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**CAPITAL GAINS TAXATION OF SHARES AND
BONDS UNDER THE ETHIOPIAN INCOME TAX
LAW: COMPARATIVE ANALYSIS OF THE
ADEQUACY OF THE EXISTING RULES FOR THE
CAPITAL MARKET**

BY

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CAPITAL GAINS TAXATION OF SHARES AND BONDS

UNDER THE ETHIOPIAN INCOME TAX LAW:

COMPARATIVE ANALYSIS OF THE ADEQUACY OF

THE EXISTING RULES FOR THE CAPITAL MARKET

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Declaration

I, the undersigned, declare that this thesis entitled “*Capital Gains Taxation of Shares and Bonds Under the Ethiopian Income Tax Law: Comparative Analysis of the Adequacy of the Existing Rules for the Capital Market*” is my original work and has not been presented for a degree in any other University, and that all sources of materials used for the thesis have been fully acknowledged.

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— *Aboo Badhasa* —

Dedication

To Ema and Alba

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Acronyms

Art/s- Article/s

CGT- Capital Gains Tax

ECMA- Ethiopian Capital Market Authority

ESX- Ethiopian Securities Exchange

FMV- Fair Market Value

LTCG- Long Term Capital Gains

MOF- Ministry of Finance

MOR- Ministry of Revenue

SMEs- Small and Medium Enterprises

STCG- Short Term Capital Gains

T-bills- Treasury Bills/Bonds

Abstract

This study examines the adequacy of the existing rules of capital gains taxation (CGT) on the transfer of shares and bonds under Ethiopia's income tax regime, contextualized within its implications for the nascent capital market. Through doctrinal analysis of Ethiopia's income tax laws, regulations, directives, drawing on interviews with Ethiopian tax authorities, capital market stakeholders, alongside a comparative assessment of six jurisdictions (USA, UK, South Africa, Nigeria, Kenya, and Morocco), the research highlights critical inefficiencies in the existing regime which was established before the advent of a formal capital market. The research findings show the challenges of a regressive 30% flat tax rate on transfer of shares and bonds, particularly when compared to lower rates applied to immovable assets, which exacerbates market illiquidity, disproportionately penalizes securities transactions, and perpetuates a "lock-in effect". Further, the lack of differentiation between short-term and long-term capital gains which exacerbates speculative trading, the absence of preferential treatment for listed securities which disincentivizes formal market participation, and inadequate provisions for small businesses, contrasts sharply with global best practices, undermining Ethiopia's aspirations to cultivate a dynamic securities exchange. Practical challenges such as undervaluation of transactions and administrative inefficiencies in tracking small-scale gains further compound compliance gaps and equity concerns.

In light of these challenges, the author recommended for; reduction of CGT rates on transfer of shares and bonds to 15% or less, introduction of tiered tax rates with a 1-year holding period to distinguish short-term (taxed as ordinary income) and long-term gains (preferential rates), in addition to introduction of SME-focused exemption per defined thresholds, implementing tax-free thresholds to alleviate administrative burdens, and to safeguard fiscal integrity. The study also advocated for harmonizing tax policies with capital market objectives, such as exempting or lowering taxes for securities listed on the ESX to enhance market participation. By addressing these gaps, Ethiopia can foster a dynamic capital market, and harness securities trading as a sustainable source of public financing. Ultimately, this research seeks to contribute to the development of a more favorable legal environment for capital market operations in Ethiopia.

CHAPTER ONE

INTRODUCTION

1.1. BACKGROUND OF THE STUDY

Capital gains are gains earned more than the cost on the sale, exchange, conversion, or disposal of capital assets.¹ Capital gains tax systems in general & specifically capital gains tax on shares and bonds have been part of most developed and developing countries since the first capital gains tax regime was introduced in Norway in 1911 and followed by the USA in 1913.²

However, the capital gains tax (herein after CGT) concept was first introduced to Ethiopia in 1994.³ It was introduced by a whole new separate proclamation called 'Payment of Tax on Gains from Capital Proclamation'.⁴ This proclamation was legislated with the aim of developing an effective legal framework for the transaction of capital assets which were expanded as a result of revitalization of the private sector within the economy of the country.⁵ According to this proclamation, capital gain means a gain realized from the increase in value upon the sale of urban houses, shares and bonds.⁶ And gains derived from trading these assets were subject to 30% flat rate CGT.⁷

The 2002 Income tax proclamation, by repealing this proclamation, incorporated the gains on transfer of capital assets under its schedule D.⁸ It refers capital gains as gains accrued from the transfer (sale or gift) of shares and building held for business, factory, office. Here the tax rate was different i.e. the building held for business, factory, office was taxed at flat rate of 15% and shares

¹ William Byrne, *Recent Developments in Capital Gains Taxation*, (Public Finance Analysis, New Series, Bd. 38, 1980) 92.

² Christopher Charles, *The operating costs of taxing the capital gains of individuals: a comparative study of Australia and the UK, with particular reference to the compliance costs of certain tax design features*, (D.Phil. Dissertation, University of New South Wales, 2003) 47.

³ Taddese Lencho, *The Ethiopian Income Tax System: Policy, Design and Practice*, (D.Phil. Dissertation, University of Alabama, 2014) 498.

⁴ Proclamation No. 108/1994, Payment of Tax on Gains from Capital Proclamation, *Negarit Gazette*, 2nd Year, No.25.

⁵ *Id*, the preamble para. 1.

⁶ *Id*, art 3.

⁷ *Id*, art 4.

⁸ Proclamation No.286/2002, Federal Income Tax Proclamation, *Negarit Gazette*, 8th Year, No.34, art. 37 and art. 119(2).

were taxed by the flat rate of 30%.⁹ The same goes for the Federal Income Tax Proclamation 979/2016, which simply added capital gains from transfer of bonds as taxable gains.¹⁰ And under its regulation, expanded the definition of shares and bonds to include any interest in shares or bonds, such as, in the case of shares, a right or option to acquire shares.¹¹ The effect was that preferential tax rate treatment was extended to transfer of buildings compared to shares and bonds. And it failed to establish robust and detailed CGT legal framework on transfer of shares and bonds, as a result of the absence of detailed provisions in the law that help in discouraging schemes of tax avoidance by parties to transfer of shares, and the absence of a capital market from where objective values of shares may be determined is also another contributing factor to the problem.¹²

Because of the absence of formal capital market, securities were issued and traded only informally in Ethiopia. However, in 2021 the Capital Markets Proclamation was enacted,¹³ this proclamation enables the establishment of a capital market where bonds & shares will be bought and sold.¹⁴ Nevertheless, an effective capital market needs, among other things, to build a robust capital gains taxation framework on transfer of shares and bonds. Thus, this research will analyze other countries' experiences in the taxation of capital gains derived from the exchange of shares and bonds by drawing lessons from the comparative exercise. It analyses the need for robust legal framework of CGT on shares and bonds in the Ethiopian income tax regime, which will enhance the effectiveness of the newly launched capital market in the country. Therefore, the analysis is made against the backdrop of global capital gains taxation on shares & bonds reform and Ethiopia's legal frame work in the area, by specifically focusing on capital gains with respect to shares and bonds.

1.2. STATEMENT OF PROBLEM

The Ethiopian capital market development is likely to face a number of constraints in Ethiopia, one of the major constraint is the current tax regime of the country on transfer of shares and bonds that does not encourage the transaction of securities, since, it taxes the capital gains from sale of

⁹ *Id*, art 37(1).

¹⁰ Proclamation 979/2016, Federal Income Tax Proclamation, *Negarit Gazette*, 22nd Year, No.104, art. 59(7).

¹¹ Regulation No.410/2017, Council of Ministers Federal Income Tax Regulation, *Negarit Gazette*, 23rd Year, No.82, art 6.

¹² Taddese Lencho, *supra* note 3, 507.

¹³ Proclamation No. 1248/2021, Capital Markets Proclamation, *Negarit Gazette*, 27th Year, No.33.

¹⁴ Lea Mehari, *Challenges for a Protective Regime Insider Trading Laws & Regulatory Framework in The Context of The Ethiopian Securities Exchange & The International Experience* (LL.M. thesis Addis Ababa University 2022) 9.

shares and bonds at a tax rate of 30%¹⁵ while exempting or taxing other type of capital asset i.e. immovables by favorable lower flat rate of 15%.¹⁶ This high tax rate on transfer of shares and bonds will discourage investment on share & bond. A higher rate of CGT on transfer of shares and bonds makes the investors keep assets which have appreciated, this is called the lock in effect. Thus, the higher the tax rate on capital gains, the more intense will be this effect.¹⁷ Absence of detailed rules on taxation of gains derived from transfer of shares and bonds also creates ambiguity for the collection of CGT on shares and bonds.¹⁸

With presence of such CGT regime on transfer of shares and bonds, the capital market had been launched in Ethiopia. A critical analysis of the international market reveals that imposing higher rates of CGT results in lower volume of stock investment and lesser growth in securities.¹⁹ Thus, the ambition of creating an effective capital market in Ethiopia requires creating conducive environment for the exchange of shares and bonds, one of such factors is the taxation aspect of the transaction. With the maximum tax imposition on capital gains from shares and bonds under the existing income tax law hardly will it encourage investors to trade shares and bonds.²⁰

Previously before the introduction of the capital market in Ethiopia, for shares and bonds, there existed no ready markets and sales were done infrequently and arbitrarily.²¹ However, after the introduction of the capital market in Ethiopia it is expected that there will be frequent exchanges of such assets.²² Furthermore, Ethiopia had subjected the CGT of shares and bonds to its income tax legislation, when there was no capital market in the country. So, the CGT legal framework on transfer of shares and bonds should cop up with these developments as well. But, surprisingly little seems to have been done towards formal analysis of the effects of the current CGT on transfer of shares and bonds. It is the tax legislations aspects of these events that form the basis of this paper.

¹⁵ Federal Income Tax Proclamation, *supra* note 10, art. 59(2).

¹⁶ Solomon Abay, *Financial Market Development, Policy and Regulation: The International Experience and Ethiopia's Need for Further Reform*, (D.Phil. Dissertation, University of Amsterdam, 2011) 146.

¹⁷ Bruce Bartlett, *The case for ending the capital gains tax*, (Financial Analysts Journal, May-June 1985) 24.

¹⁸ Serkalem Eshetie, *Constitutional and Administrative Issues in Relation to Capital Gains Tax Ethiopia: The Case of Bahir Dar City Administration*, (LL.M. thesis, Bahir Dar University, 2016) 77.

¹⁹ John Hulse, *The Capital Gains Tax and the Stock Market*, (The Tax Magazine 34, no. 8, August 1956) 519-23.

²⁰ Arthur Kent, *The Question of Taxing Capital Gains: I. The Case for Taxation*, (Law and Contemporary Problems 7, no. 2, Spring 1940) 202.

²¹ Jetu Edosa, *Legal Aspects of Stock Market Development in Ethiopia: Comments on Challenges and Prospects*, (Mizan Law Review, Vol. 8, No.2, December 2014) 444.

²² *Id.*, at 439.

So, for Ethiopia in order to establish an effective capital market it needs to develop a robust CGT legal framework on the transfer of shares and bonds. However, the sufficiency of the Ethiopian rules on CGT of shares and bonds contained in the income tax legislation to encourage the capital market has not been evaluated so far while the world-wide best experience indicates that detailed and organized specific rules on CGT of shares and bonds is needed to grasp the fruits of the capital market. This research, therefore, attempts to explore and critically analyze the Ethiopian legal framework vis-à-vis the international experience (six jurisdictions) around the world, in an attempt to identify the gaps and suggest necessary legal reforms.

1.3. THE RESEARCH QUESTIONS

1.3.1. MAIN RESEARCH QUESTION

Depending on the statement of problem mentioned above, the central question that this research tried to answer is “Whether the current Ethiopian income tax regime has contained adequate capital gains tax rules on transfer of shares and bonds in light with the introduction of the capital market?”.

1.3.2. SPECIFIC RESEARCH QUESTIONS

The research is aimed at addressing the following research questions:

1. Has Ethiopia put in place adequate CGT rules on shares and bonds under the current income tax regime?
2. What are the major legal and policy gaps arising from the existing CGT framework of shares and bonds in Ethiopia?
3. How do these challenges impact the development of the capital market in Ethiopia?
4. What can be learned from the comparative experience in the design of legal frameworks in CGT on shares and bonds in various jurisdictions and recommendations in this respect?

1.4. THE RESEARCH OBJECTIVES

The general objective of this research is to examine the adequacy of the current CGT law on transfer of shares and bonds with a view to identify the legal and practical issues. Accordingly, the following specific objectives are intended to be achieved in this research: -

1. Analyze the adequacy of the current CGT provisions related to transfer of shares and bonds under Ethiopian income tax law.

2. Identify and evaluate the legal and policy challenges posed the current CGT system and highlight the problems that arise from design problems of the CGT laws.
3. Assess the impact of CGT of shares and bonds on the development of Ethiopia's capital market.
4. Compare Ethiopia's approach to select countries from both the developed and the developing world to suggest the best way forward for the restructuring of Ethiopian CGT of shares and bonds in order to enhance the capital market.

1.5. RESEARCH METHODOLOGY

In the course of the study, the researcher has used qualitative methods of conducting research, in which an attempt to understand the existing proclamations, regulations, and directives related to CGT on shares and bonds in Ethiopia is made through extensive legislative analysis. It will also involve qualitative interviews by conducting stakeholder interviews with tax experts and policymakers, to assess the CGT practice and gather insights on the implications of current CGT laws on exchange of shares and bonds. In addition, this study will also benefit from a comparative analysis, which will be conducted by comparing the Ethiopian CGT legal framework with the laws and practices of six other countries with a view to identifying the best practices.

1.5.1. RESEARCH METHODS

1.5.1.1. DOCTRINAL METHOD

This study used a legislative analysis of the current legal provisions of the income tax proclamation, regulations & CGT directives, to gain deeper understanding of the historical and evolving context of tax legislations of the country in the area. Sources such as academic journals, books, government documents, theses and dissertations have been also reviewed to review literatures related to Ethiopian CGT on shares and bonds. Other countries legislations on the matter and literatures on their experiences in CGT on shares and bonds will be consulted. For this purpose, the legislations themselves, journals, books, and other research findings will be made use to establish the international conceptual framework. The impact of the existing legal framework of CGT on the capital market is then qualitatively analyzed by accommodating the views of the tax authority, concerned governmental organs, and the perspectives of the Ethiopian Capital Market Authority themselves.

1.5.1.2. COMPARATIVE ANALYSIS

The experiences of selected countries have been tried to be inferred to benefit from comparative analysis and take lessons thereof. The sampling design adopted for selection of the countries is the purposive sampling technique. This research paper tries to make a critical examination of what type of legal framework for the CGT on shares and bonds is needed to ensure the Ethiopian Capital Market will be able to function properly.

For this reason, the researcher has chosen USA and UK outside of Africa and to put the reality of developing countries in to context chosen Nigeria from western part of Africa, Kenya from eastern part of Africa, South Africa from southern part of Africa and Morocco from the northern part of Africa, these Africa countries compared to other African countries have established the top 5 vibrant capital markets in Africa. USA and UK have also been chosen not only because they have successful capital markets but they have been chosen because as USA and UK pioneered the world in coming up with the CGT concept, they had established robust CGT legislation on shares and bonds. So, these six countries are chosen for analyzing the global best practice for generally having the best experience in taxation and effective capital market also.

1.5.2. SOURCES OF DATA

The researcher collected data items relevant to this particular research from primary and secondary data sources. The Income tax law proclamation, its subsequent regulations and the CGT directive would be analyzed as a primary source of data to understand the concepts of CGT under the Ethiopian tax legislation by evaluating the legal gaps and challenges posed by these provisions. The CGT legislations of selected countries are also utilized to grasp the international experience. Additionally, the primary data is also collected from interviews with selected senior experts of Ministry of Finance, Ministry of Revenue, Ethiopian Capital Market Authority, Ethiopian Securities Exchange and investors with the aim to gather their opinions and experiences. On the other hand, the researcher employed secondary data gathered from a broad array of sources such as books, journal articles, legal commentaries, working papers, research studies, reports, theses, and other publications that were pertinent to the subject matter of this investigation.

1.5.3. DATA COLLECTION INSTRUMENTS

1.5.3.1. INTERVIEW AND FOCUSED GROUP DISCUSSION

Since it is the mandate of the MoF to enact the directives on CGT and also as it is the mandate of the MoR to enforce those directives respondents from the two federal institutions would be interviewed purposively. In addition to this, as it is the mandate of the Capital Market Authority to regulate and establish effective capital market in the country respondents from the authority would be interviewed purposefully. The selection of interviewees would be undergone by employing a purposive sampling strategy by giving first consideration to the experience, role and other attributes of the individuals the study requires. In order to achieve this objective, the interview process will be conducted using a semi structured interviewing technique, which provides the researcher with consistency and flexibility in order to probe relevant data.

1.6. THE LITERATURE REVIEW

Based on the researcher's knowledge, there is no domestically written literature that specifically deals with capital gains taxation in the context of transfer of shares and bonds. There are, however, different domestically written articles and research works dealing with various issues in relation to CGT in general.

One of such research work is carried out by Taddese Lencho (PhD), in his dissertation paper titled "The Ethiopian Income Tax System: Policy, Design and Practice".²³ This dissertation paper examines the structure and design of the Ethiopian income tax schedules and test if the schedules, as designed, are effective tools for implementing the basic tax policy objectives of Ethiopia. In this respect, by comparing the CGT principles or the government's intention of the legislation with the practice, Dr Taddese argued that the biggest drawback to the implementation of CGT upon shares is the absence of stock markets in Ethiopia and a valuation problem which facilitates the avoidance of payment of the CGT by underpricing the value of shares.²⁴ And suggested that CGT to fulfill the legislator's intention; the put in to place of adequate systems of valuations. In addition, since capital gains are irregular sources of income, He suggested the tax rates are distinguished and maintained at low levels compared to the rates imposed on other income forms.²⁵

²³ Taddese Lencho, *supra* note 3.

²⁴ *Id* at 503-04.

²⁵ Taddese Lencho, *supra* note 3, 538.

Another research works concluded on CGT are conducted by Serkalem Eshetie²⁶ and Getu Amsalu²⁷ both theses navigated administrative difficulties entangled with capital gains taxation in Bahir Dar and Addis Ababa cities along with the question, which government has the power to tax it (the federal or regionals). Both papers had dealt with practical and administrative problems concerning CGT in general.²⁸

Mr. Belete Addis had also wrote an article on the title “The Taxation of Miscellaneous Income Sources under the Federal Income Tax Proclamation of Ethiopia: A Critical Analysis”²⁹ in this work Mr. Belete by assessing the taxable units and tax bases of the taxing provisions of schedule D and the many changes introduced under the Schedule including CGT, argued that such changes will be meaningful if the tax administration on the ground is also reformed to reflect the positive changes introduced under the tax laws.³⁰

Though the aforementioned literatures have mentioned some of the issues concerning CGT in general, none of them has attempted to assess the sufficiency of the Ethiopian rules on capital gains taxation of shares and bonds contained in the income tax legislation to foster the capital market. Therefore, this research seeks to scrutinize and critically evaluate the Ethiopian legal framework in comparison with the international experience around the world with the view to determining loopholes and making necessary legal reforms regarding the CGT legal framework on transfer of shares and bonds. Both Mr. Serkalem’s and Getu’s research work deal with CGT by focusing on the constitutional, practical and administrative issues concerning the collection of CGT in Bahir Dar and Addis Ababa cities. They don’t specifically address the concerns regarding the legal and policy issues on CGT of shares and bonds in light with the launch of the capital market in Ethiopia. The research work of Dr. Taddese and Mr. Belete entertained the case of CGT on shares and bonds in light of the taxation principles of general income tax and schedule D tax legislations of Ethiopia, However, this study assesses Ethiopian CGT legal framework by using comparative analysis. By undergoing this literature review, this particular research unlike the mentioned works, will fill the

²⁶ Serkalem Eshetie, *supra* note 18.

²⁷ Getu Amsalu, *Legal and Practical Issues Relating to Capital Gains Tax: The Case of Addis Ababa City Administration*, (LL.M. thesis Addis Ababa University, 2021).

²⁸ *Id.*, at 47.

²⁹ Belete Addis, *The Taxation of Miscellaneous Income Sources under the Federal Income Tax Proclamation of Ethiopia: A Critical Analysis*, (Bahir Dar University Journal of Law Vol.12: No.2, June 2022) 354.

³⁰ *Id.*, at 367.

knowledge gap in describing how capital gains taxation of shares and bonds can contribute to the growth and proper functioning of the capital market. By exploring the legal challenges associated with capital gains taxation of shares and bonds in Ethiopia's newly created capital market recommends a legal reform specifically for CGT of shares and bonds.

1.7. SIGNIFICANCE OF THE STUDY

This study will provide an in-depth examination of the Ethiopian legal framework for Capital Gains taxation of shares and bonds, thus offering valuable insights for legislators, policy makers, legal practitioners, and players in the capital market. The findings are anticipated to be significant in proposing legal reforms that solidify the legal framework of CGT on shares and bonds, promote the development of capital market, and ensure that Ethiopia's practices in taxing capital gains on shares and bonds are in tandem with best international practices.

1.8. LIMITATION AND SCOPE OF THE STUDY

This research limitation relates to the absence of previous literature and court cases on the topic of CGT in the context of shares and bonds in the Ethiopian tax legislations. The researcher therefore had to conduct the research anew as there is no adequate publication on this precise topic in Ethiopia. Additional development in the area of the study is suggested by the author to establish the gaps in literature or practice that can be identified.

The paper confines itself to an exploration of CGT with respect to shares and bonds, by disregarding the capital gains on immovables. The scope of this study is also limited to examination of the capital gains taxation legal regimes of the shares and bonds of seven countries (Ethiopia, USA, UK, South Africa, Nigeria, Kenya and Morocco).

1.9. ORGANIZATION OF THE PAPER

To conduct proper in-depth research, the paper is organized into four chapters. Chapter one deals with the proposal of the research. Chapter two deals with the theoretical framework of CGT in general and taxation of capital gains from shares & bonds specifically in light of international experiences. Chapter three deals with the CGT of shares and bonds under the Ethiopian income tax regime with particular focus on the legal and practical issues. The last chapter sets the conclusion of the work & possible recommendations.

CHAPTER TWO

THE CONCEPT OF CAPITAL GAINS TAX AND TAXATION OF CAPITAL GAINS ON SHARES AND BONDS: THE INTERNATIONAL EXPERIENCE

2.1. INTRODUCTION

This chapter discusses the conceptual framework of CGT by reviewing the meaning, method of taxation, problems related to CGT, and rationales for preferential treatment of CGT, before thoroughly examining the general overview of taxation of capital gains on transfer of shares and bonds. This part also examines the international experiences in taxing capital gains on shares and bonds in six different countries i.e. USA, UK, South Africa, Nigeria, Kenya and Morocco, by analyzing their rationales, challenges, and legal frameworks.

2.2. MEANING, METHODS OF TAXATION AND PROBLEMS OF CGT

2.2.1. MEANING OF CGT

Capital gains arise from the appreciation in the value of assets over their acquisition cost. A capital gain is said to accrue when an asset appreciates and considered realized when there is a sale or donation of the asset.³¹ Capital gains can be described as receipts in excess of cost resulting from sale, exchange, conversion or transfer of assets.³² Therefore, in working out CGT, the entire money received from the disposal of a capital asset is not taxable, instead the gain only draws tax implication. The increase in value of a capital asset can be due to the efforts of the owner or without his work due to inflation, demand for the asset, politics, weakness of competitors, and other factors.³³ Regardless of the root cause of an increase in capital gain, as long as there is some

³¹ Diana Hourani and Sarah Perret, *Taxing capital gains: Country experiences and challenges*, (OECD Taxation Working Papers No. 72, 2025) 8.

³² William Byrne, *Recent Developments in Capital Gains Taxation*, (Public Finance Analysis, New Series, Bd. 38, 1980) 92.

³³ *Id.*

increase there will be CGT.³⁴ So, for tax calculation purpose, the only thing that matters is how much the asset has appreciated in value by reducing some deductible costs.³⁵

Capital gain refers to non-recurring or one-time earnings from dealings that are not part of a person's usual business, whereas income refers to recurring gains.³⁶ In addition to this CGT is exceptional in the way it needs the realization or the appearance of an anticipated realization.³⁷ It is special also due to its payment at the time of realization on voluntary basis. It is taxed differently from ordinary incomes depending on how long it has been held. Or, it is exempted from tax or taxed on part of the gain only. And also mitigate the effects of inflation, it is inflation-indexed.³⁸

2.2.2. METHODS OF TAXING CAPITAL GAINS

The efficient and proper handling of the CGT enhances the capital market, fiscal fairness, restrict income tax evasion, enhance vertical equity, and reduce investment distortion.³⁹ There are arguments in support of ranging from zero rates to high rates of tax on capital assets.⁴⁰ Here we will outline the different methods adopted world widely to impose CGT. Regarding compilation of the CGT legal framework the method of taxing capital gains can vary from full integration with the income tax code (as USA model) to those in which CGT is a separate tax (UK model).⁴¹

There are theoretically two distinct approaches to the collection of this tax: taxation of capital gains at accrual and realization point. The tax is due, in an accrual system, theoretically immediately when there is a change in the value of an asset, or, for practical purposes, periodically. According to a realization-based tax regime, only when the asset is sold by the investor does the need to pay taxes emerge, i.e. a gain or loss.⁴²

³⁴ Yoseph Edrey, 'what are capital gain and capital loss anyway?' (Virginia Tax Review, Vol. 24) 144.

³⁵ Simbo Gemechu, *Capital Gains and Value-Added Taxes on Acquiring Immovable Collateral and Resale of the Acquired Property by Banks: The Law and The Practice*, (LL.M Thesis, Addis Ababa University, 2023) 10.

³⁶ *Id.*

³⁷ Noel Cunningham and Deborah Schenk, *The Case for a Capital Gains Preference*, (48 Tax L Rev 319, 1993) 322.

³⁸ Samuel Jibao, *Property taxation, capital gains tax, and mining rights tax in Zambia current performance and options for reform*, (2016) 15.

³⁹ Wei Cui, *Taxation of Capital Gains*, (Papers on Selected Topics in Protecting the Tax Base of Developing Countries, UN paper, Sept. 2014) 3.

⁴⁰ Arun Advani, *The taxation of capital gains: principles, practice, and directions for reform*, (Warwick Economics Research Papers, No. 1379, October 2021) 18.

⁴¹ Chris Evans and Cedric Sandford, *Capital Gains Tax- The Unprincipled Tax*, (British Tax Review, No.5, 1999) 389.

⁴² Marco Sahm, *Methods of Capital Gains Taxation and the Impact on Asset Prices and Welfare*, (National Tax Journal, Vol. 61, No. 4, December, 2008) 743-68.

Concerning the tax base, various methods exist of which the most prevalent approach of handling capital gains and losses is referred to as the comprehensive-but-mixed formula. The categorization in this case is comprehensive because it covers nearly all capital gains and losses, but mixed because it makes a distinction between long-term⁴³ and short-term gains.⁴⁴ Some countries put more weight on distinguishing between business and non-business transactions or classifying speculative versus non-speculative activities than on a time-related classification (short-term versus long-term). Here capital gains are taxable if they are derived from business operations although they have been classified as non-business, have a speculative intent. However, capital losses from speculative but non-business activities can't be deducted.⁴⁵

2.2.3. PROBLEMS OF CGT

Basically, the CGT issue is troublesome because of the realization requirement for taxability. Under this requirement, the taxpayer himself determines when his gains and loss shall be brought to account. Thus, taxpayers can postpone tax liability by merely not realizing their gains, i.e., by not selling or exchanging their appreciated asset.⁴⁶ The advantages accruing from the postponement of realization lead investors to continue to hold appreciated assets when a portfolio shift would be profitable in the absence of taxation, thereby discouraging the mobility of capital to its most profitable uses. This is called the "lock-in" effect.⁴⁷

An additional problem that taxation upon realization may create is bunching. In a progressive income taxation system, gains that have been accumulating over several years are brought in to the taxable income of the year of realization, and thereby push the taxpayer into an excessively high tax bracket.⁴⁸ As a result of the illusory nature of such gains in a situation of inflation as well as of the sporadic or irregular character of such gains some press even the complete exemption from tax of such gains.⁴⁹

⁴³ 'Longterm' commonly means more than one or two years, but the variations from country to country run from six months to five or six years.

⁴⁴ Carl Shoup, *Taxation of Capital Gains Abroad*, (Australian Tax Forum 1, no. 2, June 1984) 196.

⁴⁵ Arthur Kent, *The Question of Taxing Capital Gains: I. The Case for Taxation*, (Law and Contemporary Problems 7, no. 2, Spring 1940) 198.

⁴⁶ Federal Income Tax Treatment of Capital Gains and Losses, (Prepared by Tax Advisory Staff of the Secretary, Treasury Department, United States Government Printing Office, 1951) 12.

⁴⁷ William Byrne, *supra* note 32, at 92.

⁴⁸ William Byrne, *supra* note 32, at 93.

⁴⁹ Gagan Kumar, *Taxation of Capital Gains: A Comparative Study*, (Journal of the Indian Law Institute, Vol. 30, No. 2, April-June 1988) 139.

Administering the CGT effectively demands records of assets held, the periods of ownership, original and comparable costs, selling costs, etc., this creates a dilemma in developing countries because they are not equipped to maintain recording, unearthing old records, valuation of assets, etc. This, make it difficult to impose the CGT appropriately.⁵⁰ But despite these various issues relating to the nature and tax treatment of capital gains, worldwide tax systems have continued to impose broadly varying tax structures for capital gains under their respective tax systems.

2.3. RATIONALES FOR FAVORABLE TAX TREATMENT OF CAPITAL GAINS

This sub-section assesses the rationales for favorable CGT treatment with reference to the ordinary income taxation. The favorable tax treatment of capital gains has been the common characteristics of most tax systems, and is a reflection of the perceptions of its contribution to economic growth.⁵¹ Different rationales are usually advanced for the favorable taxation of capital gains. The principal reasons are to enable economic growth through saving, investment, and entrepreneurship, to mitigate the lock-in effect, to mitigate the effect of double taxation, to avoid the taxation of inflationary gains and to further other policy goals.⁵² Thus, it is hoped that those reasons for preferential treatment of CGT had imbued a worldwide consensus that preferential treatment of capital gains is fairer than taxing them in the same manner as ordinary incomes.⁵³

2.4. GENERAL OVERVIEW OF CGT ON TRANSFER OF SHARES AND BONDS

Prior to previewing the CGT on shares and bonds, defining share & bond clearly is vital. In the case of a corporation, a share is, an ownership unit, entitling the owner a proportional interest in the assets, returns, and voting power of the company. If somebody relinquishes his share and gains from share disposal, then he is liable to pay CGT. It should be noted that shares could be sold and bought in primary capital market and the secondary market.⁵⁴ A bond is a security or certificate that an organization or government issues to borrow money and is bearing interest.⁵⁵ When a bond

⁵⁰ Juanita Amatong, *Taxation of Capital Gains in Developing Countries, Staff Papers* (International Monetary Fund, Vol. 15, No. 2, 1968) 361.

⁵¹ *Id.*

⁵² Diana Hourani and Sarah Perret, *supra* note 31, at 18.

⁵³ Richard Krever, *A Critique of Capital Gains Taxation Problems and Proposals*, (Major Tax Planning vol.14, 1962) 803.

⁵⁴ Jetu Edosa, *Legal Aspects of Stock Market Development in Ethiopia: Comments on Challenges and Prospects*, (Mizan Law Review, Vol. 8, No.2, December 2014) 442.

⁵⁵ Woldetinsae Fentie, *Bond Issuance and Regulation in Ethiopia: the Case of Grand Renaissance Dam Bonds*, (LL.M. thesis, Addis Ababa University, 2014) 7.

is sold it can be sold for over par value. Therefore, wherever there is profit through bond transfer one is liable to pay CGT.

In CGT on transfer of shares and bonds the following are major elements that determine the taxing regime. This overview covers the realization concept, holding period & tax rate structure, exemptions, treatment of losses and certain concessions.

2.4.1. THE REALIZATION CONCEPT

Generally speaking, the transfer of a share or bond for a consideration is considered realization; the most elementary form is the sale of the share or bond, but it can also encompass business liquidation, and, occasionally, gratuitous transfers.⁵⁶ In most countries, gain or loss on disposal of the share or bond will never be capital gain or loss except if disposed through "sale or exchange".⁵⁷ Consequently, payment by the debtor of a bond of a corporation on its terms or redemption thereof is not a "sale or exchange" of the bond. This is, however, also treated as a transaction as if the bond were sold or exchanged.⁵⁸ The gain or loss to the bondholder is accordingly capital gain or loss.⁵⁹

Securities held for investment do qualify as "capital assets." In general, one can safely assume that a taxpayer who owns securities, holds them for investment, and therefore will recognize a capital gain or loss on sales or exchanges. The principal exception is in the case of a dealer in securities who holds stocks and bonds primarily for sale to customers in the ordinary course of his trade or business. Securities which he holds in inventory are non-capital assets. Such a "dealer" is to be differentiated from a so-called "trader" who, while he may be actively involved in the business of purchasing and selling securities, does so for his own account and is not involved with customers. Unlike those in the hands of a "dealer", those in the hands of a "trader" are capital assets.⁶⁰

Regarding convertible bonds and debentures, they have been exempted from tax on conversion on the principle that where the holder of a bond makes use of the benefit in the document to convert it into another security of the obligor corporation, the conversion is not a closed transaction for

⁵⁶ Juanita Amatong, *supra* note 50, at 364.

⁵⁷ Boris Bittker, *Capital Gains and Losses-The Sale or Exchange Requirement*, (Hastings Law Journal 32, no. 4, March 1981) 745.

⁵⁸ Bernard Lentz, *Capital Gains and Losses Affecting Securities Transactions*, (Temple Law Quarterly 26, no. 3, Winter 1953) 254.

⁵⁹ Robert Gunning, *Share and Capital Gains Tax*, (Brocton Law Journal 5, no. 2, 1969) 41.

⁶⁰ Bernard Lentz, *supra* note 58, at 256.

purposes of taxation and therefore does not result in realization of gain or loss. The exchange is viewed as an exchange of the security and not as a disposal of it.⁶¹ But only if it is under a right of conversion in the bond will the conversion be tax-free. It is not yet certain whether this right must be in the bond outstanding or whether it can be added later.⁶²

2.4.2. THE HOLDING PERIOD AND TAX RATE STRUCTURE

Capital gains earned from disposal of shares and bonds are treated differently, depending on the holding period of the share or bond.⁶³ Thus, shares and bonds holding period distinguishes between short-term and long-term gains, with the former taxed by ordinary income tax rates, and the latter at reduced rates. The holding period is formulated to differentiate between transactions entered into for profit and those carried out for investment. The short-term movements in value are expressed to have their source in speculative transactions, while investments are made primarily for annual yield and appreciation in value.⁶⁴ If there is a profit the transaction creates a chargeable gain; if there is a loss the transaction creates an allowable loss.

World widely, there are three structures of CGT rates: flat rate, progressive rate, and percentage inclusion with progressive rates. The flat rate structure is common to countries with a schedular tax system. All countries that use a flat rate charge lower tax rates on capital gains than they charge on ordinary income.⁶⁵ The progressive rate system is contended to be more equitable than a flat rate tax, since capital gains increase the taxable capacity of a person. Percentage inclusion at progressive rates is another less complicated alternative to capture a portion of capital gains, regardless of holding period in excess of some minimum, and to tax this portion preferential rates or ordinary income tax rates. The percentage-inclusion plan, combined with escalating rates, places the increased taxable capacity in funds through capital gains, while also restricting the taxing of a grouped income by placing only a fraction of the gains within it.⁶⁶

⁶¹ Arthur Fleischer & William Cary, *The Taxation of Convertible Bonds and Stock*, (Harvard Law Review 74, no. 3, January 1961) 478.

⁶² *Id.*, 480.

⁶³ Gagan Kumar, *supra* note 49, at 145.

⁶⁴ Juanita Amatong, *supra* note 50, at 364.

⁶⁵ *Id.*, 365.

⁶⁶ *Id.*, 373.

2.4.3. EXEMPTIONS

Some countries provide for fixed threshold exemptions of amounts from the gains derived from disposal of shares and bonds. Exemption of a minimum level of capital gains can be appealing from an administrative viewpoint. Owing to the nonrecurring nature of capital gains and the simplicity of concealing capital transactions, especially those of small amounts, permission of an exemption limit would greatly reduce the number of cases to be enforced and processed.⁶⁷

2.4.5. CERTAIN CONCESSIONS

With a view to encouraging investment in capital markets, provisions are introduced providing for preferential or total relief from capital gains tax for exchange of shares and bonds. Irrespective of the structure of tax rates employed, the rate should not be greater unless lesser than normal income. The economic effects of taxation of capital gains are curiously negative, such that the impact of CGT at high rates on capital gains immobilizes the capital market, and dissuades or prevents investment of capital in new projects carrying risk, thus stifling industrial expansion and inducing unemployment.⁶⁸ Its psychological impact on investment has been very negative and it has had the effect of preventing free circulation of stocks and shares without which it is hardly possible to be able to enjoy a high level of industrial progress.⁶⁹

2.5. INTERNATIONAL EXPERIENCES ON THE TAXATION OF CAPITAL GAINS FROM SHARES AND BONDS

2.5.1. DEVELOPED COUNTRIES EXPERIENCE

2.5.1.1. USA

Under the US federal income tax law, capital assets are defined as all property other than property held for sale in the ordinary course of business.⁷⁰ In line with this, shares and bonds are considered to be capital assets that produce either capital gains or losses under US tax laws. Capital gains in the market value of capital assets are handled under present tax legislation when they are realized,

⁶⁷ Juanita Amatong, *supra* note 50, at 361.

⁶⁸ Arthur Kent, *supra* note 45, at 204.

⁶⁹ Gagan Kumar, *supra* note 49, at 141.

⁷⁰ See for more; the American Internal Revenue Code of 1954.

i.e., when the asset is sold or exchanged to a new owner, rather than when the asset's market value actually changes.⁷¹

The US law differentiates among capital assets based on the holding period for which the asset has been held.⁷² In general terms, profit or loss arising on sale or exchange of shares held for over 12 months is long-term capital gain or loss.⁷³ Gains or losses from sale or exchange of shares held for 12 months or shorter are to be treated as short-term capital gain or loss.⁷⁴ Net long-term capital gain minus net short-term capital loss is to be treated as net capital gain. Capital losses can only be offset against capital gains.⁷⁵

Long term capital gain on stocks is taxed progressively under a more favorable tax rate schedule than wage income and short-term capital gain. The highest federal tax rate on capital gain is 20% (0-20%) on assets that have been held for more than 12 months. Short term capital gain on stocks is taxed progressively under the same tax rate schedule as ordinary income. The normal income tax rates (10-37%) are applied to capital gains on assets held for 12 months or less.⁷⁶ Hence, short term capital gains on shares transfer are usually taxed as other incomes, but long-term capital gains on shares transfer are taxed preferentially, i.e. at lower effective rates than regular income.⁷⁷

Other than this, long-term capital gain on closely held business stock is also excluded from tax if the sale of Qualified Small Business Stock⁷⁸ held for more than 5 years is excluded from tax up to

⁷¹ Neil Stevens, *Taxation of Capital Gains: Principle Versus Practice*, (Federal Reserve Bank of St. Louis, October 1978) 2.

⁷² For many years the distinction between short-term and long-term capital gains was six months. Under the 1976 tax legislation, nine months was the dividing point for capital assets sold in 1977 and one year thereafter.

⁷³ IRC, *supra* note 70, at Section 1(h).

⁷⁴ *Capital Gains Tax Fairness Act* of 1993, Congress Legislation, s. 288-103rd congress, see also; IRC *supra* note 70, s. 1222 (1), (2) and (3), (4).

⁷⁵ *Id.*

⁷⁶ Diana Hourani and Sarah Perret, *supra* note 31, at 63.

⁷⁷ Federal Income Tax Treatment of Capital Gains and Losses, *supra* note 46, at 1.

⁷⁸ To be eligible, the investor must not be a corporation. The investor must have acquired the stock at its original issue and not on the secondary market. The investor must have purchased the stock with cash or property, or accepted it as payment for a service. At least 80% of the issuing corporation's assets must be used in the operations of one or more of its qualified trades or businesses.

the greater of a cap (\$10 million) or 10 times the taxpayer's adjusted basis in all qualified small business stock issued by such company and sold or exchanged by the taxpayer during that year.⁷⁹

According to the IRC Section 1091 it is provided the wash-sale rule as per which the losses are disallowed if an investor buys substantially identical securities within 30 days. Capital losses to the extent to which they are not offset by long- or short-term gains, these losses in the individual case are deductible only up to the extent of capital gains, along with the taxable income of the taxpayer.⁸⁰ Losses suffered by corporate taxpayers may be deducted only to the extent of gains.⁸¹ Both are, however, granted a carry-over, corporations in general for five years⁸² and individuals to an unlimited extent.⁸³

Regarding capital gains derived from bonds, in USA corporate bonds are taxed progressively under the same tax rate schedule as labor income, the same as short term capital gains by the progressive tax rate of 10% - 37%.⁸⁴ Municipal bonds are exempt from taxation federally, and thus their capital gains can be handled differently.

2.5.1.2. UK

The UK has, for many years, held that capital gains are not income, with the exception of professional traders, and hence were not subject to tax. They now have a system similar to that in the US, where capital gains are taxed at reduced rates compared to normal income.⁸⁵ When CGT was first introduced in 1965, it was as a backstop for income tax, to keep remuneration from being driven out of income tax base.⁸⁶ It arrived at flat rate of 30 percent, unrelated to tax rates of personal incomes. Difference in tax treatment by asset class was initiated for the very first time under reform in the year 2016 as then-existing CGT rates were decreased by 8 percentage points (20%).⁸⁷ UK do not consider income to arise where there are profits from the disposal of capital assets, except

⁷⁹ Diana Hourani and Sarah Perret, *supra* note 31, at 64.

⁸⁰ IRC of 1954, *supra* note 70, at s. 1211 (b).

⁸¹ *Id.*, s. 1211 (a).

⁸² *Id.*, s. 1212 (a).

⁸³ *Id.*, s. 1212 (b).

⁸⁴ Diana Hourani and Sarah Perret, *supra* note 31, at 64.

⁸⁵ J. A. Kay and M. A. King, *The British Tax System*, (2nd ed., New York, Oxford University Press, 1980) 81.

⁸⁶ William J. Byrne, *supra* note 32, at 107.

⁸⁷ Arun Advani, *supra* note 40, at 3.

that the taxpayer would treat such sales as his trade or business. As much as they do not tax capital gains, they do not allow for capital losses to be deducted against income.⁸⁸

There are two fairly dissimilar forms of tax on capital gains: the short-term tax, or Schedule D Case VII and the long-term tax, or Capital Gains Tax. They are both sometimes called 'Capital Gains Tax' but in fact are quite different.⁸⁹ Short term tax is levied when a share is bought and sold within 12 months. And, tax on long term profits arising when someone buys and sells shares and the period between the contracts is over 12 months.⁹⁰

Capital gains that are incurred on shares & bonds disposed of in UK is taxed within the tax band of 10% basic rate to 20% higher rate.⁹¹ There are some exemptions in the UK CGT shares regime, these are; business transfer roll-over relief, which applies where a business taxpayer sells a business to a company in return for shares,⁹² Enterprise Investment Scheme relief, which defers a gain on disposal of an asset where shares are subscribed for an EIS company;⁹³ and Venture Capital Trust deferral relief, which defers a gain on disposal of an asset where shares are subscribed for a VCT company.⁹⁴

Regarding capital gains earned from the transfer of shares, gains above an exempt amount of GBP 3,000.00 are taxed progressively (0% - 20%) on a more favorable tax rate bracket than earned income.⁹⁵ Special rules apply for identifying shares disposed of as matching with other shares of the same class held by the taxpayer.⁹⁶

Where there is a gain, the transaction creates a chargeable gain; where there is a loss, the transaction creates an allowable loss. A chargeable gain is to be computed as net profit i.e., profit after paying broker's commission and stamp duty. An allowable loss is also to be computed in the

⁸⁸ Godfrey Nelson, *The Question of Taxing Capital Gains: II. The Case against Taxation*, (Law and Contemporary Problems 7, no. 2, 1940) 208-216.

⁸⁹ Robert Gunning, *supra* note 59, at 40-43.

⁹⁰ Taxation of Chargeable Gains Act 1992 (TCGA 1992), Sec 2.

⁹¹ *Id.*, Secs 1H and 1I.

⁹² *Id.*, sec 162.

⁹³ *Id.*, sec 150C.

⁹⁴ *Id.*, sec 151A.

⁹⁵ Diana Hourani and Sarah Perret, *supra* note 31, at 63-64.

⁹⁶ Gammie M., *Taxing capital gains – thoughts from the UK*, (UNSW Law Journal, Vol. 6, No. 2, July, 2000) 37.

same way.⁹⁷ The tax is applicable on persons who are resident and ordinarily resident in the U.K. Where for overseas domicile, only gains within and introduced into the country are taxable and losses overseas are not allowed. Short term profits are added to income at the end of the tax year and charged at the maximum rate of income, Schedule D, Case VII.⁹⁸ The transfer between husband and wife or from wife to husband does not give rise to any tax liability.⁹⁹

In the case of closely held business profits from disposing of at least a 5% interest in a business that has been owned for at least 2 years may be subject to Business Asset Disposal Relief (BADR). The BADR provides a lower flat rate of 10% on the qualifying capital gain. There is a lifetime cap on the relief.¹⁰⁰ For corporations, capital gains are taxed under normal corporation tax rates i.e. capital gains are added to a corporation's chargeable profits.¹⁰¹

Interest on UK gilts (government borrowings) is exempted from tax, in an effort to encourage investment in government borrowings. The expression 'corporate bond' is an everyday commercial term for company issues of securities to raise debt finance and has no distinctive tax meaning other than as part of the framework for identifying qualifying corporate bonds (QCBs). In the UK, Qualifying Corporate Bonds (QCBs) are exempt from capital gains tax debt securities, with disposal gains or losses not subject to tax. A bond must be denominated in sterling, have no rights of conversion or redemption into another currency, and be a "normal commercial loan".¹⁰²

2.5.2. DEVELOPING COUNTRIES EXPERIENCE FROM AFRICA

2.5.2.1.SOUTH AFRICA

CGT was introduced in South Africa on 1 October 2001 as part of the Income Tax Act, 1962 (Act No. 58 of 1962). Prior to this date, capital nature gains were exempt from South African income tax in full. According to the definition of gross income under section 1 of the Income Tax Act, income tax in south Africa is imposed on all income from sources except a source which is capital in nature. Therefore, any income derived from a capital source would not be chargeable under the

⁹⁷ Robert Gunning, *supra* note 59, at 42.

⁹⁸ Robert Gunning, *supra* note 59, at 43.

⁹⁹ *Id.*, at 41.

¹⁰⁰ Diana Hourani and Sarah Perret, *supra* note 31, at 63.

¹⁰¹ Gammie M., *supra* note 96, at 38.

¹⁰² *Id.*

income tax rates. These laws were however amended in 2001 such that these capital nature receipts will be taxed, albeit in a different form. The Eighth Schedule of the income tax Act regulates how these capital receipts are to be taxed.

Capital gains are taxed at an effective rate lower than the rate for regular income. Any capital gains and capital losses occurring on the sale of assets are assessable to CGT except as exempted by specific provisions. Section 26A of the Income Tax Act, 1962 provides that a taxable capital gain is to be added to the taxable income of an individual. CGT is therefore not a separate tax but part of tax on income.¹⁰³ CGT is levied on the "disposal" of an "asset" as those terms are located in the Eighth Schedule.¹⁰⁴ The taxpayer basically deducts the "base cost" of the asset from the "proceeds" of the disposal in order to arrive at a capital gain or loss.¹⁰⁵ Although CGT forms part of income tax, the two taxes are not fully integrated. Thus, capital gains are calculated according to the Eighth Schedule rules and then included in the "taxable income" of a taxpayer for income tax purposes at a given inclusion rate which differs based on the type of taxpayer. The inclusion rate is 40% for individuals and 80% for companies of the capital gain will be taxed. The marginal tax rate for individuals is 18% and 21.6% for companies. The effective "CGT rate" is thus the product of the taxpayer's marginal rate of income tax and his applicable inclusion rate for capital gains. Individuals exempt from income tax are thus also exempt from CGT.¹⁰⁶

The maximum rate of effective taxation of capital gains on shares and bonds is 18%. Where 40% of net capital gains realized are subject to normal income tax rates. An individual is entitled to an exclusion of ZAR 40,000 per annum when determining the net capital gain in a year (in the taxpayer's year of death, the annual exclusion is increased to ZAR 300,000).¹⁰⁷ While corporate profits earned by companies are liable for regular corporate rate of tax, taxable income accounts for only 80% of profits and therefore the effective rate of capital gains tax for companies is

¹⁰³ *ABC of Capital Gains Tax for Individuals*, Issue 12, (South African Revenue Service, 2021) 1.

¹⁰⁴ A wide meaning is given to the term "disposal". The following are some examples of events that are disposals: sale of an asset, donation of an asset, expropriation of an asset, vesting of an interest in an asset of a trust in a beneficiary, death of a person, ceasing to be a resident and loss or destruction of an asset.

¹⁰⁵ Matthew Marcus, *The Effect of South African Dividend and Capital Gains Taxes on Cost of Capital, Firm Value and Capital Structure*, (D.Phil. Dissertation, University Of Cape Town, October 2010) 28.

¹⁰⁶ *Id.*, at 30.

¹⁰⁷ South African Government, *Capital gains tax in South Africa*: briefing by the National Treasury's Tax Policy Chief Directorate to the Portfolio and Select Committees on Finance 24 January 2001.

21.6%.¹⁰⁸ In general, the Eighth Schedule is applicable on disposal of any asset and is levied on individuals as well as companies.

But alongside CGT there is a Transfer Tax on Securities; which is charged when the securities are purchased compared to the day that income or proceeds are received on the property. The tax is charged on the transfer of any listed or unlisted share. The tax is charged by the purchaser and it is charged on the value of the shares transferred. Currently this tax is calculated as 0.25% of the value of shares transferred.¹⁰⁹

Government bonds in South Africa are exempted from CGT. However, corporate bonds are taxed. Apart from this, South Africa does not differentiate between short-term and long-term holdings (compared to the U.S.). Gains are taxed equally regardless of holding period.¹¹⁰

2.5.2.2.NIGERIA

Nigeria's CGT is governed by the Capital Gains Tax Act 1967 (Cap. C1, Laws of the Federation of Nigeria 2004). Gains made by a chargeable person on the sale of chargeable assets will be charged under the CGT Act.¹¹¹ It charges gains on the sale of shares, bonds, and other chargeable assets. These gains arise on disposal (sale, gift, exchange, or transfer). The charge is a simple 10% of chargeable gains.¹¹²

The gains made on disposal of interests in a Nigerian company are liable to CGT, apart from some exceptions (i.e. where the deal is above NGN 100 million or where gains are being reinvested in a Nigerian company within 12 months or where the transaction is a regulated securities lending transaction).¹¹³ Gains on a merger and takeover are exempted from CGT. In Nigerian taxation of capital gains on shares and bonds there is also an exemption threshold, i.e. gains of up to or equal

¹⁰⁸ Commissioner for the South African Revenue Service, *Guide to Capital Gains Tax*, 2023.

¹⁰⁹ Linda Papp, *The feasibility of the introduction of additional wealth taxes in south Africa: An African perspective*, (Mcom thesis, University of Pretoria, 2012) 33-34.

¹¹⁰ Income Tax Act, 1962, Paragraph 5 of the Eighth Schedule.

¹¹¹ Nigerian Capital Gains Tax Act, Cap C1 LFN 2004.

¹¹² Nigerian Capital Gains Tax Act 1967, Sec 2.

¹¹³ *Id.*

to Naira 1,000 (\approx \$2.20) are exempted.¹¹⁴ Gift and inheritances transfers are also exempt except where it is being done in the course of a trade.¹¹⁵

The cost of the chargeable asset and the incidental cost of disposal is deducted from the proceeds of sale to determine the chargeable gains. Expenses allowable under CGT are fees, commissions or remuneration in respect of professional fees and cost of transfer.¹¹⁶ As for the taxation of losses; Capital losses can be deducted up to the gains in the same year of tax (Section 32 CGTA). They carry no carry forward to future years, however. Aside from this, losses cannot be used to offset ordinary income.

Like most countries, in Nigeria also gains derived from Federal Government Bonds and Treasury Bills are exempt from CGT.¹¹⁷ By and large, lack of tiered rates or inflation indexing in the Nigerian CGT system will discourage investment.

2.5.2.3.KENYA

Kenya's CGT is governed by the Income Tax Act (Cap. 470) and the amendments in the Finance Act 2014, at a flat rate of 5%. Later increased to 15% by the Finance Act 2022. The bill envisioned taxing capital gains on real estate and on securities. Rollover relief was accorded to the shares in special investments quoted in the Nairobi Stock Exchange. Only against gains was the loss being deductible and not against other kinds of income. Indefinite carry-over of unrealized loss was permitted. The meaning of 'property' is wide and includes securities in Kenyan resident private companies (though a special exemption from CGT applies to securities quoted in Kenya).¹¹⁸ It catches gains arising on disposal of shares, bonds, and other chargeable assets.¹¹⁹ Gains on the disposal of interests in shares or equivalent interests in foreign persons which obtain over 20% of their value directly or indirectly from immovable property in Kenya to CGT in Kenya. Or, Similarly, CGT will also be levied where a non-resident person with over 20% of a Kenyan company's share capital directly or indirectly disposes of his/her interest. Therefore, in terms of shares, they fall under CGT unless listed in the Nairobi stock exchange i.e. private equity, and

¹¹⁴ *Id*, Sec 36.

¹¹⁵ *Id*, Sec 26.

¹¹⁶ *Id*, Sec 13.

¹¹⁷ *Id*, Sec 30.

¹¹⁸ Kenyan Financial Act of 2022.

¹¹⁹ Kenyan Income Tax Act, Sec 3(2)(f).

carry a fixed rate of 15% for individuals and corporates which increased from 5% in 2022. However, the gains arising from dealing in listed shares in the Nairobi stock exchange that are more than or at least 12 months are exempt from CGT.¹²⁰

CGT is charged at the time of property transfer. This is upon registration of the transfer instrument in the transferee's name indicating transfer of interest in the property from the seller to the buyer. Net Gain is sales proceeds minus the acquisition and incidental cost CGT is on gains arising from property sale. "Transfer" constitutes, if property is disposed of in any manner, whether or not for consideration, constitutes a transfer. Gifts amount to realizations, but, in contrast to the CGT Bill, there is no constructive realization of capital gains on death.¹²¹

There is an annual exemption limit of gains up to KES 20,000 (\approx \$140) a year for individuals.¹²² Tax exemptions are also allowed; on issue by a company of its own shares and debentures, transfer of assets between spouses; transfer of assets to immediate family; to a company where spouses or a spouse and immediate family have 100% shareholding, Transfer of property due to internal restructuring within a group which has been in existence for at least 24 months, and which does not involve a transfer of property to a third party, the tax-free treatment is applicable for mergers, amalgamations, or share swaps.¹²³ Regarding tax treatment of losses; capital losses are utilized to reduce gains in the same year of income (Section 15(3), Income Tax Act). Losses are rolled over for 9 years to offset gains occurring in the future. Losses cannot be utilized to reduce trading income (e.g., wages or business profit).¹²⁴ Gains realized on trading in Kenya government or local authority bonds and treasury bills are exempt from CGT. Gains arising from pension funds within approved retirement schemes are tax-free too.

2.5.2.4.MOROCCO

The CGT tax on Morocco is governed by the General Tax Code and amended yearly by the Finance Law. The tax is imposed on profits derived from the disposal of shares, bonds, and other movable assets.¹²⁵ Residents (taxed on worldwide gains) and non-residents (taxed on Moroccan-sourced

¹²⁰ *Id*, Sec 34 A.

¹²¹ William Byrne, *supra* note 32, at 95-97.

¹²² Kenyan Income Tax Act, *supra* note 119, at Sec 34 A.

¹²³ *Id*, Sec 15.

¹²⁴ *Id*.

¹²⁵ The General Tax Code of Morocco, art 60.

gains) are subjects of the tax. However, based on Double Taxation Treaties reduced rates can be granted to non-residents under treaties.

The CGT is initiated upon the accruing of gains upon disposal (sale, gift, or exchange). Prior to 2019 in Morocco CGT on shares was levied at a uniform rate of 20%; but then reduced to 15% to harmonize with regional trends and enhance capital markets. Therefore, the current CGT on shares rate of taxation is 15% flat rate on net gain for listed shares and 20% flat rate on net gain for non-listed shares. However, Gains on bonds usually are taxed as interest income at 20%, with the exception of those which are exempt (e.g., government bonds).

Morocco lacks a separation of short-term and long-term holding for shares/bonds. There is, however, an exception for start-ups whereby gains on shares in qualifying start-ups held ≥ 3 years may be exempted (Finance Law 2022).

The CGT is levied on capital gains from the sale of shares, bonds, and other financial assets at the rates below:

Nature of capital gain	Tax rate (%)
Capital gains derived from the sale of listed shares	15
Capital gains derived from the sale of non-listed shares	20
Capital gains derived from the sale of bonds	20

Source; PwC World Wide Tax Summaries 2024.

Regarding the tax treatment of losses in Morocco; Capital losses are deductible against gains of the same year.¹²⁶ Carrying forward unused losses for 4 years (it was upped to 2 years from 2020). Losses cannot, however, be used to offset common income. For companies, capital gains are considered non-current income and are taxed at the normal corporate income tax rate. Capital gains that are accrued from the sale of stocks and bonds are subject to a tax of 20%.¹²⁷

¹²⁶ *Id.*, art 60-3.

¹²⁷ Gregoire Chaste and Jalal Benhayoun, *International Tax Morocco Highlights 2023*, (Deloitte Global, 2003) 1-7.

Capital gains realized on Moroccan government securities are exempted from CGT.¹²⁸ Regarding pension funds as well gains made within approved retirement funds are exempted.¹²⁹

CHAPTER THREE

CAPITAL GAINS TAXATION ON SHARES AND BONDS UNDER THE ETHIOPIAN INCOME TAX LAW: COMPARATIVE ANALYSIS OF THE ADEQUACY OF THE EXISTING RULES FOR THE CAPITAL MARKET

3.1. INTRODUCTION

This chapter discusses the legal regime of CGT on transfer of shares and bonds in Ethiopia with the legal and policy gaps put in to consideration. Accordingly, the chapter commences with the historical background of CGT on shares and bonds in Ethiopia, then assesses the adequacy of the currently enforce legal framework on the subject by discussing the tax rate structure, the holding period criteria, the listed/not listed securities criteria, the small business exclusion, threshold for exclusion criteria.

3.2. HISTORY OF CGT OF SHARES AND BONDS IN ETHIOPIA

Ethiopia's first modern income tax law, enacted in 1944 under the title "Proclamation to Provide for the Payment of a Tax by All Individuals and Businesses"¹³⁰, marked a milestone in formalizing taxation outside the agricultural sector.¹³¹ However, the concept of taxing capital gains from the sale of assets such as shares, bonds, or property remained absent from the Ethiopian tax system for decades, despite its global emergence in the early 20th century.¹³² It was not until 1994, with the introduction of Proclamation No. 108/1994,¹³³ that capital gains were explicitly recognized as a taxable category, making Ethiopia a late adopter in this area of fiscal policy. Prior to 1994, gains

¹²⁸ The General Tax Code, *supra* note 125, art 7.

¹²⁹ *Id.*

¹³⁰ Proclamation No. 60/1944, Personal and Business Income Tax Proclamation, *Negarit Gazeta*, 3rd Year, No. 9.

¹³¹ Tadesse Lencho, *Towards Legislative History of Modern Taxes in Ethiopia (1941-2008)*, (Journal of Ethiopian Law, Vol. 25, No. 2, 2012) 115.

¹³² Introduced in Norway in 1911 and followed by the USA in 1913.

¹³³ Proclamation No.108/1994, Payment of Tax on Gains from Capital Proclamation, *Negarit Gazette*, 2nd Year, No.25.

arising from the transfer of capital assets, including shares and bonds were not treated as a distinct taxable category.¹³⁴

The payment of tax on gains from capital proclamation enacted with the aim of creating robust legal framework for the transaction of capital assets which were expanded because of the revitalization of the private sector in the economy of the country which were result of adoption of free market economy by the transitional government.¹³⁵ Based up on the taxation principles of equity and neutrality as the gains from those transaction generates gains for the owner, the payment of tax on gains from capital transfer were introduced to the Ethiopian tax system.¹³⁶

According to this proclamation, the definition of capital asset includes, urban houses,¹³⁷ shares and bonds.¹³⁸ In line with this capital gain means a gain realized from the increase in value upon the sale of urban houses, shares and bonds.¹³⁹ A uniform 30% tax rate was applied to all capital gains, irrespective of the asset type.¹⁴⁰ This one-size-fits-all approach simplified administration but drew criticism for lacking nuance in addressing different investment behaviors. To alleviate the burden on smaller transactions, annual aggregate gains below 10,000 Ethiopian Birr were exempt from taxation.¹⁴¹ This threshold aimed to reduce administrative costs for both taxpayers and authorities while shielding low-value transactions from undue complexity. Under Ethiopia's 1994 CGT framework, the taxable value of a capital asset is determined by its sale price.¹⁴² However, prior to calculating the final taxable amount, there are deductions permitted to adjust the gross gain: inflation adjustment, losses incurred from the disposal of other capital assets within the year preceding the sale may be deducted.¹⁴³

While the 1994 CGT law was enacted as a standalone statute, it operated in tandem with Ethiopia's broader income tax system through strategic cross-references. The CGT law itself focused narrowly on defining taxable assets (e.g., urban real estate, shares, bonds), setting the 30% flat

¹³⁴ Taddese Lencho, *The Ethiopian Income Tax System: Policy, Design and Practice*, (D.Phil. Dissertation, University of Alabama, 2014) 499.

¹³⁵ Payment of Tax on Gains from Capital Proclamation, *supra* note 133, at 182.

¹³⁶ *Id.*, the Preamble para 2 and 3.

¹³⁷ *Id.*, art 2.

¹³⁸ *Id.*, art 3.

¹³⁹ *Id.*

¹⁴⁰ *Id.*, art 4.

¹⁴¹ *Id.*, art 8.

¹⁴² *Id.*, art 5.

¹⁴³ *Id.*

rate, and outlining exemptions. It deferred to the main income tax law for administrative, procedural, and enforcement mechanisms, such as audit procedures, dispute resolution, and penalty regimes. This integration ensured alignment with broader principles of equity and neutrality, even as the law's separation allowed targeted rules for capital transactions.¹⁴⁴ While the 1994 proclamation marked a significant step toward formalizing CGT, its flat-rate structure overlooked distinctions between short-term speculative gains and long-term investments. Critics argued that the 30% rate, applied uniformly to high-value real estate and financial assets alike, risked discouraging investment in capital markets or property development.

In 2002, the Ethiopian government enacted comprehensive reforms to modernize its income tax system, consolidating and replacing prior income tax laws with a unified legal framework.¹⁴⁵ A pivotal aspect of the 2002 reform was the full incorporation of CGT into the core income tax framework.¹⁴⁶ The *2002 Income Tax Proclamation*¹⁴⁷ repealed the standalone *1994 Payment of Tax on Gains from Capital Proclamation*, folding CGT into Schedule D, a category for miscellaneous income sources.¹⁴⁸ This integration eliminated the prior separation of CGT as a special tax regime, streamlining administration and aligning capital gains with broader income tax principles.¹⁴⁹

The 2002 law significantly reduced the range of assets subject to CGT. Taxable transfers were restricted to: business use buildings and shares. Notably, the reforms exempted gains from the transfer of residential buildings and omitted any mention of bonds, effectively removing them from the CGT scope.¹⁵⁰ The 2002 CGT structure imposed varying rates depending on the type of asset being transferred. Specifically, buildings utilized for business, factory, or office purposes were taxed at a fixed rate of 15%, whereas transfers of company shares were subject to a significantly higher flat rate of 30%.¹⁵¹ This disparity in taxation created a preferential treatment for the transfer of real estate assets over shares, representing a notable shift from earlier CGT law. However, while this system favored property transactions, the proclamation introducing these rates fell short of

¹⁴⁴ Taddese Lencho, *supra* note 124, at 500.

¹⁴⁵ Tadesse Lencho, *supra* note 131, at 123.

¹⁴⁶ *Id.*, 123-124.

¹⁴⁷ Proclamation No. 286/2002, Federal Income Tax Proclamation, *Negarit Gazette*, 8th Year, No.34.

¹⁴⁸ *Id.*, art 37 and art 119(2).

¹⁴⁹ Taddese Lencho, *supra* note 134, at 507.

¹⁵⁰ *Id.*, 501.

¹⁵¹ Federal Income Tax proclamation, *supra* note 147, at art 37(1).

constructing a thorough legal framework for CGT on shares and bonds.¹⁵² Additionally, the lower tax rate applied to buildings inadvertently granted tax advantages to businesses holding substantial real estate portfolios, enabling such companies to reduce their tax liabilities compared to those dealing primarily in shares or securities.¹⁵³

Under the proclamation, losses incurred from the transfer of assets may be acknowledged and utilized to offset capital gains, but with specific restrictions. First, such losses can only be applied to reduce gains from transfers governed by the same Article. They cannot be used to offset other forms of income or gains outside this scope. Any losses that remain unused in a given fiscal period may be carried forward indefinitely to offset future gains under the same provision. Second, losses resulting from transfers to “related parties” (as defined in Article 2(4) of the law, which outlines criteria for related parties or connected entities) are explicitly disallowed. This prevents taxpayers from claiming losses on transactions involving closely linked individuals or entities, thereby curbing potential abuse through artificial loss creation.¹⁵⁴

The proclamation mandate that any entity or individual making payments related to capital gains must withhold the applicable tax amount at the time of payment.¹⁵⁵ This withheld tax must then be remitted to the Tax Authority within 15 days following the end of each calendar month.¹⁵⁶ The framework aims to balance flexibility in loss carryforwards with safeguards against misuse, while enforcing strict timelines for tax remittance and reporting to enhance accountability and revenue collection.¹⁵⁷

The method of determining the taxable gain resulting from the transfer of capital assets involves calculating the difference between the proceeds from the alienation of the asset and its original acquisition cost or nominal value. Specifically, for shares, the basis is their par value.¹⁵⁸ The taxable gain is computed as the excess of the sale price over this par value.¹⁵⁹ When calculating this capital gain, certain adjustments and deductions are permitted.¹⁶⁰ Regarding exemptions, CGT

¹⁵² Taddese Lencho, *supra* note 134, at 507.

¹⁵³ *Id.*

¹⁵⁴ Federal Income Tax proclamation, *supra* note 147, at art 37 (6)(a)(b).

¹⁵⁵ *Id.*, art 54(1).

¹⁵⁶ *Id.*, art 54(3).

¹⁵⁷ *Id.*, art 67(1).

¹⁵⁸ Regulation 78/2002, Council of Ministers Federal Income Tax Regulation, *Negarit Gazette*, 8th Year, No.36, art 15 (1).

¹⁵⁹ *Id.*, art 15(2).

¹⁶⁰ *Id.*, art 15(3).

exemption applies exclusively to residential buildings if the property has been used continuously and entirely as the owner's primary dwelling for a minimum of two years immediately preceding the date of sale.¹⁶¹ This exemption is conditional on the property not being utilized for non-residential purposes during this two-year period.

Currently, the 2002 income tax proclamation is repealed and replaced by the new Federal income tax proclamation 979/2016, which expanded the scope of taxable capital gains to include bonds, which were previously excluded.¹⁶² And under its regulation, expanded the definition of shares and bonds to include any interest in shares or bonds, such as, in the case of shares, a right or option to acquire shares.¹⁶³ And extended cost inflation adjustment only to buildings by excluding shares and bonds.¹⁶⁴ The 2016 tax reform has brought several legislative changes including introduction of the Tax Administration Proclamation No. 983/2016, and Tax Administration Regulation No. 407/2017. It is for the first time a tax administration proclamation dealing exclusively with administrative matters enacted in the country.¹⁶⁵ The 2016 ITP, unlike the previous income tax¹⁶⁶ provisions, it classifies assets subject to CGT into two classes: Class 'A' comprising immovable assets¹⁶⁷ and Class 'B' referring to shares and bonds including any interest in these.¹⁶⁸ The content of the proclamation will be discussed in the following section in detail.

3.3. ETHIOPIAN LEGAL FRAMEWORK FOR CGT OF SHARES AND BONDS

3.3.1. FEDERAL INCOME TAX PROCLAMATION 979/2016

The treatment of CGT varies by jurisdiction; some countries impose a distinct tax specifically on capital gains, while in many others, capital gains are included as part of the overall income tax.¹⁶⁹ Ethiopia integrates CGT within its general income tax framework rather than treating it as a separate tax. Under Schedule D of the Federal Income Tax Proclamation No. 976/2016, capital

¹⁶¹ *Id*, art 16.

¹⁶² Proclamation 979/2016, Federal Income Tax Proclamation, *Negarit Gazette*, 22nd Year, No.104, art 59(7).

¹⁶³ Regulation No.410/2017, Council of Ministers Federal Income Tax Regulation, *Negarit Gazette*, 23rd Year, No.82, art 6.

¹⁶⁴ *Id*, Art.56(1) and also the subsequent Ministry of Finance Directive on capital gains Directive No. 8/2019 and the amended income tax regulation no. 520/2022 follow the same footsteps.

¹⁶⁵ Getu Amsalu, *Legal and Practical Issues Relating to Capital Gains Tax: The Case of Addis Ababa City Administration*, (LL.M. thesis, Addis Ababa University, 2021) 22.

¹⁶⁶ Federal Income Tax proclamation, *supra* note 147.

¹⁶⁷ Income Tax Proclamation, *supra* note 162, art. 59 (2) & (7).

¹⁶⁸ Income Tax Proclamation, *supra* note 162, art. 59 (2) & (7), Income Tax Regulation, *supra* note 163, art 3.

¹⁶⁹ Chris Evans and Richard Krever, *Taxing Capital Gains: A Comparative Analysis and Lessons for New Zealand*, (New Zealand Journal of Taxation Law and Policy, Vol. 23, 2017) 486.

gains are categorized as taxable income, aligning with Article 6(4)(c)(3), which identifies gains from the disposal of shares or bonds issued by Ethiopian resident companies as taxable. The law broadly defines income as “every form of economic benefit,” encompassing both recurring and non-recurring gains, including irregular capital gains.¹⁷⁰ So from this we can construe that capital gains derived from the disposal of capital assets are part of the income of the person no matter what they are infrequently done. As one of the features of capital gains taxation is its imposition on irregular earning or it is event-based. However, while these gains are taxed as part of total income, they are calculated separately to reflect their event-based nature.¹⁷¹

Schedule D applies to income sources not covered by other schedules.¹⁷² It imposes taxes on gains from the disposal of immovable assets, shares, and bonds,¹⁷³ with Ethiopia opting for a selective approach taxing only these asset classes to simplify enforcement in a context of limited administrative capacity.¹⁷⁴ Taxpayers of CGT in Ethiopia include both residents and non-residents. Non-residents are only taxed with respect to their Ethiopian source income.¹⁷⁵ Ethiopian source income is defined in Article 6 of the proclamation; they will incur tax if they gain from selling: shares or bonds from a resident company, or an interest in shares or bonds from a resident company.¹⁷⁶ The tax implications for non-residents depend on the asset's location and the residency status of the issuing company.¹⁷⁷ In contrast, Ethiopian residents are subject to taxation under Article 59 regardless of these factors.¹⁷⁸

Schedule D features fixed tax rates without differentiating between corporate and individual taxpayers regarding the tax rate. The highest tax rate is 30%, which applies to capital gains from the sale of shares and bonds.¹⁷⁹ For CGT purposes, taxable assets and properties are divided into

¹⁷⁰ Income Tax Proclamation, *supra* note 162, art 2(14).

¹⁷¹ *Id.*, art 76(2)(d).

¹⁷² Federal Income Tax Proclamation, *supra* note 162, art 64 (1)(a).

¹⁷³ *Id.*, art 59(1).

¹⁷⁴ Belete Addis, *The Taxation of Miscellaneous Income Sources under the Federal Income Tax Proclamation of Ethiopia: A Critical Analysis*, (Bahir Dar University Journal of Law, Vol.12, No.2, June 2022) 354.

¹⁷⁵ Federal Income Tax Proclamation, *supra* note 162, art 7(2)

¹⁷⁶ *Id.*, art. 6 (4) (c) and Income Tax Regulation, *supra* note 163, art 6 (2).

¹⁷⁷ *Id.*, art 5

¹⁷⁸ *Id.*, art 7(1)

¹⁷⁹ *Ethiopian Tax Law Text Book*, Misganaw Gashaw, Zerihun Assegid, Mulugeta Akalu and Aschalew Ashagre, (June, 2022)149.

two categories: class A assets pertain to immovable properties and are subject to a CGT rate of 15%. In contrast, class B assets, which include shares and bonds, are taxed at a CGT rate of 30%. This means the tax rate on disposal of shares and bonds is double of the tax rate on disposal of Class A assets, equal to the tax rate of corporate taxation rate¹⁸⁰ and higher than most incomes in the progressive tax rates of individual employment, rental and business incomes.¹⁸¹

The taxable gain is determined by subtracting the total cost of the asset and an inflation adjustment from the total consideration received during disposal.¹⁸² Consideration refers to the full monetary value received by the seller upon transferring the asset.¹⁸³ Cost basis includes, the original purchase price paid to acquire the asset and incidental expenses directly tied to the acquisition or disposal, such as brokerage fees, government levies, taxes, or administrative costs.¹⁸⁴ However, if an asset is acquired through a gift, its fair market value at the time of receipt is treated as the cost basis for CGT purposes.¹⁸⁵ For assets used both in business operations and as taxable capital assets, Article 59 specifies that only the gain exceeding the asset's cost basis is taxable. However, if the net book value of the asset is lower than its cost basis, the difference between these two amounts is taxed under Schedule C of the Proclamation, which governs business income.¹⁸⁶

The concept of "disposal" under Ethiopian tax law encompasses any transaction that results in the transfer of legal ownership of an asset, including sales, exchanges, or other forms of title transfer.¹⁸⁷ Article 67(1) of the Income Tax Proclamation outlines various forms of disposal through an illustrative list, with the transfer of legal ownership serving as the definitive criterion for determining whether a transaction qualifies as a disposal. This definition applies even to the partial transfer of an asset.¹⁸⁸ However, it explicitly excludes scenarios where ownership is

¹⁸⁰ Corporate tax rate for rental income is 30% (art. 14), for business income also 30% flat rate (art 19).

¹⁸¹ Individual income tax rate for employment, rental and business income are a progressive tax rate which ranges from 0%-35%. See also; art 11,14 & 19 of the federal income tax proclamation, *supra* note 211.

¹⁸² *Id*, art. 59(3).

¹⁸³ *Id*, art 70(1).

¹⁸⁴ *Id*, art 68(1)(a) (b).

¹⁸⁵ *Id*, art 68(3).

¹⁸⁶ *Id*, art. 21 (4) (b). A detailed prescription in this regard is provided under MoF Directive on Capital Gains Tax, art. 6.

¹⁸⁷ Federal Income Tax Proclamation, *supra* note 162, art 67(1).

¹⁸⁸ *Id*, art. 67 (4).

transferred involuntarily through insolvency proceedings, such as vesting by a liquidator, trustee-in-bankruptcy, or receiver.¹⁸⁹

Under the current tax framework, gains or losses on capital assets are recognized only upon realization that is, when the asset is sold or ownership is legally transferred rather than when its market value fluctuates. Importantly, capital gains are categorized as non-periodic income. However, if an individual or entity routinely engages in trading capital goods as part of their regular business operations, the profits from such activities are classified as business income and taxed under the corresponding business income tax regulations, rather than under capital gains provisions.¹⁹⁰

Gains from the disposal of shares or bonds designated as business assets (integral to regular business activities) are taxed as business income under Schedule C.¹⁹¹ Conversely, gains from non-business assets (termed "taxable assets") fall under Article 59, which governs capital gains. For example, a company selling shares above par value generates business income taxable under Schedule C.¹⁹² And a shareholder selling shares realizes a capital gain taxable under Article 59.

In addition to costs, the law recognizes previous losses concerning the disposal of a capital asset. When the cost of a capital asset at the time of disposal exceeds the consideration received, the transaction results in a recognized loss. Such losses may be used to offset gains from the disposal of assets within the same class indefinitely.¹⁹³ However, losses arising from transactions between related persons are non-deductible.¹⁹⁴ Taxpayers must substantiate losses and associated costs by submitting verifiable evidence to the tax authority.¹⁹⁵ Unsubstantiated claims are disregarded, ensuring only legitimate losses are recognized.¹⁹⁶

¹⁸⁹ *Id.*, art 67 (5).

¹⁹⁰ Belete Addis, *supra* note 174, at 303.

¹⁹¹ Federal Income Tax Proclamation, *supra* note 162, art. 21 (1) (b).

¹⁹² Directive No. 8/2019, MoF Directive on Capital Gains Tax, art. 11.

¹⁹³ Federal Income Tax Proclamation, *supra* note 162, art 59(4)(a)(b).

¹⁹⁴ *Id.*, art 59(4)(c) and see also Proclamation No. 983/2016, The Federal Tax Administration Proclamation, *Negarit Gazette*, 22nd year No. 103, art. 4, it defines related person broadly so that it includes persons that has affinal and consanguineal relation and related person that is expected to act in accordance with the directions, requests, suggestions, or wishes of the other person.

¹⁹⁵ Federal Income Tax Proclamation, *supra* note 162, art 59(4)(d).

¹⁹⁶ *Id.*, art 82 (5) & CGT Directive, *supra* note 192, art 8(4).

Concerning exemptions, A building is exempt from CGT if it has been continuously and exclusively used as the owner’s primary residence for at least two years prior to disposal.¹⁹⁷ Under the ITP, the definition of “income” is inclusive of gifts.¹⁹⁸ However, cash or assets received as gifts are exempt from CGT unless they constitute employment compensation, rental income, or business revenue.¹⁹⁹

When an asset is transferred via inheritance, succession, or a will, the deceased is deemed to have disposed of the asset at the time of death.²⁰⁰ However, the heirs are shielded from income tax liabilities under the ITP, as gains from inherited assets are explicitly exempt.²⁰¹

Rollover relief refers to the deferral of CGT liabilities or losses to a future period, typically to align with specific policy objectives. In Ethiopia, this relief applies in the following scenarios: Where the transfer is made between husband and wife as means of a divorce settlement,²⁰² where assets transferred from a deceased individual to their beneficiaries or estate executors are exempt from CGT at the time of inheritance. However, if the beneficiary later sells the inherited asset, CGT applies to any gain realized from that subsequent disposal.²⁰³ If a capital asset is lost, destroyed, or compulsorily acquired (expropriated) and the compensation received is reinvested in a similar asset within one year, the taxpayer may defer CGT. The other instance is where there is corporate reorganization, the transfer is not considered as the disposal of a capital asset.²⁰⁴ Transfers of assets during mergers, acquisitions, takeovers, spin-offs, or corporate divisions qualify for rollover relief, provided the restructuring is not driven by tax avoidance.²⁰⁵ By deferring CGT, the law aims to facilitate business reorganizations that promote economic efficiency without penalizing

¹⁹⁷ *Id*, art 59(7)(a).

¹⁹⁸ *Id*, art 2 (14), in defining “Income”, uses the expression ‘every form of economic benefit’.

¹⁹⁹ *Id*, art 65 (1) (j).

²⁰⁰ *Id*, art 67 (3).

²⁰¹ *Id*, art 65 (1) (j).

²⁰² *Id*, art 71(1)(a).

²⁰³ *Id*, art 71(1)(c).

²⁰⁴ *Id*, art 35(1)(a).

²⁰⁵ *Id*, art 35(3).

legitimate capital reallocations.²⁰⁶ Taxing corporate capital gains can impede asset sales and reorganization that reallocate capital between firms.²⁰⁷

Ethiopian tax law adopts the realization method for CGT, meaning tax obligations arise only when a capital asset is actually disposed of (e.g., sold, exchanged, or transferred).²⁰⁸ Unrealized gains are not taxed. Taxpayers under Schedule D must declare taxable income within two months of the disposal transaction.²⁰⁹

3.3.2. FEDERAL INCOME TAX REGULATION 410/2017

Alongside the Proclamation, Income Tax Regulation No. 410/2017 supplements the framework for CGT on shares and bonds. This regulation broadens the scope of taxable instruments under the proclamation to encompass any interest in shares or bonds, such as rights, options, or entitlements to acquire shares.²¹⁰ This ensures that even indirect financial interests tied to shares or bonds, like derivative rights, fall within the ambit of Ethiopia's CGT regime.²¹¹

Ethiopian tax regulations establish clear guidelines for determining an individual's tax residency status.²¹² A person is deemed a tax resident if they spend more than 183 days in Ethiopia within a single calendar year, whether consecutively or sporadically.²¹³ Nevertheless, transit days where an individual is in Ethiopia solely to travel between two international destinations are excluded from the count.²¹⁴

When an employee receives shares through an employee share scheme including shares obtained by exercising a granted option or right the disposal of such rights or options triggers CGT.²¹⁵ To calculate the taxable gain in such cases: the taxable amount is determined by the fair market value of the shares at the time they are allotted to the employee, minus any financial contribution made

²⁰⁶ *Id.*, art 35(4).

²⁰⁷ Mihir Desai & William Gentry, *The Character and Determinants of Corporate Capital Gains*, (The University of Chicago Press, Vol. 18, 2004) 2.

²⁰⁸ Federal Income Tax Proclamation, *supra* note 162, art 59(1).

²⁰⁹ *Id.*, art 83(7).

²¹⁰ Income Tax Regulation, *supra* note 163, art 6 (1).

²¹¹ *Id.*, art 6(2).

²¹² *Id.*, art 5(1)(a).

²¹³ *Id.*, art 5(1)(b).

²¹⁴ *Id.*, art 5(2).

²¹⁵ *Id.*, art 17(2)(b).

by the employee.²¹⁶ “Employee’s contribution” includes any payments made by the employee for the shares themselves and for the grant of the right or option to acquire the shares.²¹⁷

The regulation also tried to regulate CGT payable on the disposal of certain investment assets if the disposal is made through donation, the ‘gain’ is the difference between the original cost of the asset and the cost of the asset at the time of donation.²¹⁸ Liability for paying the tax shifts to the donee, not the donor.²¹⁹

Concerning disposal of registered assets such as shares and bonds, the regulation further states, in line with Art 72 of the income tax proclamation, when a registerable asset is transferred by sale, exchange or gift, the transferor is treated as having disposed of the asset and the transferee is treated as having acquired the asset at the time the contract of sale, exchange or gift is registered by an entity empowered to exercise the function of the notary.²²⁰

Under the regulation, inflation adjustment is made only for an immovable asset; it does not extend to shares and bonds.²²¹ However, this was changed by amendment regulation 485/2021, this legislation will be further discussed in the following section. The rate for inflation adjustment is a quantitative estimate at which the decline in purchasing power occurs can be reflected in the increase of an average price level, which will be determined under a directive issued by the ministry of finance.²²² If a non-resident individual or entity transfers shares directly or indirectly tied to Ethiopian assets, the transaction is treated as occurring within Ethiopia for tax purposes.²²³

3.3.3. FEDERAL INCOME TAX REGULATION (AMENDMENT) 485/2021

The Federal Income Tax Regulation (Amendment) No. 485/2021 revised specific provisions of the previous Regulation No. 410/2017. As stated in its preamble, the amendments aimed to: clarify ambiguous rules in Regulation 410/2017 that lacked precision for practical implementation. And

²¹⁶ *Id*, art 17(3).

²¹⁷ *Id*, art 17(6).

²¹⁸ *Id*, art 53(1).

²¹⁹ *Id*, art 53(2).

²²⁰ *Id*, art 55.

²²¹ *Id*, art 56(1).

²²² *Id*.

²²³ *Id*, art 57.

to address unintended economic consequences, particularly disruptions to transactions involving shares and bonds, which were adversely impacted by the original regulation's provisions.²²⁴

Ethiopia's CGT framework categorizes taxable assets into two distinct classes: Class A, comprising immovable property (buildings), and Class B, which includes financial instruments such as shares and bonds. A significant update introduced through this amendment permits inflation adjusted cost calculations for Class B assets when determining CGT liabilities.²²⁵ Prior to this revision, Regulation No. 410/2017 allowed inflation adjustments exclusively for Class A assets.

Inflation, characterized by a sustained increase in the general price level, diminishes the purchasing power of currency.²²⁶ Without adjusting asset costs for inflation during CGT assessment, taxpayers risk being taxed on illusory gains effectively penalizing them for economic losses rather than true profits.²²⁷ This issue is particularly acute in Ethiopia's high-inflation environment, where unadjusted gains may appear inflated on paper but lack real financial benefit. This adjustment ensures equitable taxation by aligning tax obligations with actual economic gains. By mitigating tax-related distortions for Class B assets, the amendment encourages investment in shares and bonds, anticipating increased market activity as the economy continues to open.²²⁸ The amended regulation mandates the use of Ethiopia's official inflation rate, as specified by the Ministry of Finance, to recalibrate asset costs.²²⁹

3.3.4. FEDERAL INCOME TAX REGULATION (AMENDMENT) 520/2022

Income Tax Regulation (Amendment) No. 520/2022, expands the scope of tax-exempt income under the existing Income Tax Regulation No. 410/2017 by including share premiums as a newly

²²⁴ Federal Income Tax Regulation (Amendment) No. 485/2021, Council of Ministers Federal Income Tax Regulation (Amendment), *Negarit Gazette*, 27th Year, No.46, preamble para 1 & 2.

²²⁵ *Id*, art 2(6) which amended art 56(1) of the income tax regulation no. 410/2017.

²²⁶ Ethiopia Amendments on Income Tax Regulations No. 410/2017, (Quarter, Issue 1, Feb. 2022, BDO Consulting PLC) 1.

²²⁷ Noel Cunningham and Deborah Schenk, *The Case for a Capital Gains Preference*, (48 Tax L Rev 319, 1993) 324.

²²⁸ Pwc, *Amendments to the Income Tax Regulations in Ethiopia*, (PricewaterhouseCoopers Limited, March 2022) 2.

²²⁹ Mamo Abdi, *Understanding Capital Gain in Ethiopia's Evolving Tax Scene*, (HST Financial Digest) <<https://www.hst-et.com/insights/insight-detail/understanding-capital-gain-in-ethiopia-s-evolving-tax-scene>> accessed on march 29,2025.

exempted category.²³⁰ Share premiums are defined under the commercial code as the difference between the par value and the selling price of newly issued shares.²³¹

This legislative update addresses a gap in the previous tax regime, where share premiums lacked explicit exemption status despite their role in corporate fundraising. By aligning tax policy with corporate law definitions, the amendment aims to reduce ambiguities in tax treatment and encourage investment in Ethiopia's stock market. The exemption of share premiums reflects the government's recognition of their nature as capital contributions rather than taxable income, ensuring companies are not penalized for raising equity capital above par value.

Prior to the CGT Directive No. 8/2019 issued by the MoF, the tax treatment of income generated through the issuance of new shares at a premium was ambiguous. This uncertainty persisted until the Directive took effect on August 7, 2019, which clarified that 30% income tax would apply to the portion of income exceeding a share's par value when companies issued new shares. For example, if a company issued shares with a par value of 100 ETB each but sold them at 150 ETB, the 50 ETB premium per share would be taxed as income under this rule.

However, a subsequent amendment to Ethiopia's tax laws introduced a critical revision. It explicitly exempted "premium income" earned by operational companies ("going concerns") from the sale of new shares to non-resident investors (e.g., foreign individuals or entities).²³² This amendment effectively overruled the earlier provision in Directive No. 8/2019, which had mandated taxation of such premiums.

To qualify for the tax exemption introduced under this legislative amendment, the income in question must satisfy three mandatory conditions *simultaneously*. Firstly, the exempted income must arise exclusively from the sale of newly issued shares by the *company itself*. Only proceeds from shares directly issued by the company as part of a capital-raising exercise are eligible. Secondly, the company issuing the new shares must be a "going concern" i.e., an entity that is financially and operationally viable, with no imminent risk of liquidation or cessation of operations. Thirdly, the exemption applies only if the purchasers of the new shares are non-resident individuals or entities (e.g., foreign investors or overseas institutions). While the amendment's

²³⁰ Federal Income Tax Regulation (Amendment) No. 520/2022, Council of Ministers Federal Income Tax Regulation (Amendment), *Negarit Gazette*, 28th Year, No.49, art 54.

²³¹ Proclamation No. 1243/2021, Commercial Code of Ethiopia, *Negarit Gazette*, Extra Ordinary Issue, art 268(2).

²³² Income Tax Regulation, *supra* note 230, art 2, which amended Art 54(1) of the Income tax regulation no. 410/2017.

preamble clarifies that its primary goal is to stimulate FDI by incentivizing non-residents to inject capital into Ethiopian companies through share premiums, the exclusion of resident buyers contradicts the principle of tax neutrality, which advocates equal treatment of taxpayers regardless of residency. So, the revised Income Tax Regulation No. 520/2022, introduces a critical distinction in the tax treatment of share premium income based on the residency status of investors.²³³

3.3.5. CAPITAL GAINS TAX DIRECTIVE 8/2019

To properly implement the federal income tax proclamation 979/2016, the MoF has been bestowed with enacting 11 directives from those ones a directive to implement income taxation of gains from the disposal of capital asset is one.²³⁴ The directive contains detailed rules for the implementation of CGT. Particularly, concerning computation of the CGT. The directive under its Art 6(3) provides a simple formula to arrive at capital gain through calculation.

$$Y = A - (B + C) \quad \text{and} \quad D = B - F$$

“A” represents the sale price of the capital asset, “B” refers to the original purchase price of the asset, “C” denotes the inflation-adjusted increment applied to the purchase price, “Y” the resulting taxable gain subject to CGT, “D” represents the book value of the asset, and “F” refers to the total depreciation claimed on the asset.

According to, the CGT Directive No. 8/2019, in the context of share, the term "disposal" encompasses scenarios where a shareholder in a SC or PLC, or a partner in a partnership, transfers their ownership stake in the entity. This includes not only the transfer of shares or partnership interests but also extends to any rights or options associated with shares or bonds, such as the right to acquire shares. Such transfers may occur through either a sale or a donation.²³⁵ Thus, for instance, if an asset is sold, the seller becomes responsible for paying taxes under Article 59 of the directive. Conversely, if the transfer occurs via a donation, the recipient of the gifted asset assumes the associated tax liability.²³⁶

²³³ Legal Update on the new Council of Ministers Regulation to amend the Federal Income Tax Regulation, (2022) <<https://mehrteableul.com/index.php/insights/news-and-updates/item/43-legal-update-on-the-new-council-of-ministers-regulation-to-amend-the-federal-income-tax-regulation>> accessed on march 29,2025.

²³⁴ Mamo Abdi, *supra* note 229.

²³⁵ Directive No 8/2019, Ministry of Finance Directive to Implement Income Taxation of Gains from the Disposal of Capital Asset, art. 3 (6).

²³⁶ *Id*, art. 13, see also; Income Tax Regulation, *supra* note 226, art. 53 (2).

The directive prohibits inflation adjustment for the disposal of shares and bonds, restricting such adjustments solely to an immovable asset.²³⁷ This distinction lacks clarity, as inflation equally erodes the purchasing power of money across all commercial activities, including those involving shares and bonds. A fair and neutral tax system should treat all economic transactions uniformly. However, the directive creates inequity by discriminating against transfers of financial instruments like shares & bonds. To address this imbalance, the Federal Income Tax Regulation (Amendment) No. 485/2021, has expanded inflation adjustments to include Class B assets, such as shares and bonds.

Under the directive, if tax authorities reject documentation submitted by a taxpayer to substantiate costs or proceeds related to the disposal of an asset, the taxable gain from the disposal will be calculated using the asset's fair market value (FMV).²³⁸ According to Ethiopia's Federal Tax Administration Proclamation, FMV is defined as the standard open market value of goods or assets at a specific time and location.²³⁹ While the proclamation does not explicitly define "open market value," it is generally interpreted as the price agreed upon in an arms-length transaction between unrelated parties for assets of similar quality and quantity. If determining FMV through open market comparisons is impractical, adjustments are made to approximate the value by referencing prices of comparable assets in the open market, factoring in differences between the actual asset and similar ones.²⁴⁰

Regarding exemptions, the disposal of a share in cooperative societies, disposal by succession and premium share disposal are excluded from CGT.²⁴¹ However, disposal by donation attracts CGT & by reducing the cost incurred from the FMV the derived gain will be taxed.²⁴² The tax payer should pay the tax directly to the revenue authority.²⁴³ However, If a sale, exchange, or donation

²³⁷ *Id*, art 6(5).

²³⁸ *Id*, art 8(3).

²³⁹ Proclamation No. 983/2016, The Federal Tax Administration Proclamation, *Negarit Gazette*, 22nd year, No. 103, art 3(1).

²⁴⁰ *Id*, art 3(2).

²⁴¹ Capital Gains Tax Directive, *supra* note 235, arts. 16,14 & 11.

²⁴² *Id*, art 13.

²⁴³ *Id*, art 15.

agreement is legally canceled, the taxpayer may request a full refund of the paid CGT, provided the claim is submitted within one year of the cancellation.²⁴⁴

3.4. THE ADEQUACY OF THE EXISTING CGT RULES ON SHARES AND BONDS FOR THE CAPITAL MARKET

The creation of Ethiopia's capital market and the launch of the ESX may lead individuals, whether as investors or advisors, to engage in the buying and selling of shares and bonds during their lifetimes. A critical consideration in such transactions will be the CGT framework governing the transfer of these securities, which necessitates careful evaluation. Globally, many jurisdictions apply preferential tax treatment to capital gains. For instance: countries like the US and the UK impose lower tax rates on capital gains compared to ordinary income. Nations such as Canada and Australia exclude a predetermined portion of capital gains from taxable income. Countries like France and Germany entirely exempt certain categories of gains from taxation. The UK, for example, allows taxpayers to earn a fixed amount of capital gains tax-free each year.²⁴⁵ The appropriate design of CGT remains a persistent challenge in income tax reform. One of the rationales for the introduction of the capital market is to support the development of the national economy through mobilizing capital, promoting financial innovation, and sharing investment risks,²⁴⁶ so, to achieve the legislatures' goal and achieve an efficient market, it is necessary to adopt a well-established legal framework on taxation of the gains derived from the transfer of shares and bonds (securities). In this section the Ethiopian CGT law regime is examined in light of those international experiences.

3.4.1. THE TAX RATE STRUCTURE ON TRANSFER OF SHARES AND BONDS

In Ethiopia, income generated from the disposal of shares or bonds is subject to a flat tax rate of 30%,²⁴⁷ regardless of whether the taxpayer is an individual or a corporation. This rate is notably higher than CGT rates in many other jurisdictions, creating a competitive disadvantage.²⁴⁸ Under Schedule D of Ethiopia's tax system, this 30% rate represents the highest bracket and is exclusively

²⁴⁴ *Id*, art 17.

²⁴⁵ Taxation of Chargeable Gains Act 1992 (TCGA 1992), Sec 2.

²⁴⁶ Proclamation No. 1248/2021, Capital Markets Proclamation, *Negarit Gazette*, 27th Year, No.33, preamble para 1.

²⁴⁷ Federal Income Tax Proclamation, *supra* note 162, arts 59(1)(2).

²⁴⁸ Interview with Ato Sirak Solomon, Senior Legal Advisor, at the Ethiopian Capital Market Authority, (ECMA, April 21,2025).

levied on gains from shares and bonds.²⁴⁹ This means the tax rate on disposal of shares and bonds is double of the tax rate on disposal of Class A assets, equals to the tax rate of corporate taxation rate²⁵⁰ and higher than most incomes in the progressive tax rates of individual employment, rental and business incomes.²⁵¹ This disrupts tax neutrality, a principle advocating equal tax treatment for economically similar activities. By imposing a disproportionately high and uniform rate on gains from shares and bonds, Ethiopia’s CGT regime creates inequity compared to the lower rates for Class A assets and the progressive structure for other income streams. Such disparity may deter investment in securities and undermining the capital market’s growth.²⁵²

This has resulted in extremely low trading volumes for these securities in the market.²⁵³ High tax rates on capital gains exacerbate the “lock-in effect” a phenomenon where investors retain assets that have appreciated in value to defer or avoid tax liabilities.²⁵⁴ The higher the tax rate, the stronger this effect becomes, discouraging active trading of shares and bonds. A well-designed CGT regime should ideally encourage investment decisions based on economic merit, ensuring capital flows to sectors or projects with the highest potential returns.²⁵⁵

Elevated tax rates on capital gains diminish the post-tax returns investors receive from holding assets, reducing their attractiveness and suppressing demand. This dynamic discourages taxpayers from divesting appreciated investments to avoid triggering tax liabilities, thereby undermining the liquidity and fluidity essential for a functional capital market.²⁵⁶ For Ethiopia, which hosts Africa’s newest and most nascent capital market, addressing the lock-in effect stemming from taxation being levied only upon the sale of assets is a critical necessity. Neutralizing this disincentive is

²⁴⁹ Misganaw Gashaw, Zerihun Assegid, Mulugeta Akalu and Aschalew Ashagre, *supra* note 179, at 151.

²⁵⁰ Corporate tax rate for rental income is 30% (art. 14), for business income also 30% flat rate (art 19).

²⁵¹ Individual income tax rate for employment, rental and business income are a progressive tax rate which ranges from 0%-35%. See art 11,14 & 19 of the federal income tax proclamation.

²⁵² Interview with Ato Estifanos Melaku, License and Registration Director, at the Ethiopian Capital Market Authority, (ECMA, April 21,2025).

²⁵³ Interview with Ato Baye Abathun, Service Tax Audit Team Coordinator, at the FDRE Ministry of Revenues, Central District, (MoR, April 24,2025).

²⁵⁴ Bruce Bartlett, *The case for ending the capital gains tax*, (Financial Analysts Journal, May-June 1985) 24.

²⁵⁵ Walter Blum, *A Handy Summary of the Capital Gains Arguments*, (Australian Tax Forum 2, no. 1, 1985) 120.

²⁵⁶ Interview with Ato Sirak Solomon, *supra* note 248.

vital to fostering a thriving capital market, as excessive retention of assets stifles trading activity, limits capital mobility, and obstructs efficient price discovery.²⁵⁷

The Ethiopian government's decision to impose a 30% CGT on shares and bonds was ostensibly designed to align this rate with the corporate income tax rate, reflecting a flawed assumption that capital gains are predominantly generated by corporations.²⁵⁸ This rationale overlooks the reality that individual investors actively participate in trading shares and bonds, raising questions about the policy's fairness and logic. The other rationale was when the CGT framework was first introduced in 1994, Ethiopia's financial landscape was dominated by transactions involving immovable assets, with minimal activity in securities trading. To maximize revenue collection at the time, the government opted for preferential tax treatment on immovable assets, incentivizing such transactions while inadvertently marginalizing investments in shares and bonds.²⁵⁹ This historical bias has perpetuated a structural disincentive against securities trading. Despite the current negligible revenue contribution from CGT on shares and bonds, policymakers have hesitated to lower the rate, fearing fiscal shortfalls. However, reducing the tax burden on these transactions would likely stimulate investment activity, offsetting potential revenue losses through increased trading volume and market participation.²⁶⁰ Critically, Ethiopia's 30% CGT rate undermines its ability to attract foreign investment, as global investors routinely compare tax regimes across jurisdictions.²⁶¹ Competing nations with lower, tiered, or exempted capital gains taxes gain a competitive edge, leaving Ethiopia at a disadvantage in securing cross-border capital inflows.

In Ethiopia, the volume of transactions involving shares and bonds is not only low but also plagued by systematic underreporting of disposal values, which undermines accurate CGT assessment.²⁶² For CGT to be calculated correctly, taxpayers must transparently declare the actual sale price of

²⁵⁷ *Id.*

²⁵⁸ Interview with Ato Mohammed Osman, Tax Policy Research & Monitoring Division Team Leader, at the FDRE Ministry of Finance, (MoF, April 29,2025).

²⁵⁹ Interview with Ato Bochu Sintayehu, Senior Legal Advisor, at the FDRE Ministry of Finance, (MoF, April 29,2025).

²⁶⁰ Interview with Ato Habtamu Hailemeskel, Senior Legal and Compliance Manager, at the Ethiopian Securities Exchange, (ESX, April 21,2025).

²⁶¹ *Id.*

²⁶² Interview with Ato Estifanos Melaku, *supra* note 252.

securities to the tax authority. However, a pervasive issue in the country is the deliberate undervaluation of transactions by parties involved in share or bond transfers.²⁶³ Frequently, buyers and sellers agree to report the par value of shares as the disposal price, even when the market value is significantly higher.²⁶⁴

While challenges such as the absence of a formal trading platform and inadequate legal frameworks have historically contributed to this problem,²⁶⁵ the primary driver remains the prohibitively high tax rate on such transactions. Recent reforms, including the establishment of the capital market and updates to income tax laws, have addressed some structural gaps, such as creating a regulated marketplace and clarifying valuation rules.²⁶⁶ Nevertheless, underpricing persists, indicating that infrastructural and legal improvements alone are insufficient without revising the tax rate structure.

Critically, the launch of the capital market, while a positive step, will fail to resolve systemic issues unless paired with tax rate reforms.²⁶⁷ Without reducing the CGT burden, investors and traders will remain inclined to underreport transactions, stifling market transparency, liquidity, and growth. Lowering the tax rate could align incentives for honest reporting, enhance revenue collection through increased compliance, and foster trust in the emerging capital market ecosystem.

In the same fashion where a bond is transferred it could be transferred above par value. So, where ever there is gain from transfer of bond one is required to pay CGT. The market for bond, particularly government bonds like T-bills, have some presence in Ethiopia, however, the corporate bond market is almost non-existent, even though the law recognizes it.²⁶⁸ This imbalance

²⁶³ Interview with Ato Ali Idris, Higher Tax Payers Tax Audit Team Coordinator, at the FDRE Ministry of Revenues, (MoR, April 24,2025).

²⁶⁴ Interview with Ato Sisay Gezu, Investigative Tax Audit Directorate Director, at the FDRE Ministry of Revenues, (MoR, April 24,2025).

²⁶⁵ Taddese Lencho, *supra* note 134, at 498.

²⁶⁶ Arts 66-72 ITP have significantly narrowed the pre-existing gaps as to the determination of ‘disposal’ of an asset and ‘consideration’, ‘cost’, ‘net-book value’, and ‘loss’ for the disposal of an asset. See for more; Income Tax Proclamation No. 979/2016, Arts. 70(2) and (6), 82(5); MoF Directive on Capital Gains Tax, Arts. 8 (5), 7,8, & 17; Tax Administration Proclamation No. 983/2016, Art 3.

²⁶⁷ Interview with Ato Habtamu Hailemeskel, *supra* note 260.

²⁶⁸ Interview with Ato Belete Kassaw, Senior Finance Manager, at the Ethiopian Securities Exchange, (ESX, April 21,2025).

has stifled the growth of Ethiopia's bond market and limited tax revenue from bond-related transactions.²⁶⁹

Ethiopia has launched its capital market despite maintaining a 30% CGT regime on transfers of shares and bonds. A comparative analysis of global markets demonstrates that high CGT rates correlate with diminished investment volumes in securities, sluggish asset growth, and reduced tax revenues over time.²⁷⁰ For Ethiopia to realize its ambition of building a dynamic and effective capital market, it must prioritize creating a tax-friendly environment that incentivizes trading in shares and bonds. Under the current income tax law, the 30% flat tax on gains from these transactions acts as a deterrent, stripping away the fiscal motivation for investors to engage in frequent or large-scale exchanges.²⁷¹ Ethiopia's uniform 30% rate eliminates the tax advantage that could encourage surplus trading of shares and bonds.²⁷² This stands in stark contrast to the preferential treatment granted to Class A assets, which benefit from lower tax burdens, fostering greater transaction activity.

Reduced rates would incentivize compliance, reduce underpricing fraud, and stimulate higher transaction volumes, offsetting the per-unit tax reduction. For Ethiopia, adopting such a reform would not only enhance market efficiency but also position the capital market as a driver of economic growth, attracting domestic and foreign investors seeking competitive, transparent trading environments. A reduction in the CGT rate serves as a catalyst for investors to liquidate their holdings and channel resources into economically beneficial ventures that drive national progress.²⁷³ Ethiopia's tax policy is not solely focused on revenue generation; it also aims to cultivate an investment-friendly ecosystem that stimulates economic activity.²⁷⁴ To achieve these dual objectives, lowering the CGT rate would promote more frequent asset sales, enabling capital to flow into sectors with higher growth potential and fostering market efficiency.²⁷⁵ It is suggested

²⁶⁹ Interview with Ato Sirak Solomon, *supra* note 248.

²⁷⁰ Alen Auerbach, *Capital Gains Taxation and Tax Reform* (National Tax Journal, Vol. 71, No. 4, 2018), 638.

²⁷¹ Interview with Ato Sirak Solomon, *supra* note 248.

²⁷² Interview with Ato Habtamu Hailemeskel, *supra* note 260.

²⁷³ *Id.*

²⁷⁴ Taddese Lencho, *supra* note 183, at 499.

²⁷⁵ Interview with Ato Belete Kassaw, *supra* note 268.

that reducing tax rates may increase capital gains realizations enough to raise the net revenue collected by the CGT.²⁷⁶

Beyond revenue considerations, a CGT cut enhances corporate fundraising capacity. Lower taxes on equity gains make shares more attractive to investors, enabling firms to issue new stock at favorable valuations. This influx of capital supports business expansion, innovation, and job creation. Simultaneously, heightened investor demand for equities driven by improved after-tax returns boosts trading volumes and market liquidity. Over time, these dynamics elevate the market value of corporate equities, creating wealth effects that further stimulate economic growth.²⁷⁷ So, the rate of CGT on the transfer of shares and bonds should be reconsidered.

CGT operates as a voluntary tax, triggered only when an asset is sold. Excessively high rates discourage divestment, as holders delay sales indefinitely to avoid immediate tax burdens.²⁷⁸ To counteract this, introducing preferential tax treatment such as reduced rates could encourage asset liquidity, attract broader market participation, and ultimately enhance fiscal revenues. Without reform, the status quo risks perpetuating market distortions, including underreported sale prices and suppressed investment in equities and bonds.²⁷⁹ Taxpayers were postponing sales of appreciated capital assets solely because of the tax.²⁸⁰ To address this, policymakers should prioritize revising CGT rates downward for shares and bonds.

3.4.2. THE HOLDING PERIOD CRITERIA

Under Ethiopia's current tax framework, long-term capital gains (LTCG) on shares and bonds receive no preferential treatment compared to short-term capital gains (STCG), as the law does not distinguish between assets held for varying durations.²⁸¹ Globally, many jurisdictions incentivize long-term investment by imposing holding period requirements to qualify for reduced tax rates.²⁸² For instance, short-term gains (assets held for less than the stipulated period) are typically taxed at

²⁷⁶ George Zodrow, *Economic Issues in the Taxation of Capital Gains*, (Canadian Public Policy, 1995, Vol. 21) 27.

²⁷⁷ Interview with Ato Belete Kassaw, *supra* note 268.

²⁷⁸ Bracewell Milnes, *A discredited tax: the capital gains tax problem and its solution*, (London: Institute of Economic Affairs, 1992) 72.

²⁷⁹ Interview with Ato Estifanos Melaku, *supra* note 252.

²⁸⁰ Interview with Ato Ermias Birhanu, Manager of Joy S.C, (Joy S.C, April 28, 2025).

²⁸¹ Interview with Ato Ali Idris, *supra* note 263.

²⁸² Diana Hourani and Sarah Perret, *Taxing capital gains: Country experiences and challenges*, (OECD Taxation Working Papers No. 72, 2025) 18.

ordinary income tax rates, which align with an individual’s marginal tax bracket, while long-term gains benefit from lower, fixed rates.²⁸³

This differentiation aims to promote patient capital that supports sustainable business growth and productive economic activities. In contrast, Ethiopia’s uniform taxation of all capital gains, regardless of holding duration, risks fostering a market dominated by speculative, short-term trading. Such an environment prioritizes quick profits over strategic investment, undermining the capital market’s role in channeling resources to high-quality firms or innovation-driven projects.²⁸⁴ Introducing LTCG relief such as reduced rates for assets held beyond a defined threshold could realign incentives, encouraging investors to engage in long-term commitments.

The legislative framework should aim to differentiate tax treatment between capital gains derived from speculative trading and those arising from long-term investment, primarily based on the duration of asset ownership. The underlying rationale is that the distinction between speculation and investment hinges on the holding period: an investor typically prioritizes sustained income generation over the asset’s lifetime, whereas a speculator focuses on short-term price fluctuations for quick profits.²⁸⁵ To incentivize patient capital and stabilize markets, the CGT regime should grant preferential rates for LTCG.

Establishing a holding period threshold creates an objective benchmark beyond which tax leniency applies.²⁸⁶ A 1-year holding period emerges as a pragmatic compromise, aligning with the annual cycle of income tax reporting and balancing administrative simplicity with economic intent. This approach acknowledges that while no timeframe perfectly segregates speculation from investment, a standardized threshold offers clarity, reduces arbitrage, and rewards enduring economic contributions.²⁸⁷

Ethiopia’s CGT regime for shares and bonds should adopt a tiered taxation model that imposes lower rates on LTCG compared to STCG, aligning with global best practices to incentivize capital

²⁸³ *Id.*, at 361.

²⁸⁴ Interview with Ato Habtamu Hailemeskel, *supra* note 260.

²⁸⁵ Interview with Ato Belete Kassaw, *supra* note 268.

²⁸⁶ Federal Income Tax Treatment of Capital Gains and Losses, (Prepared by Tax Advisory Staff of the Secretary, Treasury Department, United States Government Printing Office, 1951) 53.

²⁸⁷ Lawrence Seltzer, *The Nature and Tax Treatment of Capital Gains and Losses*, (National Bureau of Economic Research, 1951) 131.

market growth. By rewarding “patient capital” the government can foster a culture of sustained economic engagement, distinguishing genuine long-term investments from speculative short-term trading. The underlying principle is that assets retained for longer durations are more likely to reflect strategic investment intent, whereas short-term holdings often signal speculative behavior driven by market volatility.²⁸⁸

Introducing a holding period mechanism is critical to this reform. A well-designed holding period framework would enhance tax fairness and revenue efficiency.²⁸⁹ By reducing tax burdens on long-term investors, the system could increase compliance and trading volumes, broadening the tax base. Simultaneously, it would channel capital toward enterprises with long-term growth potential, driving job creation and economic diversification. For Ethiopia, this approach is not merely a fiscal adjustment but a strategic imperative to transform its capital market into a catalyst for sustainable development, attracting both domestic and foreign investment.

Income tax is assessed and collected on an annual basis, making it logical to classify short-term capital gains as profits generated from the sale of capital assets held for one year or less. By aligning this definition with the tax year cycle, such gains can be integrated into a taxpayer’s annual income and taxed at the applicable ordinary income tax rates, similar to wages, business profits, or rental income. In Ethiopia, the concept of a short-term holding period is already recognized under the Treasury Bond Purchase Directive No. 956/2022, which categorizes "Short-term Loans" as financial instruments with a maturity period not exceeding one year.²⁹⁰ This existing framework provides a precedent for extending the same temporal classification to shares and bonds. Specifically, Short-term holdings could be defined as securities held for 12 months or less before disposal. And Long-term holdings would then apply to assets retained for more than one year, warranting distinct tax treatment. Adopting this classification would harmonize Ethiopia’s tax policy across financial instruments, ensuring consistency between debt instruments like treasury bonds and equity instruments like shares.

²⁸⁸ Interview with Ato Habtamu Hailemeskel, *supra* note 260.

²⁸⁹ R. G. Sarien and O. P. Chawla, *The Capital Gains Tax in India*, (Canadian Tax Journal 11, No. 5, September-October 1963) 457.

²⁹⁰ Directive No.956/2022, The National Bank of Ethiopia Treasury Bond Purchase Directive, art 2(20).

3.4.3. THE LISTED AND NON-LISTED SECURITIES ON THE EXCHANGE CRITERIA

Under Ethiopia's current CGT regime, there is no distinction in tax treatment between listed securities and non-listed securities, as the law does not mandate differentiated taxation based on exchange listing status.²⁹¹ However, insights from interviews with the ECMA and ESX reveal that these institutions have formally proposed either reducing the 30% CGT rate or granting full tax exemptions for shares and bonds listed on the ESX.²⁹² This proposal aims to incentivize participation in the formal capital market, enhance liquidity, and align Ethiopia's tax policy with global practices that often favor listed securities.

The proposal was submitted to the MoF approximately 18 months ago, but progress has stalled due to reservations from both the MoF and the MoR.²⁹³ The MoF has argued that the revenue generated from CGT on shares and bonds is currently negligible, given the underdeveloped state of Ethiopia's capital market. Consequently, the government has deprioritized reforms in this area, opting instead to focus on broader market development before revisiting tax adjustments.²⁹⁴ Officials have indicated that CGT reforms for securities will be reconsidered only after the capital market matures, reflecting a cautious approach to fiscal policy changes.²⁹⁵ This stance underscores a lack of cohesive political will among government bodies to prioritize long-term capital market growth over short-term revenue considerations. While ECMA and ESX advocate for tax incentives to stimulate market activity, the MoF and MoR remain hesitant, citing fiscal prudence and current revenue limitations. The delay in addressing this proposal highlights systemic challenges in aligning Ethiopia's regulatory framework with the strategic needs of an emerging capital market, potentially slowing investor confidence and market expansion.

A Securities Exchange is a regulated marketplace or platform that facilitates the regular buying, selling, or trading of securities (e.g., shares, bonds) through structured mechanisms.²⁹⁶ It serves as a centralized venue where investors and institutions can transact securities in a transparent and

²⁹¹ Interview with Ato Tewodaj Mohammed, Legal Affairs Department Head, at the FDRE Ministry of Finance, (MoF, April 29, 2025).

²⁹² Interview with Ato Estifanos Melaku, *supra* note 252 and Interview with Ato Habtamu Hailemeskel, *supra* note 260.

²⁹³ Interview with Ato Estifanos Melaku, *supra* note 252.

²⁹⁴ Interview with Ato Mohammed Osman, *supra* note 258.

²⁹⁵ *Id.*

²⁹⁶ Capital Market Proclamation, *supra* note 246, art. 2(67).

orderly manner, governed by established rules and oversight. Listing, in this context, refers to the formal process of admitting a security to the official trading list of a licensed securities exchange.²⁹⁷

To stimulate the growth of capital markets and foster a culture of active participation in securities trading, a reward should be given to exchanges undergone under the auspice of the securities exchange recognized by the capital markets authority, by giving preferential tax rate to shares and bonds listed on the exchange,²⁹⁸ specifically, shares and bonds listed on exchanges recognized and overseen by the capital markets authority could benefit from reduced tax rates or exemptions on capital gains. This approach aligns with global practices, as evidenced by Kenya's implementation of preferential tax measures for financial instruments traded on the Nairobi Securities Exchange, which has enhanced market liquidity and investor engagement.²⁹⁹ Internationally, most OECD member countries adopt similar strategies to encourage investment in regulated public markets.³⁰⁰ This preferential framework is designed to channel investments into transparent, regulated markets, thereby promoting market efficiency and stability. By reducing the tax burden on listed securities, governments aim to attract both domestic and international investors, driving liquidity and fostering long-term capital formation. Such measures not only enhance the competitiveness of formal exchanges but also mitigate the appeal of informal or speculative trading venues, reinforcing the integrity of the financial system.

The process of listing securities on the ESX involves significant costs and demands additional financial commitments from companies. Without compensatory measures such as preferential tax treatment, businesses and investors are unlikely to prioritize listing their shares or bonds on the ESX.³⁰¹ To address this, offering tax incentives for listed securities is critical. Such incentives would, offset the financial burden of the listing process, motivating companies to join the exchange, promote accountability by requiring listed entities to disclose accurate financial statements, fostering investor trust, and drive adherence to corporate governance standards,

²⁹⁷ Public Offering and Trading of Securities Directive No. 1030/2024, Ethiopian Capital Market Authority Public Offering and Trading of Securities Directive, art 2(29).

²⁹⁸ Interview with Ato Habtamu Hailemeskel, *supra* note 260.

²⁹⁹ Kenyan Financial Act of 2022.

³⁰⁰ Diana Hourani and Sarah Perret, *supra* note 282, at 18.

³⁰¹ Interview with Ato Sirak Solomon, *supra* note 248.

improving operational efficiency and long-term sustainability of businesses.³⁰² Additionally, preferential tax policies would directly enhance the liquidity of the ESX, transforming it into a dynamic, modern marketplace capable of supporting diverse financial instruments, including equities and debt securities.³⁰³ Increased liquidity would attract a broader base of domestic and international investors, creating a virtuous cycle of market activity.³⁰⁴ By aligning tax policy with market development goals, Ethiopia can position the ESX as a cornerstone of its financial infrastructure, fostering innovation, stability, and inclusive growth in an emerging economy.

3.4.4. THE SMALL BUSINESS EXCLUSION AND THRESHOLD EXCLUSION FROM CGT

Over recent decades, the small business sector has emerged as a cornerstone of economic development in Ethiopia.³⁰⁵ Small and medium enterprises (SMEs) are widely recognized as drivers of innovation, job creation, and socioeconomic resilience, particularly in contexts where industrialization and formal employment opportunities remain limited.³⁰⁶ Governments, including Ethiopia's, have increasingly prioritized fostering an entrepreneurial culture, leveraging tax policy as a strategic tool to incentivize SME growth and sustainability.

Globally, many nations have introduced tax exemptions or concessions on capital gains to stimulate investment in high-potential sectors, with small businesses often being a key beneficiary. For instance, exemptions on gains from the sale of shares in qualifying SMEs encourage venture capital inflows, enabling these enterprises to scale operations, adopt new technologies, and penetrate markets. Ethiopia, facing similar developmental challenges such as poverty alleviation and economic diversification, stands to gain significantly by adopting analogous measures.³⁰⁷

To catalyze investment in Ethiopian SMEs, the CGT framework should incorporate exemptions for gains derived from shares in designated small business corporations. Such provisions would mirror international practices, where countries like the US, the UK, and India offer tailored CGT relief for transactions involving closely held or privately owned small businesses with the aim of

³⁰² Interview with Ato Belete Kassaw, *supra* note 268.

³⁰³ *Id.*

³⁰⁴ Interview with Ato Sirak Solomon, *supra* note 248.

³⁰⁵ Asmelash Abay & Lemma Tilahun, *The Contribution of Micro and Small Enterprises (MSEs) for Employment Generation and Economic Growth in Ethiopia: A Review Study*, (Journal of Economics and Sustainable Development, Vol. 9, No. 19, 2018), 48–60.

³⁰⁶ Ingram Peter, *Small business relief*, (The Tax Specialist, Vol. 4, No. 2, October 2000) 85-94.

³⁰⁷ *Id.*

reducing the financial disincentives associated with investing in or divesting SMEs.³⁰⁸ Implementing CGT exemptions for small businesses in Ethiopia would yield multifaceted benefits: Firstly, SMEs could attract more equity investments, enabling expansion and innovation. Secondly, enhanced SME productivity would create jobs and uplift local communities. Thirdly, incentivizing formal share transactions would reduce reliance on informal financing. Fourthly, aligning with international tax norms would improve Ethiopia's appeal to foreign investors.³⁰⁹

Ethiopia's current CGT framework lacks tailored provisions to support the small business sector, leaving these enterprises subject to the same tax obligations as larger corporations.³¹⁰ To foster economic growth and alleviate administrative burdens, the government should prioritize introducing targeted concessions within the CGT regime to empower small businesses. This could involve implementing measures that grant partial or full CGT relief to taxpayers classified as "small businesses," provided the disposed asset qualifies as a share in such an enterprise. For clarity, the term "small business" must be rigorously defined through established criteria. Ethiopia's existing legal framework, specifically Council of Ministers' Regulation No. 374/2016 under the Federal Urban Job Creation and Food Security Agency, offers a foundational definition. According to this regulation; Micro Enterprises are defined as entities in the service sector with capital (excluding real estate) not exceeding 50,000 Birr, or in the industrial sector with capital up to 100,000 Birr, employing up to five individuals, including the owner and family members.³¹¹ And, Small Enterprises operate in sectors such as urban agriculture, artisanal mining, or construction, with capital ranging from 100,001 to 1,500,000 Birr (depending on the sector) and employing 6 to 30 workers, inclusive of the owner and family members.³¹² Extending this definition to tax policy would enable the creation of a CGT exemption framework for qualifying small businesses. For instance, gains from the sale of shares in enterprises meeting these criteria could be fully or partially exempted, reducing financial barriers to investment and ownership transitions.

³⁰⁸ Elmer Fagan, *The Economics of Capital Gains Taxation*, (Proceedings of the Annual Conference on Taxation under the Auspices of the National Tax Association, Vol. 32, October 16-19, 1939) 117.

³⁰⁹ Interview with Ato Belete Kassaw, *supra* note 268.

³¹⁰ Interview with Ato Baye Abathun, *supra* note 253.

³¹¹ Regulation No. 374/2016, Council of Ministers Federal Urban Job Creation and Food Security Agency Establishment Regulation, art 2(3).

³¹² *Id.*, art 2(4).

The introduction of tax incentives tailored for shares and bonds issued by small businesses is anticipated to catalyze a surge in both the volume of newly issued securities and the liquidity of trading activities within financial markets. By enhancing post-tax returns for investors, these incentives are projected to elevate the market valuation of corporate equities, thereby attracting greater investment interest. This dynamic is expected to foster a conducive environment for the formation and success of a higher number of small enterprises.³¹³

A significant challenge within Ethiopia's CGT framework is the inefficiency of dedicating substantial administrative resources to collect negligible tax revenues from a large pool of taxpayers with minimal gains. This approach not only undermines the simplicity and cost-effectiveness of the tax system but also fosters taxpayer frustration, exacerbating compliance issues and eroding trust in fiscal institutions.³¹⁴ Under Ethiopian law, certain assets qualify for CGT exemptions. For instance, residential properties owned and exclusively used as a primary residence for at least two years prior to sale are exempt from CGT.³¹⁵ However, these exemptions are narrowly defined and lack flexibility, as they do not account for variables such as *threshold-based exclusions* (e.g., exempting gains below a specific value), distinctions between types of securities, or categories of investors.³¹⁶ To enhance efficiency, Ethiopia's CGT regime could adopt a tax-free threshold, exempting individuals whose annual taxable capital gains fall below a predetermined amount. By implementing such a threshold, the system would reduce administrative burdens by focusing efforts on high-value transactions, thereby streamlining operations and improving compliance rates.

In Ethiopia, introducing a dedicated annual tax-free threshold for capital gains on shares and bonds could alleviate administrative inefficiencies and reduce the CGT burden on lower-income taxpayers. For instance, gains below a defined threshold could be fully exempted, effectively removing a significant portion of small-scale investors from the CGT framework. This approach would streamline tax collection by focusing resources on high-value transactions, minimizing revenue loss while promoting fairness. By exempting modest gains, the regime would reduce

³¹³ Interview with Ato Belete Kassaw, *supra* note 268.

³¹⁴ Serkalem Eshetie, *Constitutional and Administrative Issues in Relation to Capital Gains Tax Ethiopia: The Case of Bahir Dar City Administration*, (LL.M. thesis, Bahir Dar University, 2016) 39.

³¹⁵ Federal Income Tax Proclamation, *supra* note 162, art 59(7)(a).

³¹⁶ Interview with Ato Ali Idris, *supra* note 263.

compliance costs for taxpayers and authorities alike, mitigate resentment toward the tax system, and encourage broader participation in Ethiopia's nascent capital markets.

CHAPTER FOUR

CONCLUSION AND RECOMMENDATION

4.1. CONCLUSION

By examining the legal framework governing CGT of shares and bonds in Ethiopia this work has made it clear that, Ethiopia's legal provisions on CGT of shares and bonds are not detailed and insufficient to address the complexities involved in capital market as they were enacted at the time when the country doesn't have a capital market at all. This inadequacy in the law undermines the capital market development and hinders its role for mobilization of finance to fund investments. This research had analyzed other countries' experiences (i.e. USA, UK, South Africa, Nigeria, Kenya and Morocco) in the taxation of capital gains derived from the exchange of shares and bonds by drawing lessons from the comparative exercise. It showed the need for robust legal framework of CGT on shares and bonds in the Ethiopian income tax regime, which will enhance the effectiveness of the newly launched capital market in the country and create an enabling environment that provides an improved tax regime and tax incentives is identified as important measures. In line with this, the paper identified the gaps and challenges existing in the Ethiopian CGT rules on transfer of shares and bonds. Among these, the paper concludes that the significant are:

- ✓ The current regime imposes a 30% flat tax rate on gains from the sale of shares and bonds, which is double the 15% rate applied to immovable assets. This means it equals to the tax rate of corporate taxation rate and higher than most incomes in the progressive tax rates of individual employment, rental and business incomes. This imbalance places securities transactions at a severe disadvantage, discouraging participation in the capital market. By eliminating tax incentives for securities transactions, the regime suppresses liquidity and volume in the capital market. Empirical evidence reveals extremely low transaction volumes, coupled with widespread underreporting of sale prices to minimize tax liabilities. With presence of such CGT regime and practice on transfer of shares and bonds, the capital market

had been launched in Ethiopia. This would have a negative effect on the capital market, as it is shown by the recent partial success of Ethio Telecom’s share sale where only 10.7% of offered shares were sold³¹⁷ illustrates the challenges posed by the current tax structure. The undersubscription signals that Ethiopia’s capital market remains nascent, requiring strategic interventions to transition toward a dynamic, inclusive, and globally competitive ecosystem. In light of this, the government should consider lowering the tax rate on capital gains of shares and bonds to meet this problem.

- ✓ The existing legal framework in Ethiopia does not provide preferential tax treatment for LTCG compared to STCG, despite the widespread use of holding period criteria in other jurisdictions to differentiate tax relief for gains on shares and bonds. This absence of distinction undermines the potential economic benefits of the stock market, as excessive short-term speculation dominates trading activity. To address this, the government should incentivize long-term investment, often termed “patient capital,” by introducing tax relief mechanisms for assets held over extended periods. To foster a robust capital market, policymakers should consider adopting tiered tax rates for LTCG, coupled with clear holding period thresholds.
- ✓ Under Ethiopia’s current CGT framework, no distinction is made between securities listed on the ESX and those traded outside formal exchanges, as the legal provisions do not differentiate tax treatment based on whether assets are publicly listed or privately held. The process of listing securities on the ESX involves substantial costs, including regulatory compliance fees, administrative expenses, and ongoing operational investments. Despite these financial burdens, the absence of compensatory tax incentives for listed securities fails to offset the economic challenges faced by companies and investors. Consequently, there is little motivation for businesses to undergo the rigorous and costly listing process. This lack of encouragement results in limited participation in the ESX, with fewer companies opting to list shares or bonds.
- ✓ Ethiopia’s current CGT regime does not incorporate targeted provisions to support the small business sector, subjecting these enterprises to the same tax obligations as larger corporations. This lack of differentiation imposes undue financial strain on small businesses, which often operate with limited capital and narrower profit margins. To foster economic inclusivity and

³¹⁷ Fasika Tadesse, *Ethiopia Sells 10% in Its Maiden IPO That Was Open for 121 Days*, (April, 2025), <<https://www.bloomberg.com/news/articles/2025-04-25/africa-s-newest-stock-market-holds-maiden-ipo-with-ethio-telecom>> accessed on May 07/2025.

stimulate growth, the Ethiopian government should prioritize reforms that alleviate the tax burden on small businesses. Specifically, the CGT framework should introduce tailored relief measures for taxpayers classified under a “small business” category, such as reduced tax rates, exemptions, or deductions. This classification must be clearly defined, with criteria based on factors like annual revenue, asset value, or employment size, to ensure equitable access to benefits. Another issue regarding CGT collection on shares and bonds in Ethiopia is a disproportionate amount of time and effort is spent on extracting small amounts of tax on capital gains from a large number of such individuals who have minimal gains. So, where an individual’s taxable amount of capital gains for any year does not exceed the exempt amount for the year, no tax should be payable by introducing minimum threshold. This reform would streamline tax administration, reduce compliance costs for taxpayers, and allow authorities to focus enforcement efforts on high-value transactions.

4.2. RECOMMENDATIONS

In proposing legal reforms that solidify the legal framework of CGT on shares and bonds in Ethiopia, promote the development of capital market, and ensure that Ethiopia’s practices in taxing capital gains on shares and bonds are in tandem with best international practices, the following are recommended to revisit the currently enforce Ethiopian CGT law on shares and bonds:

- ✓ The Ethiopian tax system does not target only to generate revenue; it also has the aim of encouraging investment. Thus, to bring an effective realization of capital gain and encourage investors to engage in the capital market it is recommended to reduce the rate of CGT on shares and bonds from 30%, it is suggested to make the tax rate similar to the Class A capital assets transfer which is 15% or even lower.
- ✓ After the reduction of the tax rate, it is recommended that the CGT system should also need to treat short term and long-term capital gains derived from transfer of shares and bonds differently to preserve the stability and reduce the volatility of the capital market. The legislative objective should prioritize taxing speculative gains generated from short-term trading differently from gains derived from long-term investments. To achieve this, STCG should be subject to a higher tax rate, aligned with the ordinary income tax rate, while LTCG should benefit from the reduced preferential rate (15%). The definition for STCG is

recommended to be a 1-year holding period, justified solely on the ground that income taxation is an annual affair.

- ✓ To foster the growth of Ethiopia’s capital market and cultivate a culture of trading through regulated, transparent platforms, it is proposed that tax incentives be introduced for transactions conducted through securities exchanges authorized by the ECMA. In line with this, it is recommended to exempt from CGT shares and bonds listed on the securities exchange for a minimum of 3-5 years. This policy would reward investors and entities that engage in formal, regulated market activities, thereby enhancing liquidity, transparency, and investor confidence in the capital market. By aligning tax advantages with participation in structured exchanges, the reform would discourage informal trading practices, promote market integrity, and stimulate the development of a robust securities ecosystem in line with global standards.
- ✓ To encourage investment in small businesses, it is recommended to exempt small businesses share and bond transfers from CGT as they contribute to the economic growth of the country and reduction of poverty. However, in line with this what constitutes “small business” should be stated by identifying basic conditions & should only apply if the CGT asset that is being disposed of is a share in a small business. In defining what constitutes small business the definition given by the federal urban job creation and food security agency establishment council of ministers’ regulation no. 374/2016 is recommended, which includes micro and small enterprises.
- ✓ To streamline tax administration and reduce the bureaucratic burden associated with processing minor capital gains, it is recommended that Ethiopia’s CGT framework incorporate an exemption limit or tax-free threshold for gains derived from shares and bonds. Specifically, if an individual’s chargeable gain from the transfer of shares or bonds in a given tax year falls below a predefined monetary threshold, the gain would be exempt from taxation. This reform could be operationalized by establishing a distinct annual tax-free allowance exclusively for capital gains on shares and bonds, separate from thresholds applicable to other capital assets.
- ✓ The Ethiopian government should formulate a comprehensive taxation policy framework specifically designed to catalyze the development and long-term sustainability of the country’s capital markets. This framework should outline actionable strategies and institutional mechanisms to address existing barriers, stimulate investor participation, and enhance market efficiency.

- ✓ To ensure the effective implementation of these reforms, the *Ministry of Revenue, Ministry of Finance, Capital Market Authority and Securities Exchange* must strengthen their collaborative efforts through: policy harmonization by aligning tax regulations, fiscal policies, and capital market rules to eliminate contradictions and create a coherent regulatory environment.

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ANNEX

INTERVIEW GUIDE QUESTIONS

Introduction: I am Aboo Badhasa, LL.M student at Addis Ababa University School of law. I am doing my LLM thesis on the title “Capital Gains Taxation of Shares and Bonds Under the Ethiopian Income Tax Law: Legal and Practical Issues”. The purpose of this interview is to get information on the thinking of the Ministry of Finance/ Ministry of Revenues/ Ethiopian Capital Markets Authority/ Ethiopian Securities Exchange. I would like to start by thanking you for your willingness to provide the interview.

I. For the Ministry of Finance:

- What were the underlying rationales and tax principles that influenced the introduction of CGT in Ethiopia through Proclamation 108/1994, and how did these factors shape its implementation? After 20 years of the introduction of the CGT does it achieved the aims of the legislator? If not, what factors contributed for this?
- What were the primary policy objectives behind the current CGT regime on the transfer of shares and bonds in Ethiopia? Could you elaborate on the preferential tax rate provided for

Class A (immovables) 15% flat rate compared to Class B (shares and bonds), what's the rationale behind?

- Is there political will to prioritize capital market growth over short-term revenue gains through CGT reforms?
- What considerations were taken into account regarding the absence of a holding period requirement in the current capital gains tax framework for shares and bonds? What are your views on the potential implications of this?
- What were the reasons for not differentiating between listed and non-listed securities on the Ethiopian Securities Exchange for CGT purposes? Do you see any potential benefits or drawbacks to such a distinction?
- Could you explain the policy decisions regarding the absence of a minimum threshold exclusion for CGT on shares and bonds? What are the potential impacts on small investors?
- How does the MoF view the current CGT regime's role in the development of the Ethiopian capital market? Are there any planned reforms or changes to this regime in the near future?
- Does Ethiopia have put in place a taxation policy framework for the capital markets development in Ethiopia? Is there any intention to this direction?

II. For the Ministry of Revenues:

- From the totally collected CGT revenue, how much percent is from CGT on transfer of shares and bonds?
- How does the Ministry understand the term corporate bonds for the purpose of administering CGT? Does it mean the same as debentures? If they are different, what is the difference regarding taxation?
- What are the common issues or areas of non-compliance observed by the Ministry regarding CGT on shares and bonds?
- What are the Ministry's views on the potential administrative implications of introducing holding period requirements, listed/non-listed distinctions, minimum threshold exclusions, or inflation adjustments to the CGT on shares and bonds?
- What kind of deduction do you take into consideration in the computation of CGT? Do you make inflation adjustments? Is there loss carry forward? What should a taxpayer fulfill to benefit from deduction?
- Do you impose CGT where transfer of the capital asset is made from the deceased person to his beneficiary or husband and wife as part of a divorce settlement? Is there a CGT

collection where there is corporate reorganization? Is there a payment of CGT where the company repurchases its share? When do you grant roll-over relief?

- In your experience, what are the reasons for the shareholders to transfer their shares?

III. For the Ethiopian Capital Markets Authority:

- What is the ECMA's perspective on the current CGT regime's impact on the development and growth of the Ethiopian capital market, particularly concerning the transfer of shares and bonds?
- Do you believe the current higher tax rate on capital gains acts as a disincentive for trading and investment in the Ethiopian capital market?
- How would the introduction of a holding period requirement for CGT on shares and bonds potentially affect trading volumes and investor behavior in the Ethiopian market?
- What are your views on differentiating CGT treatment for listed versus non-listed securities as the Ethiopian Securities Exchange becomes operational?
- What role does the Ethiopian Capital Markets Authority envision playing in shaping future reforms to the capital gains tax regime to foster a thriving capital market?
- Does Ethiopia have put in place a taxation policy framework for the capital markets development in Ethiopia? Is there any intention to this direction?

IV. For the Ethiopian Securities Exchange:

- How does the ESX anticipate the current CGT regime affecting trading activity and liquidity on the exchange, particularly for shares and bonds? Do you foresee any challenges related to the current CGT rules for investors trading listed securities on the exchange?
- From the exchange's perspective, what would be the potential impact of introducing different CGT rules for securities listed on the exchange versus those traded over-the-counter?
- What ambiguities or inconsistencies in the current CGT framework for shares/bonds have been identified by market participants? How does the lack of clarity in CGT provisions affect investor confidence in Ethiopia's capital market?
- What recommendations would the ESX make to policymakers regarding the CGT regime to promote a vibrant and efficient securities market?