties’, (2017) IBFD 293

<sup>158</sup> Joseph Morley ‘Why the MLI Will Have Limited Direct Impact on Base Erosion Profit Sharing’, (2019) Vol 39 North Western Journal of International Law & Business 247

<sup>159</sup> See Arnold , in Annet Wanyana Oguttu, ‘Should Developing Countries Sign the OECD Multilateral Instrument to Address Treaty-Related Base Erosion and Profit Shifting Measures?’ (CGD Policy Paper Washington DC Center for Global Development) 12 <<https://www.cgdev.org/sites/default/files/should-developing-countries-sign-oecd-multilateral-instrument-address-treaty-related.pdf>> accessed 24 February 2020

<sup>160</sup> Ibid

### 3.6.2. Developing Countries and the MLI

Different issues have been raised with regard to the participation of developing countries in the BEPS project in general and the MLI in particular. Thus, under this sub topic, discussion will be made whether developing countries should try to sign up to the MLI.

The importance of MLI to developing countries is manifested in many ways including: the MLI has the potential to beef up source taxation mainly through providing solutions to treaty shopping and abuse of PE status; providing rules that align profits taxation with value creation and by amending DTAs based on either the UN or the OECD Model, the MLI would reduce cost, time and uncertainty that would have been encountered on negotiating DTAs etc.<sup>161</sup> these are some of the major advantages that signing the MLI would bring for developing countries.

However, there are many criticisms against the MLI and many authorities recommended against the signing of the MLI by developing countries. But it is unwise to dismiss the MLI for developing countries altogether without considering the text on some of the issues. Thus, a few paragraphs will be devoted to the discussion of some of these issues hereunder.

The MLI contains provisions that deal with prevention of treaty abuse under part three of the convention.<sup>162</sup> Treaty abuse, which is mainly reflected through treaty shopping, emanates from Action 6 of the BEPS project on prevention of treaty abuse and it was considered as one of the most important BEPS concerns.<sup>163</sup> Treaty abuse occurs when residents of a non-treaty state resort to treaty shopping to obtain treaty benefits that are not available to them. They often do this ‘by interposing a conduit company in one of a contracting state so as to shift profits out of the treaty state’.<sup>164</sup> In order to fight treaty shopping, the following are some of the recommended measures:

- I) Providing a clear statement that parties to a treaty intend to avoid non-taxation or reduced taxation resulting from either through tax evasion or tax avoidance.<sup>165</sup>

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<sup>161</sup> Ibid 4

<sup>162</sup> See generally Art. 6 and 7 of the part three of the MLI

<sup>163</sup> OECD (n 3) 18

<sup>164</sup> Annet (159) 7

<sup>165</sup> OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances: Action 6 2015 Final Report*, (OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing 2015) 9

- II) Inserting the LOB rule which is a specific anti abuse rule that limit treaty benefit to entities based on conditions related to legal nature, ownership in, and general activities of an entity, and thus, requires a sufficient link between an entity and state of residence.<sup>166</sup>
- III) Providing the PPT rule which is a general anti abuse rule that denies a treaty benefit to an entity if the principal purpose of the activity or the transaction is meant to obtain a treaty benefit unless granting the benefits would be compatible with the object and purpose of the treaty.<sup>167</sup>

There is flexibility for countries in adopting the rules, thus, states can choose one of the rules of anti-abuse as long as it addresses treaty abuse.<sup>168</sup> Thus, the point is that since it is advantageous for developing countries to avoid non-taxation or double taxation, it is recommended they should adopt the treaty abuse articles in the MLI.<sup>169</sup>

A very interesting development in the MLI is in the area of improving dispute resolution and binding arbitration. Solutions to the lack of effective dispute resolution and absence of binding arbitration were raised as the main concern under Action 14 of the BEPS project.<sup>170</sup> The MLI deals with improving dispute resolution under part 5 (Arts. 16 and 17) of the convention. Art. 16 is taken as a reflection of the Mutual Agreement Procedure (MAP) which is inserted in many DTAs as a mechanism of dispute resolution.<sup>171</sup>

The arbitration issue in the MLI is generally dealt with under part 6 (Arts. 18 through 26) which also contains a binding arbitration under Art. 19. However, the binding arbitration issue is the most controversial one.<sup>172</sup> Many countries in the OECD advocated for a binding arbitration to ensure effective implementation of a treaty through MAP.<sup>173</sup> However, binding arbitration is

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<sup>166</sup> Ibid

<sup>167</sup> Ibid

<sup>168</sup> Ibid 19

<sup>169</sup> Annet (159) 7

<sup>170</sup> OECD (n 3) 23

<sup>171</sup> Annet (159)10

<sup>172</sup> Avi-Yonah and Haiyan (n 147) 159

<sup>173</sup> Annet (159) 11

criticized for being unfair to developing countries particularly where there is a dispute with experienced countries with many MAP cases at their disposal.<sup>174</sup>

In sum, the case whether developing countries sign the MLI is not settled, some argue that MLI is attractive to developing countries as it responds to treaty shopping and strengthen source taxation.<sup>175</sup> However, others, a number of them, conclude that developing countries should not rush to sign the MLI without having clear policy guidelines that inform them as they might end up adopting provisions not in their best interest.<sup>176</sup> But the problem is a number of years passed since the MLI is on the table for countries to sign up and modify their treaty provisions. Thus, providing a blanket wait and see approach, heaven knows for how long, does not address the immediate problems of developing countries.

### **3.7. Overview of Ethiopia's Treaty Network**

To start with, it has been estimated that there are around three thousand DTAs are in force.<sup>177</sup> Out of these DTAs, between 1000 and 2000 of them involve at best one developing country.<sup>178</sup> Allocating taxing rights in DTAs is largely determined by the investment position of countries where it is easy to apportion taxing rights between two states that are in an equal footing in their FDI positions.<sup>179</sup> However, in a DTA between countries that are in an asymmetric position in FDI, the capital importing country faces risk of forfeiting revenue in tax.<sup>180</sup>

With regard to the FITP, Art. 48 of the proclamation tries to address issues of tax treaty. A tax treaty is defined as international agreement for the avoidance of double taxation and the prevention of fiscal evasion.<sup>181</sup> As per Art. 48 (2) a priority rule is provided where a tax treaty prevails when there is a conflict with the FITP. However, the priority rule will be overridden to fight against treaty shopping inserted under Art. 48 (3) and the anti-avoidance rules under part

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<sup>174</sup> Ibid 12

<sup>175</sup> Avi-Yonah and Haiyan (n 147) 216

<sup>176</sup> Ibid 16

<sup>177</sup> Evert-jan Quak & Hannah Timmis, 'Double Taxation Agreements and Developing Countries', (Helpdesk Report, Institute of Development Studies 2018) 2  
<[https://assets.publishing.service.gov.uk/media/5b3b610040f0b645fd592202/ Double-Taxation-Treaties\\_and\\_Developing\\_Countries.pdf](https://assets.publishing.service.gov.uk/media/5b3b610040f0b645fd592202/Double-Taxation-Treaties_and_Developing_Countries.pdf)> accessed 4 June 2020

<sup>178</sup> Ibid

<sup>179</sup> Ibid

<sup>180</sup> Ibid

<sup>181</sup> See Art. 48 (5) (b) of the FITP

eight of the FITP. These rules are in tandem with rules against treaty shopping under Art. 7 (8) through (13) of the MLI. In this sense, the MLI is said to boost investment inflow and protect Ethiopia's tax base.<sup>182</sup> In a nutshell, the LOB and anti-treaty abuse and PE rules under the MLI are compatible and compliment Ethiopian tax treaty rules and have a potential to increase the tax base of the country.

Ethiopia has tax treaty with a number of countries. As of 2018, Ethiopia ratified 32 DTAs where 23 of them are enforced.<sup>183</sup> However, there is a discrepancy on the number of DTAs that are in force in Ethiopia. The IBFD portal shows that Ethiopia has 23 DTAs but the MOFEC has only 14 DTAs. According to Mr. Bochu Sintayehu,<sup>184</sup> the numerical discrepancy might be due to the problem of proper notification after the process of ratification of the DTAs. After the MLI, five countries (Netherlands, Ireland, Korea Republic, Romania and Singapore) requested for renegotiation of their DTA with Ethiopia.<sup>185</sup>

Regarding its approach, Ethiopia uses a blend of the UN and OECD Model Tax treaties albeit with more weight to the UN Model.<sup>186</sup> In fact, MOFEC has a Model Tax tailored to the specific priority of the country.<sup>187</sup> However, there are different practical challenges to the bilateral negotiation of DTAs in Ethiopia as can be touched briefly herein under.

### **3.7.1. Challenges in Negotiating DTAs in Ethiopia**

In negotiating DTA with developed countries, there are different considerations. One of these is balancing attracting investment and protecting tax revenue of the country.<sup>188</sup> In the past, the country gave priority to attracting FDI over tax revenue but now the policy is towards a balanced approach.<sup>189</sup> The other issue is that developed countries want technical service and other Passive Income to be taxed based on PE but we refuse since it hurts our tax revenue.<sup>190</sup>

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<sup>182</sup> Birhanu (n 18) 30

<sup>183</sup> Ethiopia's Treaty Network Status as of July 2018, (a document from Ministry of Finance and Economic Cooperation,)

<sup>184</sup> Interview with Mr. Bochu Sintayehu, Legal Advisor, Ministry of Finance and Economic Cooperation, 8 June 2020

<sup>185</sup> Ethiopia's Treaty Network Status (n 157)

<sup>186</sup> Interview With Mr. Bochu Sintayehu (n158)

<sup>187</sup> FDRE's Model for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion, (Tax Policy Directorate, MOFEC 2019)

<sup>188</sup> Interview With Mr. Bochu Sintayehu (n158)

<sup>189</sup> Ibid

<sup>190</sup> Ibid

Similarly, with regard to withholding rates, the developed countries want us to reduce them but we argue that our interest, royalty and dividend rates are very low in our domestic legislation. But they insist arguing that “what is the benefit of the DTA if you tax us based on your domestic legislations?” and we try to compromise.<sup>191</sup> This shows how arduous it is to negotiate DTA bilaterally.

In relation to considering the ratification of the MLI, Mr. Bochu opined that Ethiopia did not consider ratification of the MLI and research is not made on the issue though a future consideration might be a possibility. According to Mr. Bochu, It is good for the country to move bilaterally taking into account the situation of our counterpart countries. If we ratify the MLI, we might lose our flexibility.

However, for those countries with increased number of DTAs, the MLI is considered as an important tool to easily modify tax treaties by incorporating specific anti-avoidance provisions.<sup>192</sup> In this regard, Ethiopia has 32 ratified DTAs out of which 24 of them ratified the MLI and five of them have already requested renegotiation.<sup>193</sup> Given the numbers, it is important for Ethiopia to use the MLI in the BEPS project. Moreover, it is difficult for Ethiopia to negotiate with countries that ratified the MLI since they will be more acquainted with the rules and developments regarding the MLI. Thus, the country might find itself in a disadvantageous position in negotiating bilateral DTAs even with its counterpart developing countries that joined the BEPS initiative and ratified the MLI.

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<sup>191</sup> Ibid

<sup>192</sup> German Cooperation (n 60)13

<sup>193</sup> FDRE’s Model for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion, (Tax Policy Directorate MOFEC 2019)

## Chapter Four

### 4. The Legal and Practical Challenges in Taxing the Digital Economy

To start with, discussions under preceding chapters are testimonial to the idea that the unprecedented level of digitalization of the economy continues to wreak havoc on international tax rules and tax administration systems. Yuval Noah Harari is probably correct when he suggested radical tax reform of taxing information as peer-to-peer blockchain and crypto currencies will make transactions without a specific national currency or any currency at all.<sup>194</sup> Even though this is a brave new world suggestion into the future, it unequivocally depicts the challenges where tax systems are heading as the world economy continues to be digitalized. To this end, this chapter is devoted to the discussion of the crux of the matter on challenges of the income taxation of the digital economy in Ethiopia.

Accordingly, the absence of tax and non-tax legislations pertinent to the taxation of the digital economy, challenges in joining BEPS and ratifying the MLI, tax administration challenges in taxing income from the digital economy and tax issues associated with electronic payment system are some of the issues that would be critically examined under this chapter.

#### 4.1. Absence of Tax and Nontax Legislations in Taxing Income from the Digital Economy

Income taxation of the digital economy requires important tax and non-tax legislations that are essential in facilitating the electronic commerce transaction and taxing the same. With regard to tax legislations, the discussion under chapter three of this work indicated some of the gaps associated with the Ethiopian tax laws in taxing cross boarder online income sourced from digital economy. In this regard, in the income tax law, the source-residence and PE rules are founded upon the 'old' fixed place requirement which makes it utterly difficult to tax search engines, social media outlets and other online based entities that reap profits without being subjected to Ethiopian tax law.

Regarding domestic online businesses or payments, at the face value, it is not much difficult to stick legal teeth on online businesses for tax purposes. The Ministry of Revenue can use the expansive definition of 'income' under Art. 2 (14) with Art. 21 of the FITP when the online

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<sup>194</sup> Yuval N. Harari, *21 lessons for 21<sup>st</sup> Century*, (Spiegel and Grau New York 2018) 17

income generating activity is done by businesses. If not, the amassing provision, Art. 63 is there for incomes not falling in other schedules which can be used in this scenario. This is because of the fact that even though there is a possibility that digital economy creates new types of businesses, it is also a reflection of 'old' businesses going digital. Thus, there is a concurrence that digital economy does not pose unique tax issues.<sup>195</sup>

However, since the issue of taxing digital economy is a new territory, it is difficult to approach it with 'old' tax laws designed to collect and administer 'physical' based businesses. Thus, the absence of clear rules and guidelines makes it difficult to trace income of new online based businesses or existing ones that are using online avenues to generate income.

In relation to non-tax legislations, rules that authorize and regulate the digital economy remain at center stage. As digital economy is highly intertwined with virtual financial flows, instruments authorizing and regulating modes of electronic money movement are significant. In this respect, the NBE is empowered to regulate and authorize payment related aspects in the country.<sup>196</sup> However, it took nearly a decade for the NBE to come up with a directive that regulate and authorize payment system.<sup>197</sup> This may not seem outlandish as the prime emphasis was given to the security, safety and efficiency of the national payment system in the proclamation.<sup>198</sup> Thus, the absence of a motive for digitalization might be the factor behind the dormancy.

As indicated before, the NBE brought to light very recently a payment instrument issuer directive designed to encourage digital payment.<sup>199</sup> The directive, in the main, is meant to provide for 'innovative payment instruments' with a view to increase the use of financial services, protection of users of payment instrument and to reduce risks associated with the use of

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<sup>195</sup> Pascal Saint-Amans and Raffaele Russo, 'The Men behind BEPS' (2014) 25 INT'L TAX REV 10, 11

<sup>196</sup> See generally Art. 4 of the National Payment System Proclamation No. 718/2011, *Fed. Neg. Gaz.* Year 17, No. 84

<sup>197</sup> Historically, the promulgation of the National Payment System Proclamation is dated back to 2011. However, for a period spanning a decade, little has been done to digitalize the payment system.

<sup>198</sup> See generally paragraph 1 and 2 of the preamble of the National Payment Proclamation. See also Art. 35 (3 to 7) of the same proclamation where forging payment instruments and participating in transaction in payment instrument without authorization are made offences.

<sup>199</sup> National Bank of Ethiopia Oversight of the National Payment System Licensing and Authorization of Payment Instrument Issuer Directive No. ONPS/01/2020 (hereinafter the Payment Instrument Issuer Directive)

payment instruments.<sup>200</sup> The directive authorizes private entities other than banks to participate as payment instrument issuer. As such, hosts of requirements are put in place in the directive for those applying for license. A minimum of 50 million paid up capital is demanded for would be licensees.<sup>201</sup> The directive also provides for stringent entry requirement regarding the soundness of the persons running payment instrument issuer. Hence, the fitness and propriety test for directors, chief executive officers and senior executive officers is akin to what is provided for other financial sectors.<sup>202</sup>

Art. 8 of the directive requires payment instrument issuer to ‘keep’ and ‘identify’ a minimum of three types or categories of electronic money account. The directives designates account categories in ‘levels’ where level 1 account is allowed to have a maximum of 5 thousand birr and the amount of daily transaction limit is 1 thousand birr.<sup>203</sup> A maximum of 20 thousand birr is set for the level 2 account and 5 thousand birr is made a limit for daily transaction. And a maximum of 30 thousand birr is put as a ceiling for level 3 account with 8 thousand birr of daily transaction limit.<sup>204</sup> In addition, walk-in users (persons using payment instrument services without having electronic account) are allowed for a daily maximum transaction of 5 hundred birr.<sup>205</sup> However, amount limitation does not exist for an account belonging to an agent where a transaction is made in relation to users.<sup>206</sup>

Even though the issuance of the directive in itself could be taken as a good gesture in facilitating electronic payment in the country, it is challenging to consider it as a giant leap for a number of reasons. First, the maximum ceilings on daily transaction in the accounts are not commensurate with inflation in the country. For example, the 5 hundred birr daily maximum cap on walk-in

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<sup>200</sup> See generally paragraph 1, 2 and 3 of the preamble of the Payment Instrument Issuer Directive

<sup>201</sup> See Art. 4 (3) (b) (VII) of the Payment Instrument Issuer Directive.

<sup>202</sup> See generally Art. 5 of the Payment Instrument Issuer Directive for the detailed requirements of those persons running the payment instrument issuer company. The NBE regulates banks, insurances and microfinance institutions in almost similar manner. This approach might be good to detect any tremor of failure. However, it might also result in overregulation where flexibility is required in financial institutions like microfinances.

<sup>203</sup> See Art. 8 (1) of the Payment Instrument Issuer Directive.

<sup>204</sup> Ibid

<sup>205</sup> See Art. 8 (5) of the Payment Instrument Issuer Directive. See also Art. 2 (23) for the definition of walk-in users.

<sup>206</sup> See Art. 8 (6) of the Payment Instrument Issuer Directive.

users will not be enough to pay Television subscription fee or purchase airline ticket. Second, the directive provides for stringent entry requirement which is similar to other financial institutions. Providing tough entry requirement might hinder those applying for license running counter to the objective of encouraging innovation in digital payment set under the directive.<sup>207</sup> Thus, one will hope that the cautious introduction of the directive might also be translated into a cautiously flexible approach in the years to come.

Yet the electronic signature law is an important non-tax legislation that facilitates electronic commerce in the country. In fact, the proclamation is armed with the objectives of promoting electronic commerce; give recognition to electronic signatures and authentication of messages.<sup>208</sup> It has to be borne in mind that this proclamation is meant to give effect to contracts made electronically. Thus, the corollary is that freedom of contract dictates that it is up to the parties to use electronic signature save where it has been made mandatory.<sup>209</sup> The law also provides for the recognition of electronic message and electronic signature under Art. 5 and 6 of the proclamation respectively. Therefore, the proclamation plays center stage in facilitating electronic commerce in the country.

However, the electronic signature proclamation is not comprehensive to deal with the wider spectrum of issues related to electronic payment, electronic commerce and tax etc. To this end, a tad comprehensive legislation that might regulate, facilitate and deal with broad issues related to electronic commerce is on its way to be introduced. The new draft law, dubbed as Electronic Transaction Proclamation, is envisaged to introduce a ‘responsive information and communication technology legal framework’ that clears the way among others to the Ethiopia’s participation in the ‘information age and economy’.<sup>210</sup> The prevention and removal of legal barriers to the use of electronic messages to render ‘equal treatment to users of paper based documentation and computer based information’ is made part of the policy objective of the proclamation.<sup>211</sup> This is important to strengthen the evidentiary value of electronic messages.

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<sup>207</sup> See generally paragraph 1 of the preamble of the Payment Instrument Issuer Directive.

<sup>208</sup> See paragraph 1 and 3 of the Electronic Signature Proclamation

<sup>209</sup> See generally Art. 4 (1) of the Electronic Signature Proclamation.

<sup>210</sup> See generally paragraph 1 of the preamble of the draft Electronic Transaction Proclamation.

<sup>211</sup> See generally paragraph 2 of the preamble and Art. 7 and 13 of the draft Electronic Transaction Proclamation.

However, the admissibility of electronic message has already been recognized under the Electronic Signature Proclamation.<sup>212</sup> Though it may not serve as a reminder for seasoned and savvy lawyers, it might still be a quick fix for an inquisitorial with less background in legal practice.

In the draft proclamation, electronic transaction is taken to mean ‘the conducting of businesses over computer mediated network’. And electronic commerce and online banking are mentioned by name as activities falling in the definition before enclosing it with the famous catch all phrase of ‘including but not limited to’.<sup>213</sup>

The interesting aspect of the draft proclamation is that the Ministry of Information and Technology (MIT) is empowered to render policy direction on the digital economy and oversight of the draft proclamation along with the Ethiopian Communication Regulatory Authority (ECRA) with the power to come up with directives on matters arising from the proclamation.<sup>214</sup> The possible conundrum in this regard is that ‘matters’ covered in the draft proclamation are very wide and some of them might be beyond the expertise of the two institutions. For example, ECRA is given the task of handling issues of consumer protection on issues arising from the draft proclamation where there is a veteran Trade Competition and Consumers Protection Authority.<sup>215</sup> What is more, the NBE, as will be discussed shortly below, is preparing a National Payment Strategy that makes payments digitally. Thus, overlap and redundancy of authorities over digital payment system will create confusion. However, since this is only the draft proclamation, some modifications might hopefully be on the menu before its adoption by the lower house.

In sum, even though non-tax legislations are important in facilitating taxing the domestic digital economy, the preceding discussion shows that they are incomprehensive and some are being introduced very recently. It is difficult to conclude that electronic commerce has full-fledged legal backing though works are being done to change this state of affair.

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<sup>212</sup> See Art. 5 (1) of the Electronic Signature Proclamation.

<sup>213</sup> See generally Art. 2 (25) of the draft Electronic Transaction Proclamation.

<sup>214</sup> See generally Art. 6 (1) and 49 (2) of the draft Electronic Transaction Proclamation.

<sup>215</sup> See Art. 32 (3) of the draft Electronic Transaction Proclamation.

## **4.2. Practical Challenges in Taxing the Digital Economy in Ethiopia**

The above discussions under this chapter tried mainly to have an in-depth look at the legal lacunas in the income taxation of the digital economy in Ethiopia. And it is important to turn into the practical aspect of the matter though this is not a tribute to ‘the law and practice’ cliché. Thus, practical challenges in joining the BEPS project and ratifying the MLI, tax administration challenges in the income taxation of the digital economy, income tax related issues in using electronic payment and lack of system integration between banks and tax authorities are issues to be addressed under this topic.

### **4.2.1. The Challenges and Benefits of Joining BEPS for Ethiopia**

As addressed in this work, taxing complex MNEs that use sophisticated tax planning is way beyond even developed countries with robust implementation capacities necessitating collaboration among states. As a result, many jurisdictions are participating in the BEPS movement spearheaded by the OECD to reach in agreement on tax challenges posed by digitalization. The number of countries participating in the project is growing by a day and as of December 2019, 137 countries joined BEPS including many developing nations.<sup>216</sup>

However, Ethiopia is not part of the BEPS project which is attributed mainly to the knowledge gap on the BEPS project itself. In an interview with Mr. Ataklti Weldeabzgi<sup>217</sup> at the MOFEC, the researcher learned that at institutional level, there is no research done on the BEPS projects that would provide sufficient information about the project. Though we are approaching to a decade since the inception of the BEPS project in 2013, the issue did not gain the attention it required in Ethiopia. Though the MOR benefits from the technical support of IMF and other institutions, it so far did not create a relationship with the OECD to participate in the BEPS because of lack of information but it is possible to establish the relationship since we are the beneficiaries said Mr. Birhanu Mamo at the MOR.<sup>218</sup>

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<sup>216</sup> OECD, ‘Members of the OECD/g20Inclusive Framework on BEPS’, (OECD 2019)

<<https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition>.> accessed May 13 2020

<sup>217</sup> Interview with Mr. Ataklti Weldeabzgi (n 13)

<sup>218</sup> Interview with Mr. Birhanu Mamo (n 15)

Moreover, as succinctly put forward by Mr. Getu Jemaneh,<sup>219</sup> the Ethiopian tax law is paper based where experts from the MOR look for goods moving around to assess tax making it unsuitable for taxing digital businesses. In this regard, joining BEPS might help the country in this endeavor.<sup>220</sup> However, joining initiative should be coupled with developing the ability and capacity to translate the principles and standards developed in the OECD into the country's tax collection system.<sup>221</sup>

Another critical observation of the BEPS project for Ethiopia came from Mr. Aschalew Ashagre<sup>222</sup> who articulated on the needs of strengthening the Ethiopian Tax Administration before joining BEPS. As OECD leans towards advantages of developed countries, Ethiopia needs a careful and critical assessment of the project before being a part.<sup>223</sup> According to Mr. Aschalew, joining BEPS initiative should be based on knowledge through ironing out the benefits that the project would bring to the country. The problem in this regard is the Ethiopian Tax Administration lags behind and not in a strong position to accommodate developments in the BEPS era.<sup>224</sup> Indeed, a study on some developing countries that joined the initiative indicates that problems in the Tax System and Tax Administration are major hurdles to implement the more sophisticated BEPS recommendations.<sup>225</sup>

Even though practical issues relating to taxation of the digital economy might seem up in the air, there are social media start ups and software companies that seek legal advice on their tax obligation in Ethiopia even if they do not have a PE presence in the country.<sup>226</sup> The absence of legal clarity is the main concern in this regard.<sup>227</sup> Thus, participating in the BEPS project is an important approach to have a develop standards for the digital economy and translate them into domestic legislations. Joining the BEPS project would undoubtedly benefit Ethiopia in modernizing its tax system. on the contrary, being a bystander would render the country clueless

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<sup>219</sup> Interview with Mr. Getu Jemaneh, Partner, Business Support Service, HST Consulting PLC, June 2 2020

<sup>220</sup> Ibid

<sup>221</sup> Ibid

<sup>222</sup> Interview With Mr. Aschalew Ashagre, Assistant Professor, Addis Ababa University College of Law and Governance Studies, School of Law, June 2 2020, Mr. Aschalew has years of experience in teaching, researching and practicing on Ethiopia's tax law.

<sup>223</sup> Ibid

<sup>224</sup> Ibid

<sup>225</sup> German Cooperation (n 60) 40

<sup>226</sup> Interview with Mr. Hawaz Merawi, Associate, Tadesse Kiros Law office, June 10 2020

<sup>227</sup> Ibid

regarding international tax standards making revenue collection from the digital economy a pie in the sky.

#### **4.2.2. Problems Associated with the Ratifying MLI**

As has been alluded to before, developing multilateral instrument that draw lessons from the works of the BEPS project is considered as a great move towards updating thousands of DTAs and many jurisdictions are joining the initiative through the ratification of the MLI.<sup>228</sup> However, in Ethiopia, the importance or otherwise of the MLI is yet to be researched.<sup>229</sup> The research on the MLI and other area of the BEPS project at MOFEC is associated with lack of skilled manpower, hesitation and not being proactive and migration of employees.<sup>230</sup>

Concerning international tax issues in Ethiopia, it has been almost be a general rule of thumb that the OECD does not further the interests of developing countries and associating the BEPS project with the sole effort of benefiting the well-to-do nations. The inception of the BEPS project is linked with the problem of developed nations suffering from losing tax revenue to tax heaven states.<sup>231</sup> However, even though developed countries are having problems with different BEPS issues, researches indicate that developing countries are equally losing revenue.<sup>232</sup> Moreover, developing countries that lack the necessary expertise and infrastructure to fight the highly sophisticated MNEs will likely to suffer more revenue loss in tax than developed countries.<sup>233</sup> Even though the MOFEC supposed to focus on tax policy and research, it is currently spending its good time on tax administration issues that knocks its door through appeal and other means.<sup>234</sup>

#### **4.2.3. Tax Administration Challenges in Taxing the Digital Economy**

The preceding discussions under this chapter revealed that despite the glaring gaps in the income tax law, there is a possibility to tax domestic online based businesses or entities that use online platforms in doing business. However, the ‘possibility’ is overshadowed by lack of capacity to

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<sup>228</sup> Avi-Yonah and Haiyan (n 147) 216

<sup>229</sup> Interview with Mr. Ataklti Weldeabzgi (n 13)

<sup>230</sup> Ibid

<sup>231</sup> Ibid

<sup>232</sup> OECD (n 1) 8

<sup>233</sup> Ibid

<sup>234</sup> Interview with Mr. Ataklti Weldeabzgi (n 13)

enforce by the Ministry of Revenue (MOR). A number of reasons are attributed to this state of affair. According to Abere Abebe<sup>235</sup> at the MOR lack of controlling mechanisms is one of the problems. A stark example in this regard is the case of three online businesses that went to the MOR on their own accord to be registered for tax.<sup>236</sup> Similarly, some businesses are visiting MOFEC to know whether they have tax obligation on their online business.<sup>237</sup> Mrs. Mahlet Made Abebe<sup>238</sup> at the Ministry also stressed on the lack of fully integrated information system. As a result, the MOR relies on third party informants.<sup>239</sup> Thus, the view that where there are buyers and sellers in the digital economy, taxing the same should be reckoned is a correct assessment.<sup>240</sup>

It is also important to mention the problems in the tax administration system used by the Ministry of Revenue. For more than a decade, the Ministry employed the Standardized Integrated Government Tax Administration System (SIGTAS) which is implemented at the country level.<sup>241</sup> Even though the system is still in operation, it has many technical and functional problems. Moreover, it is a manual based system making it unsuitable for the sophisticated tax administration in the digital era.<sup>242</sup>

#### **4.2.3.1. Activities Conducted to Alleviate the Tax Administration Problems in Taxing the Digital Economy and the Challenges thereto**

With the current wave of laws and government rhetoric on digital economy, it seems we are seeing a light beyond the tunnel. In this regard, it is important to look into some of the works that are underway in building a modern tax system good fit for digital economy and problems in this endeavor.

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<sup>235</sup> Interview with Mr. Abere Abebe (Legal Drafting and Advisory Team Leader), Ministry of Revenue, 10 December 2019

<sup>236</sup> Ibid

<sup>237</sup> Interview with Mr. Ataklti Weldeabzgi (n 13)

<sup>238</sup> Interview with Mrs. Mahlet Amde Abebe, Tax Operation Deputy Manager, Ministry of Revenue, 17 March 2020

<sup>239</sup> Ibid

<sup>240</sup> Interview with Mrs. Mahlet Amade Abebe (n 238)

<sup>241</sup> Interview with Mr. Birhanu Mamo (n 15)

<sup>242</sup> Ibid

At the Ministry of Revenue, attempts have been made to digitalize the system of tax administration by introducing online registration, filing, declaration, refund, report, etc.,<sup>243</sup> With regard to Electronic filing and payment of tax obligation, the Ministry is trying to train employees of some tax payers' organizations as interview with Mrs. Misgana Debele<sup>244</sup> at the MOR reveals. However, the challenge is that the users fear technology and the problem in the system and network connection contributes to limited use of e-filing.<sup>245</sup> Moreover, according to Mr. Debele Tura,<sup>246</sup> e-payment is less developed compared to e-filing in that there are only three government held businesses are using the e-payment platform. The problem is that e-payment requires collaboration with NBE, telecom, etc. but this cooperation yet to be materialized.<sup>247</sup> Thus, despite the efforts, the problems are more than a little bump on the path towards a digitalized tax administration system needed in the digital economy.

### **4.3. Electronic Payment and Tax Issues in Ethiopia: a Look at the Practice**

It has been a decade since the NBE authorized mobile banking.<sup>248</sup> Many commercial banks in the country now provide different modalities of e-payment services. According to Mr. Abebe Nigussie<sup>249</sup> at the CBE, the bank offers card banking, POS, mobile banking, internet banking and CBE birr. There are many businesses that are using e-payment platforms offered by banks. However, hotels, supermarkets and pharmacies come at the front when it comes to the use of e-payment mainly through POS machines.<sup>250</sup> POS machine, a card based e-payment modality, is

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<sup>243</sup> Ibid

<sup>244</sup> Interview with Mrs. Misgana Debele, የታክስ ማስታወቅ ከፍተኛ ባለሙያ, Ministry of Revenue, 11 December 2020

<sup>245</sup> Ibid

<sup>246</sup> Interview with Mr. Debele Tura, የታክስ ማስታወቅ ሙሪ ባለሙያ, Ministry of Revenue, 11 December 2020

<sup>247</sup> Ibid

<sup>248</sup> National Bank of Ethiopia Licensing and Supervision of the Business of Financial Institutions, Regulation of Mobile and Agent Banking Services Directives No. FIS 01/2012

<sup>249</sup> Interview with Mr. Abebe Nigussie, Mobile Banking Acting Manager at Commercial Bank of Ethiopia, 24 March 2020

<sup>250</sup> Interview with Mr. Mulugeta Zerga, Mobile and Agent Banking Service Manager, Wegagen Bank 24 March 2020.

handed out to businesses by commercial banks.<sup>251</sup> Ethiopian Airlines ticket and DSTV subscription payment etc. are transactions made through mobile banking.<sup>252</sup>

However, there are many challenges associated with the use of e-payment. To this end, lack of awareness of businesses and individual customers is a key factor behind the low level of development of e-payment in the country. People do not trust the technology and they think that they are safe with cash in their hands.<sup>253</sup> According to Mr. Meseret Nigussie, businesses are reluctant to use e-payment modalities claiming that they do not have expertise to operate the e-payment systems and they do not have users. But internet connection problem and power outage remain the major challenges for the low usage of e-payment.<sup>254</sup>

The problem of internet connection is raised by nearly all respondents at commercial banks and Ministry of Revenue as one of the major factor behind the challenges in the development of the electronic payment system. However, according to Mr. Gezahegn Tafese,<sup>255</sup> the speed of the internet connection is determined by customers themselves. For example, it is up to banks to determine the level of internet connection speed suitable for their system. Since the cost rise as the speed of internet connection increases, banks or other institutions may want to be economical.<sup>256</sup> Putting it blatantly, either the banks or other institutions do not have the expertise to correctly assess the level of internet connection speed required to operate their system or they want just to reduce their costs. However, this does not mean that there is no internet connection problem, but internet connection problem affects all users and it is not unique to banks or tax authorities.<sup>257</sup>

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<sup>251</sup> Interview with Mr. Yonas Behailu, Electronic Payment Team Leader, Birehan Bank, 31 March 2020

<sup>252</sup> Interview with Mr. Meseret Nigussie, Customer Service Officer, Dashen Bank, 30 April 2020

<sup>253</sup> Interview with Mr. Biniyam Tadele, Customer Service Officer at Zemen Bank, 31 March 2020

<sup>254</sup> Interview with Mr. Meseret Nigussie (n 252)

<sup>255</sup> Interview with Mr. Gezahegn Tafese, Design Manager, Ethio-telecom 30 April 2020

<sup>256</sup> Ibid

<sup>257</sup> Ibid

#### 4.3.1. Lack of System Integration between Banks and Tax Authorities

To start with, a modern tax administration that aspires to fulfill the expectation of tax payers is required to collaborate with third parties.<sup>258</sup> In this regard, creating strong cooperation with businesses, government agencies, academics, tax advisors, etc. is important not only to facilitate revenue collection but to induce a possible tax policy change.<sup>259</sup> However, the MOR is so far mainly on its own in building digital tax administration system which somewhat led to the stand still of the e-payment work.<sup>260</sup>

In particular, the lack of system integration between banks and the MOR might raise possible tax collection difficulties. A stark example in this regard is when a transaction is made through digital payment virtually without receipt; it might pose a challenge in assessing business income of tax payers. And it will also be difficult for tax payers using digital payment to ask deduction or refund from the MOR. In fact, there are businesses that refuse to use e-payment products arguing that tax authorities will not accept their transaction because of absence of receipt.<sup>261</sup> Those tax payer businesses that already use e-payment are forced to go through the hassle of moving money collected from e-payment to their main account so that it is visible to the tax authority.<sup>262</sup>

The perplexing issue of receipt in e-payment might be resolved since the new payment instrument issuer directive entitles users of e-payment to receive electronic receipt or physical receipt where the person is unable to give electronic receipt.<sup>263</sup> Moreover, providing a standard transaction receipt is made part of the obligation of the payment instrument issuer.<sup>264</sup> Though providing a standard receipt is meant to give protection to consumers, the process is important to introduce electronic receipt that might alleviate the tax conundrum in the e-payment transactions.

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<sup>258</sup> OECD , *Tax Administration 2017: Comparative Information on OECD and Other Advanced and Emerging Economies*, (OECD Publishing 2017) 29

<sup>259</sup> Ibid 30

<sup>260</sup> Interview with Mr. Debele Tura (n 256)

<sup>261</sup> Interview with Mr. Abebe Nigussie (n 249)

<sup>262</sup> Ibid

<sup>263</sup> See generally Art. 7 (5) of the Electronic Instrument Issuer Directive.

<sup>264</sup> See Art. 12 (2) (d) of the Electronic Instrument Issuer Directive.

The preceding discussion showed that absence of integration of the system of banks with MOR makes revenue collection difficult and also stands as a challenge for the development of the use of e-payment products in the country as businesses fear not to complicate their tax issues. However, there are works aiming at integration of banks with tax authority. A good example in this regard is that the system that integrates Wegagen Bank and the Ministry of Revenue is on its final stage to go operational.<sup>265</sup> Moreover, the NBE is preparing what is called a National Digital Payment Strategy with a vision to make all payments through digital means.<sup>266</sup> According to Mrs. Marta H/Mariam, even though the strategy is currently in its drafting stage, it is expected to be finalized in a very short period of time. Despite the strong commitment of the NBE to modernize the digital payment system, lack of expertise and manpower are the major challenges behind the slow process.<sup>267</sup>

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<sup>265</sup> Interview with Mr. Mulugeta Zerga (n 250)

<sup>266</sup> Interview with Mrs. Marta H/Mariam, Payment and Settlement System Director, National Bank of Ethiopia, 24 March 2020

<sup>267</sup> Ibid

## **Conclusions and Recommendations**

### **Conclusions**

The notable Rules of international taxation (source, residence and permanent establishment) have been under tremendous pressure exerted by the unbridled force of digitalization of the economy. Territoriality has been the hallmark of these century old rules designed for bricks-and-mortar economy. As a result, taxing online based businesses that have virtual presence that do not respect borders has been a tough call for many jurisdictions. Thus, against this Backdrop, many countries are participating under the G20/OECD's Action 1 of the BEPS project that deals with the tax challenges posed by digitalization.

Even though there are different promising works done at the OECD BEPS project in establishing nexus and profit allocation rules to tax the digital economy, consensus is not achieved among jurisdictions so far. This shows the complexity of the issues as almost a decade is passed without agreement.

The development of the MLI has been one of the most important achievements of the BEPS project where a multilateral tax instrument would be possible for the first time. The MLI serves as an important tool to modify the existing thousands of DTAs. However, criticisms are forwarded against the MLI particularly in relation to its binding arbitration rule which is thought to be negatively affecting developing countries with less experience and expertise on arbitration. As a result, many commentators suggested that developing countries should adopt a wait and see approach and not rush to the ratification of the MLI.

The cautious approach proposal for developing countries was forwarded against the whole project of the OECD as the organization is there to further the interests of developed nations. However, this is not strictly true since the UN is observing and monitoring on behalf of developing countries and many developing countries are also participating and having their say on the BEPS project.

In Ethiopia, the country is not participating in the BEPS project nor ratified the MLI. This is mainly because of lack of knowledge due to the absence of research at organizational level. The MOFEC, the entity supposed to work on the joining of the BEPS project and facilitating the ratification of the MLI is suffering from lack of expertise and a will to act.

The importance of MLI to developing countries is manifested in many ways including: the MLI has the potential to beef up source taxation mainly through providing solutions to treaty shopping and abuse of PE status; providing rules that align profits taxation with value creation and by amending DTAs based on either the UN or the OECD Model, the MLI would reduce cost, time and uncertainty that would have been encountered on negotiating DTAs etc.<sup>268</sup> Moreover, in Ethiopia, the anti-avoidance, treaty shopping and PE rules of the MLI are important in fighting BEPS and broadening the tax base of the country.

Failure of the country to join the BEPS project left the country clueless in taxing search engines, social media giants and other online based MNEs that use Ethiopian market without paying tax to the country. There is no point in adopting a wait and see approach on the issue of joining BEPS as participating in the project will help Ethiopia to be in a better position to benefit in tax from the global digital economy and modify its tax policy in the process.

With regard to taxing the domestic digital economy in Ethiopia, the Ministry of Revenue does not have the required tax administration system. The Ministry did not integrate its system with financial institutions that would facilitate tracking transactions made through electronic payment.

The electronic payment system, a key aspect of digitalization has legal and practical issues in the country. Internet connectivity and power outage problems are mentioned at the fore front in the financial sector as major setback in using electronic payment products of banks. The process of legally buttressing the digital economy has taken root only very recently with introduction of the payment instrument directive by the NBE. The NBE is also preparing a digital payment strategy with a vision to integrate all payment system digitally. It is also important to mention the draft electronic transaction proclamation in this endeavor.

The Ministry of Revenue is also trying to introduce electronic filing and electronic payment of tax obligations and works have also been underway to integrate the tax administration system with financial institutions. However, unless the country join the BEPS project and try to transform its tax policy in a manner suitable to the digital economy, all the current efforts will be drop in the ocean.

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<sup>268</sup> Annet (159) 4

## **Recommendations**

It is not illogical to expect extensive way out for the hosts of challenges found out in this thesis. However, one can be reminded of the lessons from comparative tax reforms that ‘silver bullet’ solutions that serve as a prescription to ailment of income taxation are hard to come by.<sup>269</sup> With that top note, some recommendations are in order herein under.

The problem of income taxation of the digital economy is not unique to Ethiopian tax administration. It is a global problem seeking global solution. Thus, it is important for Ethiopia to join the BEPS project. The source-residence and PE rules that contemplate some level of physical economic presence in the country are not best suited to tax the digital economy based on virtual economic world. In order to modify or change these rules, Ethiopia need not reinvent the wheel; it needs only part of the BEPS project. However, it is simplistic to suggest that all problems of income taxation of the digital economy will be put to rest if Ethiopia joins the G20/OECD BEPS project. But to be able to better respond to the problems, the efforts of joining should be preceded and accompanied by consulting experts and research on the policy solutions tailored to the needs of the country.

With regard to ratifying the MLI, it is important for Ethiopia to closely monitor the development rather than adopting a wait and see approach. In this regard, the Ministry of Finance and Economic Cooperation should research and evaluate the pros and cons of ratifying the MLI. As Ethiopia did not join the BEPS project from which the MLI is prepared and did not conduct a study on the issue at institutional level, it is unwise to suggest the country to rush into ratifying the MLI before in-depth look into the matter.

With regard to the domestic online businesses, the Ministry of Revenue needs to have a clear guideline on the tax obligations of these businesses. The absence of clear rule created confusion on these businesses. As it has been found out in the research, online businesses are going to both the Ministry of Revenue and Ministry of Finance and Economic Cooperation to find out whether they should be registered for tax. It is also paramount to devise robust tax administration system that can handle the online based system which is currently in short supply.

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<sup>269</sup> Taddese (n 10) 521

Some of the existing businesses are using different digital payment products provided by banks. However, the Ministry of Revenue will have hard time in assessing income taxes as there is no system integration between the Ministry and Financial Sectors. Thus, this research recommends that the Ministry needs to swiftly integrate its system with banks.

One of the most important lessons from the experience of going through different OECD reports and recommendations on the BEPS project is that tax administration reforms will not succeed without collaboration with key institutions. To this end, the Ministry of Revenue should closely work with mainly the NBE and commercial banks to integrate its system and with Ethio-telecom on network infrastructure in order to have a modern strong tax administration system that can respond to the income tax challenges posed by digitalization of the economy.

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## **Interviews**

- Interview with Mr. Abebe Nigussie, Mobile Banking Acting Manager at Commercial Bank of Ethiopia, 24 March 2020
- Interview with Mr. Abere Abebe (Legal Drafting and Advisory Team Leader), Ministry of Revenue, 10 December 2019
- Interview With Mr. Aschalew Ashagre, Assistant Professor, Addis Ababa University College of Law and Governance Studies, School of Law, June 2 2020
- Interview with Mr. Ataklti Weldeabzgi, Domestic Taxes Policy Research Team Leader, Ministry of Finance and Economic Cooperation, 16 December 2019
- Interview with Mr. Biniyam Tadele, Customer Service Officer at Zemen Bank, 31 March 2020

- Interview with Mr. Birhanu Mamo, Strategic Partnership Directorate Director, Ministry of Revenue, 16 December 2019
- Interview with Mr. Bochu Sintayehu, Legal Advisor, Ministry of Finance and Economic Cooperation, 8 June 2020
- Interview with Mr. Debele Tura, የታክስ ማስታወቅ ሙሪ ባለሙያ, Ministry of Revenue, 11 December 2020
- Interview with Mr. Getu Jemaneh, Partner, Business Support Service, HST Consulting PLC, June 2 2020
- Interview with Mr. Gezahegn Tafese, Design Manager, Ethio-telecom 30 April 2020
- Interview with Mr. Hawaz Merawi, Associate, Tadesse Kiros Law office, June 10 2020
- Interview with Mr. Meseret Nigussie, Customer Service Officer, Dashen Bank, 30 April 2020
- Interview with Mr. Mulugeta Zerga, Mobile and Agent Banking Service Manager, Wegagen Bank 24 March 2020.
- Interview with Mr. Yonas Behailu, Electronic Payment Team Leader, Birehan Bank, 31 March 2020
- Interview with Mrs. Mahlet Amde Abebe, Tax Operation Deputy Manager, Ministry of Revenue, 17 March 2020
- Interview with Mrs. Marta H/Mariam, Payment and Settlement System Director, National Bank of Ethiopia, 24 March 2020
- Interview with Mrs. Misgana Debele, የታክስ ማስታወቅ ከፍተኛ ባለሙያ, Ministry of Revenue, 11 December 2020

