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**Debre Berhan University**



**“From the community to the community”**

**LL.M. PROGRAM IN BUSINESS & INVESTMENT LAW**

**COLLEGE OF LAW**

**A Critical Analysis of Business Income Taxation of  
Electronic Commerce in Ethiopia in Light of the OECD  
Taxation Framework Conditions**

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**A Critical analysis of business income Taxation of Electronic Commerce in Ethiopia in  
Light of the OECD Taxation Framework Conditions'**

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## **I. Declaration**

I, Yared Addis Zeleke, do hereby declare that the thesis “A Critical analysis on business income Taxation of Electronic Commerce in Ethiopia in Light of the OECD Taxation Framework Conditions” is my original work and that it has not been submitted for any degree or examination in any other University where other peoples work has been used, these has been properly acknowledged.

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This thesis has been submitted for examination with my approval as advisor

External advisor

internal advisor

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Date

## **II. Acknowledgment**

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Yared Addis

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### **III. Acronym**

Art. - Article

ATM- Automated Teller Machine

B2B- Business-to-Business

B2C- Business-to-Consumers

B2G- Business-to-Government

C2C- Consumer-to-Consumer

CFA- Committee on Fiscal Affairs

E-commerce - Electronic Commerce

EDI- Electronic Data Interchange

ERCA- Ethiopian Revenues and Customs Authority

EU- European Union

OECD- Organization for Economic Co-operation and Development

PE- Permanent Establishment

TAG- Technical Assistance Group

UN- United Nations

UNCITRAL- United Nations Commission on International Trade Law

UNCTAD- United Nations Conference on Trade and Development

US- United States

VAT- Value Added Tax

WTO- World Trade Organization

## IV.

## V.

*The digital economy has over the past years developed at a dramatic pace, generating substantial revenues for entities and individuals trading on this platform. Along with it, there are a bundle of conceptual and theoretical issues. One of such issue is the taxation of e-commerce. As far as tax is concerned, debate into whether and how such activity can be taxed has attracted the attention of many scholars, policy makers and other interested bodies. In Ethiopia, very little research has been done so far. This study analyses how the current business income taxation framework of Ethiopia interlinks with global tax principles and whether the laws enacted to tax the traditional way of trading is easily applied to e-commerce business income tax or not. The thing here is that the conventional tax principles, laws, institutions dwell on the principle of physical locations i.e. principles of territoriality or geographical attachment. On the other hand, e-commerce can be undertaken in a virtual space where the principles related to physical location and territoriality have no or little value. In Ethiopia, e-commerce being backed by different government policies and strategies is growing and the government recently enacted electronic commerce transaction proclamation. Sources on the area indicate that e-commerce is growing with 31% per year with a capacity of generating huge money significant for tax. However, whether the legal and institutional framework related to tax applies in the context of e-commerce has not been adequately studied. The purpose of this thesis is to identify and examine the challenges of business income taxation of e-commerce in Ethiopia in light of OECD. As far as the methodology is concerned, the research adopts qualitative legal research methods. Accordingly, analysis of Ethiopian income tax, administration Laws, relevant literature, and analysis of the laws in light of OECD has been done. Primary data was also collected through interviews with purposively selected experts from INSA, ERCA, MOT, Ethio-telecom MCIT, and academician. The paper has revealed that there is no clear and comprehensive legal framework that adequately and meaningfully addresses the issues of taxation of e-commerce. There is also a lack of readiness on the side of the tax administrator (lack of awareness, lack of skilled human power, and lack of necessary technological platform, for example) to properly administer taxation of e-commerce. This study argues that as e-commerce and the potential revenue are growing the tax treatment of e-commerce will be an issue to worry about. The study recommends that the government should strengthen the ongoing tax reform focusing on the amendment of existing tax policy and laws, and strengthen and modernize the institutional framework from an e-commerce viewpoint. In this regard, the government needs to take OECD's and other advanced experience.*



## **Chapter one: General Introduction**

### **1.1. Background of the Study**

The advancement and development in the sector of Information Communication Technology (ICT) has opened up a lot of opportunities for countries and individuals. Today, ICT provides the cheapest means of conducting commercial transactions via the Internet. One development in this aspect which involves buying and selling of goods and services through the Internet otherwise called electronic commerce (e-commerce), is rapidly growing around the globe.

Commerce in its traditional definition up until the late 1990s has been based on the 'physical mode' of operation whereby customers used to conduct trade by means of visiting the physical establishments where transactions of placing their orders, receiving the goods and paying for them took place.<sup>1</sup> The milestone changes to the 'brick-and-mortar' way of transacting have occurred in the late 1990s with the development of the internet and its further wide-ranging and far-reaching expansion across the globe which resulted in the development of Electronic Commerce (E-commerce) impacting individuals, business entities and national economies.<sup>2</sup> This event immediately marked the beginning of the age of electronic commerce.

E-commerce is simply defined as commercial transactions of service in an electronic format. It can be also defined as the process of buying and selling or exchange of products, services and information via a computer network including the internet.<sup>3</sup> The market category of e-commerce includes B2B (Business-to-Business), B2C (Business-to-Consumer), B2G (Business-to-Government) and sometimes G2C- (Government to citizen).<sup>4</sup>

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<sup>1</sup>YuliaVladimirE-commerce in the Modern World-Electronic Transactions and Some Challenges and Perspectives: Comparative Analysis, of UK, Egypt and South African Legislation p 8,university of liverpool

<sup>2</sup> B H. Malkawi, 'E-commerce in Light of International Trade Agreements: The WTO and the United states-Jordan Free Agreement', (Summer 2007), International Journal of Law and Information Technology

<sup>3</sup>Dr. P Ashokkumar, ' E-Commerce law and its legal Aspects'(January 2018) 4 International Journal of Law, 72-74

<sup>4</sup>Michael Geist, 'A guide to global e-commerce law' <<https://www.itu.int/ITU-T/special-projects/ip-policy/final/Attach04.doc>> , accessed 15th may 2020

E-commerce had introduced the world with a new mechanism of commerce which is faster and easier.<sup>5</sup>Electronic commerce has the potential to be one of the great economic developments of the 21st Century.<sup>6</sup>Electronic trade allows consumers purchasing faster, reaching more goods and services without borders and buying with no physical movements. It also provides selling faster, reaching more customers and having less administrative costs.The economic distance between producers and consumers will shrink, traditional intermediaries will be replaced in many instances, new products and markets will be created, and new and far closer relationships will be forged between businesses and consumers and between the different parts of global enterprises.Due to these fundamental changes new challenges will arise in areas such as the legal recognition and enforcement of electronic contracts, protection of consumers, and protection of personal data, prevention and prosecution of cybercrimes, proper collection of taxes due on cross border electronic transactions as well as protection of intellectual property rights. These changes require a reassessment both of the effectiveness of government policies towards commerce and of traditional commercial practices and procedures, most of which were formed with a much different image of commerce in mind.

The taxation aspect especially the business income tax regime of ecommerce is the concern of this thesis. E-commerce may have several challenges to the taxation system of any country. However, the scope of this paper is limited to assessing the challenges in relation to taxation of business income in case of e-commerce in Ethiopia.

The first basic issue is whether or not e-commerce should be taxed or not. There are different views raised on whether e-commerce should be taxed or not. The basic reason raised against taxation of e-commerce is that because it will discourage the growth of e-commerce. According to this view taxing e-transaction would discourage innovation.<sup>7</sup>But there are reasons raised for that e-commerce businesses should be taxed like any other businesses.<sup>8</sup> Firstly, e-commerce has now become the order of today's world and many transactions are done via e-commerce in this

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<sup>5</sup> Mary Low, Lise LewenigatuKabasunakatuba, Umesh Sharma , The Challenges to taxing e-commerce: A Comparative Analysis for the Pacific,p.3.

<sup>6</sup> A Report by the Committee on Fiscal Affairs, as presented to Ministers at the OECD Ministerial Conference, "A Borderless World: Realising the Potential of Electronic Commerce" on 8 October 1998 p 3

<sup>7</sup> Supra note at 5

<sup>8</sup> ibid

case, it will leave the government without revenue, if it goes taxed. So it should be regulated by the law and should be taxed to increase government revenue and to contribute for the economic growth. As tax comprises of main source of government revenue, the law and the institutional arrangements should accommodate the regulation of digital business taxation.

Secondly, there is a need to treat traditional businesses and internet based transactions impartially and this is one of the principles of international taxation, neutrality.<sup>9</sup> This reason has a lot to do with competition businesses undertaken in traditional way and though e-commerce. After all, e-commerce is not a new business but it is way of doing business.<sup>10</sup>

Apart from to tax or not to tax question, the application of tax principles and laws and the enforcements in relation to administration is also another concern on taxation of e-commerce. So taxation should be done according to what is prescribed under the law.

The issue has attracted the attention of international organizations such as the OECD, the Financial Action Task Force, and the United Nations Conference on Trade and Development (UNCTAD) as well as at the national levels in the respective jurisdictions. The OECD, with its long and successful history of developing practical solutions to international tax issues, reacted quickly and by 1998 had agreed the Ottawa Taxation Framework Conditions.<sup>11</sup>

The OECD guidelines of the Ottawa taxation framework condition are not binding on any country, but serve two central purposes acting as a regulatory scheme which governments may use as a model in their creation and implementation of laws regarding e-commerce.<sup>12</sup> Many countries have developed this taxation framework conditions through internalization to their law.<sup>13</sup>

In the Ethiopian case as well, the Ministry of Communication and Information Technology, has recently enacted a law to govern electronic commerce,<sup>14</sup> and several other compartmentalized

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<sup>9</sup>Supra note at 1

<sup>10</sup> ibid

<sup>11</sup>Implementation of Ottawa taxation framework conditions the 2003 report p3

<sup>12</sup>Ferrette CP (2000) 4

<sup>13</sup> Supra note at 11

<sup>14</sup><<https://www.2merkato.com/news/business-proclamations-and-regulations/893-ethiopia-working-on-e-commerce-law>> accessed 11th May 2020



pieces of legislations are enacted that have relevance to the e-commerce.<sup>15</sup> The ICT sector is the least developed one in the country, despite the fact that e-commerce business is going rapidly in the world.<sup>16</sup> It is difficult to say that the Ethiopian tax laws were written taking into account the digital transaction.<sup>17</sup> The laws were written with the focus traditional ways doing business physically.

The question, therefore arises whether the Ethiopian tax laws on their current form provides for the imposition of business income tax on digitalized products and whether the law is consistent with the principles formulated by OECD and other countries taxing the digital economy.

Even though, there is a recent move by the Ethiopian government to enact an e-transaction law, the proclamation has neglected the most important aspects of e-commerce i.e. taxation. E-commerce, which itself represents a new business model, creates challenges to the tax systems of different countries. Given taxes are national, several taxation issues related to the physical or geographical location of a person, a company, or transaction will be raised.

Tax jurisdictions are very much dependent on territorial nexus principles.<sup>18</sup> The internet has no location and this makes the application of source and residence principle difficult. This makes the application of permanent establishment principle difficult. In assuming taxation jurisdictions the nexus of income of a business to the territory of a country is measured by the principle of permanent establishment. However, with the emergence of e-commerce finding such presence within a country is tenuous at best since there are no business offices in existence anywhere.<sup>19</sup> The question therefore, arises whether the Ethiopian tax laws on their current form provides for the imposition of business income tax on digitalized products and whether the law is consistent with the principles formulated by OECD and other experienced countries. In short,

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<sup>15</sup>See Electronic Signature Proclamation, 2018, Proc No. 1072, Fed Neg Gaz., Year 24, No. 25, National Payment system proclamation, 2011, Proc No 718, Fed Neg Gaz., Year 17 No. 84, Freedom of the Mass Media and Access to Information Proclamation, 2008, Proc 590, Fed Neg Gaz. Year 14 No 64, Computer Crime Proclamation, 2018, Proc No.958, Fed Neg Gaz. Year 22 No. 83, Ethiopian Commodity Exchange Proclamation, 2007, Proc No. 550, Fed Neg Gaz., year 1, No. 6

<sup>16</sup>[www.abysinialaw.com](http://www.abysinialaw.com) Legal Aspects of Electronic Commerce: The Case in Ethiopia

<sup>17</sup> ibid

<sup>18</sup>SubhajtBasu, 'International Taxation of E-Commerce: Persistent Problems and Possible Developments,' Journal of Information, Law and Technology, 2008, at p.8.[Here in after, Basu, International Taxation of ECommerce: Persistent Problems and Possible Developments]

<sup>19</sup> ibid

as taxes are the main source of government revenue, business income taxation of e-commerce would be a critical component of Ethiopia's tax system that should be studied including legal and institutional frameworks in light of better standards and guidelines. Besides, assessing the challenges posed in the taxation of the business income of the digital transaction needs discussion. This makes the business income taxation of e-commerce in Ethiopia a primary concern of this paper. To narrow the scope, this study aims to analyze the challenges of business income taxation of e-commerce in light of the OECD guidelines.

## **1.2. Statement of the problem**

As stated in the introductory part, the development of electronic commerce is a recent phenomenon in the world. In Ethiopia the introduction of e-commerce is a very young occurrence having a few years of history.

The century we are living in is the age of information and communication technology. Several studies have confirmed that the use of electronic communications improves the efficiency of commercial activities, enhances trade connections and allows new access opportunities for previously remote parties and markets, and thus play a fundamental role in promoting trade and economic development, both domestically and internationally.<sup>20</sup> The digital economy has over the past years developed at a dramatic pace, generating substantial revenues for entities and individuals trading on this platform in Ethiopia and the world. As the digital economy continues to grow, mainstream businesses are starting to move their transactions online, while e-commerce specialists, such as, Google, Facebook and Alibaba, and continue to thrive. The shift from a physically oriented commercial environment to a knowledge-based electronic environment poses serious and substantial legal issues such as taxation and taxation regimes. The recent situational analysis on e-commerce in Ethiopia conducted by the MCIT indicated that e-commerce generates 60 million USD per year and is growing with 0.03 rates per year.<sup>21</sup> This clearly shows the promising growth of E-commerce. Besides, the report of the NBE demonstrated that tax is

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<sup>20</sup>United Nations Convention on the Use of Electronic Communications in Contracts <<http://www.uncitral.org/pdf/english/texts/elect com/06-57452-ebook.pdf> > accessed 15th May 2019 , preamble

<sup>21</sup> UNCTAD, Information Economy Report 2015: Unlock the Potential of E-Commerce for Developing Countries, New York and Geneva, Sales No. E.15. II.D.1, 2015,

the largest source of government revenue in the country. Therefore, it is inevitable to have a legal framework that could address the issues revolves around e-commerce. The electronic signature law of Ethiopia, for instance, as part of the e-commerce law in its preamble provides that, it has become necessary to create a conducive legal framework to promote electronic commerce and electronic services in the country,<sup>22</sup>and it has become necessary to provide legal recognition to the exchange of electronic messages and determine the rights and obligations of participating parties.<sup>23</sup>

As a part of legal development, the Ethiopian government comes up with a draft e-commerce law and policy that for the first time deals with the operation of electronic commerce in 2018. This has been enacted as Electronic transaction proclamation No. 1205/ 2020 recently.

Thus, due to the promising growth of e-commerce in Ethiopia, the government should tax electronic commerce to raise revenue to sustain government expenditure especially in the face of shrinking traditional tax bases.

As I discussed in the background part, the current tax systems were designed to operate in a (more) physical environment and are established before the introduction of ecommerce. This leads to a question on whether they accommodate ecommerce transactions or not and whether they are compatible with taxation framework conditions developed by OECD, which is advanced.E-Commerce would present challenge to the taxing regimes of nations.<sup>24</sup>Tax administrations throughout the world face the formidable task of protecting their revenue base without hindering either the development of new technologies or the involvement of the business community in the evolving and growing e-marketplace.<sup>25</sup>Thus, the application of the business income tax of Ethiopia in e-commerce requires proper attention and regulation by the authority.

There are several issues that could be raised as an issue when the traditional tax rules are applied to e-commerce.The first concern stems from the fundamental principles of tax. It is key that tax

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<sup>22</sup>Electronic Signature Proclamation (n 5), preamble, first paragraph

<sup>23</sup>ibid, preamble second paragraph

<sup>24</sup>Lymer A 'Taxation in an Electronic World: the international debate and a role for tax research' (2000) 3 ATAX Discussion Paper Series 2

<sup>25</sup> ibid

should adhere to the doctrine of neutrality and equity. These principles advocate that equal tax should be applicable to the business alike regardless of the way of doing it and tax should not be a mechanism of creating unfairness. Thus, to maintain the neutrality and equity of tax, the OECD asserts that E-commerce should be subject to existing taxes to the same extent as conventional commerce. Thus, if the issues in the taxation of e-commerce are not well addressed, this will, in turn, make the country to be a tax haven. Indeed, several areas of particular concern could be raised as an issue when the traditional income tax rules are applied to e-commerce.

The first main issue is the anonymity of the internet increases the challenges of tax authorities to identify the parties to the transaction but the identity of the parties is basic in the traditional business. The current tax systems were designed to operate more in a physical environment in which most transactions are documented in writing at the place where the transaction occurs or where taxable income arises.<sup>26</sup> One of the biggest challenges that e-commerce presents to tax regimes is that it leads to disintermediation, or the elimination of intermediaries or middlemen who are critical for identifying taxpayers in business transactions.<sup>27</sup> But it is difficult when we come to the digital transaction because these transactions have a distinct character since it is carried out without papers and pens, offices, warehouses and even without employees.

So, internet will create challenges for the Ethiopian taxing authority to verify the details of transactions and the income generated from the trading activity, this could lead to a tax loss to the government.

The other main issue with digital transactions under Ethiopian income tax law is related to permanent establishment. 'Permanent establishment' is a key tax concept because, under most tax treaties, a business must be determined to have a permanent establishment presence in a country before that country can attempt to tax the profits of the business.<sup>28</sup> Digital transaction involves non-physical elements and is carried out electronically but the Ethiopian law

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<sup>26</sup>ibid

<sup>27</sup> Jones, R. and Basu, S. (2002) 'Taxation of electronic commerce: a developing problem', *International review of law, Computers & technology*, 16(1), pp.35-52..

<sup>28</sup> Chan C W 'Notes on Taxation of Global E-commerce on the Internet: The underlying issues and proposed plans' (2000) 9 *Minnesota Journal of Global Trade* 244

defines the permanent establishment as a fixed place of business through which the business of a person wholly or partly is conducted.<sup>29</sup>The question is whether or not we can establish this permanent establishment in digital transactions or not, and the law does not seem to consider the internet based transaction and seems to exclude place of taxable activities that are mobile. The existence of a PE is a minimum threshold required for a country to tax non-residents business profits derived from sources in that jurisdiction where they are carrying on a business.<sup>30</sup>As such countries exercise a right to tax based on source jurisdiction when the income of nonresidents is earned from sources within their borders. If a nonresident has a permanent establishment in a source country then it becomes subject to taxes of such a source country. According to Article 5 of the OECD Model Convention, there are two general types of PEs: (1) the fixed place of business PE and (2) the agency PE.<sup>31</sup> The relationship between Articles 5(1) and 5(5) shows that a Contracting State obtains taxing rights over a non-resident entity only if that enterprise first has a fixed place of business, either through the management of assets of the non-resident entity located in the Contracting State, or through the acts in the Contracting State of individual employees with the non-resident entity, or a dependent agent, which involves an individual or the company to act on behalf of the non-resident entity in the Contracting State.<sup>32</sup>The Income- tax proclamation of Ethiopia has the scope of application to residents of Ethiopia with respect to their worldwide income and to non-residents with respect to their Ethiopian source income.<sup>33</sup> The PE concept is central element in determining taxation rights under the law<sup>34</sup>, it has been given due emphasis on the research.

The source- based method of taxation places different economic activities into various categories and taxes the income at the place giving rise to the activity, while, on the other hand, residence-

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<sup>29</sup>Federal Income Tax proclamation, 2016, Proc No 979, Fed Neg Gaz., Year 22 No. 104 Art.4{1}

<sup>30</sup>Leonardo F.M. Castro, Problems Involving Permanent Establishments: Overview of Relevant Issues in Today's International Economy, 2, GLOBAL BUS. L. REV (2012) at 129 (July 15, 2020) Available at <https://engagedscholarship.csuohio.edu/gblr/vol2/iss2/3>

<sup>31</sup>See Art 5/1, art 5/5 of the OCED Model Convention

<sup>32</sup>Supra note at.22 p. 130

<sup>33</sup> Ibid at, Art, 7(1)&(2)

<sup>34</sup> OECD (2001), Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions, OECD Publishing, Paris, <https://doi.org/10.1787/9789264189799-en>. P 14

based taxation allows a sovereign to tax its residents on their worldwide income.<sup>35</sup> The concept of residency is grounded in the permanent establishment principle, and residency requirements are usually tied to some geographic or physical presence in the country.<sup>36</sup> The term ‘source’ however, is not defined in the Income Tax proclamation.

Therefore, since, websites does not have specific premises; equipment’s and website information can be moved from one server to another depending on the requirement mostly the internet infrastructure. In this case it is not possible to apply the concept of permanent establishment rule on digital transactions. This allows tax evasion and creates difficulty to determine jurisdiction to levy tax.

The principle of permanent establishment is not the only principle of tax policy that has been called into question as a result of the expansion of the Internet and information communication systems. The principle of tax neutrality has also been put in the hot seat. As the name suggests, the principle denotes that any equitable tax system treat economically similar income equally. If applied in the context of Internet taxes, this will result in several disparities in its application. The principle would thus require that income earned through electronic means be taxed similarly to income earned through more conventional channels of commerce.<sup>37</sup> However, it could be argued that the application of the principle of tax neutrality to Internet transactions would otherwise place e-commerce at a competitive disadvantage relative to other modes of commerce, defeating one of the purposes of an equitable tax system.<sup>38</sup>

But the tax system should be designed to accommodate the digital economy. The law and the institutional framework should be designed in a way to tax the digital economy that can protect tax evasion, avoidance or tax planning. An analysis of how the income generated from ecommerce should be taxed therefore seems to call into question the applicability of existing tax principles and the tax system at large.

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<sup>35</sup>Choudhary V ‘Electronic Commerce and Principle of Permanent Establishment Under International Tax Law’ (2011) 4 International Tax Journal 35.

<sup>36</sup> Chan CW ‘Taxation of global E-commerce on the Internet: The Underlying Issues And Proposed Plans’ (2000) 9 Minnesota Journal of Global Trade 233 255.

<sup>37</sup>Ibid at 244.

<sup>38</sup> ibid.

The other central issue in the realm of taxation of e-commerce is concerned with the characterization of income. Characterization of income has a paramount importance in relation to conflict of jurisdiction for the power to tax based on the nature or type of income. Moreover, the characterization of income has also a lot to do with the characterization of the e-commerce transaction especially in relation to good vs. service vs. intangible distinctions. Basu explained characterization of income will have two problems. Firstly, different countries may impose different taxes on the same electronic transaction in that way affects the decision where to establish because of tax incentives. Secondly, the difference tax ascribed to the same product purchased by conventional and e-commerce means will result in inequitable treatment.

The other thing e-commerce poses a challenge in the realm of taxation is the jurisdictional issue. At the risk of stating the obvious, tax is truly jurisdictional. So far, there are two principles used to establish nexus between the tax payers or the income and taxing country. These principles are known as the source and residence principle. Countries according to the residence principle will assume tax jurisdiction to the residents of their countries. However, viewing this in the context of e-commerce, the principle of residence is challenged as it demands some physical facility. And, in e-commerce, the location of the business venture usually is on the internet. And as far as source rule is concerned, source rule is based on the presumed existence of nexus between the income and the country. This is problematic, however, in that geographical presence or physical location has no or limited, if any, place in the eyes of e-commerce and this is because e-commerce business is conducted in virtual space where physical or geographical locations has nothing to help to undertake the business.

Furthermore, digital tax administration and enforcement in business income taxation is another dilemma in realizing the digital economy taxation.

Hence, even though businesses in Ethiopia are evolving to digital one, as this thesis will seek to demonstrate, the law does not address the issues adequately and requires further regulation. And this thesis believes the relevance of discussing on how the Ethiopian business income tax laws interlink with tax principles and model laws developed by OECD. It will put the business community engaged with the traditional commerce at disadvantage position and creates unfair advantages for digital firms businesses. This is because competition presupposes treating equally all businesses. Tax is one of the tools to level the playing field and if e-commerce is not taxed, it

obviously will put these businesses at better advantage to attract consumers in terms of price and other things. Thus, in order to make equal footing, taxation of electronic commerce is a must.

Digital transaction also creates opportunities and incentives for businesses to avoid tax under the current international taxation regime. Different literatures state that digital commerce as incompatible with the current international tax regime and create opportunities for tax evasion.

With no easy solution in sight to the e-commerce tax dilemma, the area of tax administration continues to be a haven for uncertainty.

Thus, this nature of digital transaction explodes different issues which also pursues the administrative readiness and the necessary technological platform and generally the challenges of taxation of e-commerce in Ethiopia. Therefore, the legal and institutional gap in this regard has to be identified by inquiring the theoretical, legal and institutional framework of taxation of businesses incomes of the digital transactions in general. Therefore, suitable legal atmosphere would be created for the issue in the Ethiopian setup.

### **1.3. The Objective of the study**

#### **1.3.1. Main objective**

The main objective of this study is to critically analyze the legal and institutional framework for business taxation of Electronic Commerce in Ethiopia in light of the OECD taxation framework conditions.

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

This study specifically intends to;

- To explore the development and regulation of e-commerce transaction in the Ethiopia economy
- To analyze the business income tax laws on Taxation of Electronic Commerce in Ethiopia in Light of the OECD guideline for taxation of digital transactions.
- To assess the challenges faced by the federal tax authority in enforcing business Taxation of Electronic Commerce in Ethiopia.



- To provide recommendations so as to improving the Taxation of Electronic Commerce in Ethiopia.

#### **1.4. Scope of the study**

This work is focuses on only taxation relating to thebusiness income of e-commerce in the Ethiopian economy and the work is restricted to assess its legal aspect. So as to make the study manageable and comprehensively address the issues by the time, it focuses mainly on assessment of contemporary challenges faced bythe ministry of revenue at federal level.

#### **1.5. Research questions**

##### **1.5.1. Main question**

Is the existing legal system in Ethiopia relating to business income tax applicable to e-commerce transactions? Is it compatible with the OECD taxation framework conditions?

##### **1.5.2. Specific Questions**

Is Ethiopian business tax law adequate to tax e-commerce transactions?What are the issues in business income taxation of e-commerce?

What challenges are encountered in the enforcement of business tax law in Ethiopia relating to ecommerce transactions? Is there any administrative and institutional readiness to tax e-commerce in Ethiopia?

Does Ethiopian business tax law adhere to basic rules of OECD guide line relating to taxing the electronic commerce?

What reform measures need to be taken by the different stake holders of the sector so as to curb the challenges to tax e-commerce in Ethiopia in light of OECD taxation framework conditions

#### **1.6. Significance of the study**

This research makes a good contribution to the business taxation implications of theelectronic commerce framework in Ethiopia. And this research also attracts further interest for researches because very little research has been done in this area, especially in Ethiopia. And this study is one of the original works in the Ethiopian context. So it will extend the knowledge base in the

field of taxation of e-commerce to tax authorities, officers and academicians in that it would help new researchers to do further study on the area. And also the outcome will be much useful to legislative and policymakers as it will enable them to see the importance of revisiting and possible amendments in line with the result of the study.

### **1.7. Research Methods**

The research approach for this research is qualitative legal research. This approach is selected because the objectives and the research questions require deep understanding and rigorous legal reasoning. Hence beyond analysis of black letters of law, the research has empirical nature so as to see the institutional practice and policy enforcement. The study has used both primary and secondary data analysis and interpretation of pertinent laws governing the issue are used as primary source together with unstructured interview with properly selected scholars and government officials from the ministry of revenue and security agency.

The study focuses on the conceptual, legal framework, and practice of ecommerce taxation of business income in Ethiopia at the federal level, if any. In doing so, the researcher tried to interpret the data in legal reasoning.

In terms of data sources, both primary and secondary data are employed as a source of information to the various issues involved in this thesis. The laws on e-commerce taxation and interviews are used as primary data. In addition, academic literature in the form of published journal articles, chapters in edited collections, and books will also be consulted.

### **1.8. Limitation of the study**

The main constraint is the outbreak of COVID 19 which hindered me from finding different sources that could make the research more important. The other limitation is lack of local text books and published articles on the subject under the study. Especially on the case of Ethiopia, it was hardly possible to find a study in this area and hence there was no choice other than relying on the foreign materials that are available on.

### **1.9. Literature review**

There is fairly large amount of literature on taxation of digital transaction that has been written so far but I got limited amount of literatures made specifically on business income taxation on internet commerce. Most of the literatures are written at the early stage of E-commerce, and aimed at introducing and recognition, enforcement of internet contracts and finally the taxation

issues in e-commerce. The other part of the literatures revolves around the debate to tax electronic commerce and the adequacy of current tax regimes and principles for taxation of the matter. There had been also different studies by some international organization such as the OECD to develop taxation framework and to give model laws.

Among the studies by international organizations OECD/G20 Base Erosion and Profit Shifting Project Addressing the Tax Challenges of the Digital Economy ACTION 1: 2014 is one I have assessed. The chapter discusses the background leading to the adoption of the BEPS Action Plan, including the work to address the tax challenges of the digital economy. It then summarizes the work of the Task Force on the Digital Economy leading to the production of the report. Finally, it provides an overview of the contents of the report and raises issues revolve around base erosion and profit shifting and gives solution to the problem it raised. The work concludes that the issue is not simply sovereign in its nature rather it needs an international solution.

Coming to Ethiopia, the first research I have assessed is LLM dissertation done by andualemtemesgen. The study was intended to assess how the current VAT system of Ethiopia is applicable on e-commerce transactions. The study analyzes the prospects and weaknesses of the existing VAT law in taxation of e-commerce. In doing so the research discusses concept and development of e-commerce, but since the concern of the thesis is only on VAT it lacks to discuss on other types of taxes, such as business income taxation.

The other domestic research made on digital taxation in Ethiopia is the research conducted by BelaynewAsrie conducted on the year 2012.

This research tried to identify the main opportunities and challenges created around the development of digital transaction and suggest suitable strategies to promote e-commerce. But, since the research is not a legal one, it does not deal with the taxation and other interrelated issues.

Therefore, no literature is available as far business income taxation of e-commerce in Ethiopia is concerned. Accordingly, this research having the purpose of identifying and examining the laws and institution's capacity for implementation of laws of business income taxation of digital transactions in Ethiopia and assessing whether the current taxation system accommodate the taxation of digital transaction it fills the literature gap in the area.

## **2. Organization of the Study**

This study comprises of three chapters. The first part is devoted to the overview of the study. In this part the introduction part of the study, statement of the problem, the significance of the study, research question, methodology of the study, limitation of the research and scope of the study.

The second part of the study focused on Ecommerce, E-commerce Taxation and the OECD Taxation Framework Conditions. Part three of the research had deals about Business income Taxation of electronic commerce in Ethiopia in light of the OECD taxation framework conditions; issues and challenges. At last the research ends up with possible conclusions and recommendations.

## **Chapter Two: E-commerce, Taxation and the OECD Taxation Framework Conditions**

### **2.1. The concept and nature of e-commerce**

The transformation of the global economy from an industrial focus to one based on knowledge and information presents numerous opportunities and challenges to many countries, especially those in the developing world. The Internet has played an instrumental role in this regard. So, it is the innovation of internet technology that marks the beginning of e-commerce.

E-commerce has had phenomenal growth, creating a worldwide network of virtual economies and trading systems. However, there are no single, agreed and standard definitions for e-commerce. Fundamentally, it can be said to be conventional business traded through virtual space. So e-commerce can be said that it is a transaction opposite to traditional transactions. This commerce is made electronic since the transaction is carried out with the presence of the internet. Most definitions provided by different scholars and organizations focus on the electronic nature of the transactions.

While e-commerce has been defined in various ways, one of the widely accepted definitions is by the Organization for Economic Corporation and Development (OECD), which defines e-commerce as ‘the sale or purchase of goods or services, conducted over computer networks by methods specifically designed for the purpose of receiving or placing of orders’.<sup>39</sup> Under this definition, ‘the goods or services are ordered electronically, but the payment and the ultimate delivery of the goods or services do not have to be conducted online.

The goods and services are ordered over those networks, but the payment and the delivery of goods or services may be conducted on or offline. Therefore this definition revolves on the application of technology on commercial transactions.

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<sup>39</sup>Organization for Economic Corporation and Development. Electronic and Mobile Commerce, OECD Digital Economy Papers, No. 228, 2013, Paris: OECD Publishing, Paris. <http://dx.doi.org/10.1787/5k437p2gwxw6g-en>,

The WTO defined e-commerce activities as those involving goods and services crossing borders electronically, especially the sale or purchase of goods or services conducted over the internet or other computer networks. But this definition excludes domestic e-commerce transactions.

On the other hand UN defines e-commerce as a commercial activity conducted through an exchange of information generated, stored, or communicated by electronic, optical or analogous means. Therefore according to the above definition the distinction between traditional and electronic commerce is the involvement of electronic means in the e-commerce.

When we come to Ethiopia, The scope of e-commerce law in Ethiopia shall be seen in line with the Commercial Code article 5 and the Commercial registration and business licensing proclamation of 980/2016. All the listed acts of commerce in the Code can be of susceptible to e-commerce and demand the application of e-commerce law. The electronic transaction proclamation defined e-commerce as transaction of goods and services through the internet or other information networks.<sup>40</sup> This definition made a distinction between the e-commerce and the traditional one only based on the medium of transaction. Commonly, e-commerce transactions can be further classified into various categories based upon the entities involved in a transaction.

The first one is business to business transaction, this is business between two business entities most of e-commerce is B2B types and it greatly occupies more than 80 percent.<sup>41</sup>

The second one is business to consumers; it involves marketing and selling to individual consumer. Consumers usually buy tangible products like books and intangible products like software and music.

The third one is a transaction between individuals or consumers, which is commonly called consumer to a consumer transaction. The most notable platform in this regard is e-Bay. The other one is business to government transaction. This category involves public sector companies and government. Another broad classification is they can be divided as domestic and cross-border.

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<sup>40</sup> Article electronic transaction Procl.1205/2020

<sup>41</sup> Zorayda A., E-commerce and E-business, 2003, P. 9,

## **2.2. Evolution of e-commerce**

Although the general public has become familiar with e-commerce only in the last decade or so, e-commerce has actually been around for over 42 years.<sup>42</sup> E-commerce was made possible by the development of electronic data interchange (EDI) in the 1960s for the exchange of business documents from one computer to another in a standard format.<sup>43</sup> This first generation of e-commerce, or EDI, allowed companies to securely and efficiently exchange information, place orders, and conduct electronic funds transfer through computers.<sup>44</sup> As the e-commerce market for providing services over the internet continues to grow, a number of online companies have emerged to serve the growing needs of internet users. They include Dell, Amazon, Yahoo, Baidu, Sina and Ebay amongst others. The total value of global e-commerce transactions, both domestic and cross-border, was US\$ 25 trillion in 2015, up 56 per cent from US\$ 16 trillion in 2013 (UNCTAD, 2017). Current estimates indicate that global e-commerce sales grew 13% in 2017, totaling around 29 trillion dollars. The number of online shoppers has registered a similar increase with the share of those buying from abroad rising from 15% in 2015 to 21% in 2017.<sup>45</sup>

## **2.3. E-commerce in Ethiopia**

It is recently that the e-commerce practice in Ethiopia is experiencing an increasing trend. And it has many aspects the platform in which e-commerce is done, the delivery system and the payment system.<sup>46</sup> According to my respondent e-commerce do have those three platforms. And in Ethiopia there exists informal and formal way.<sup>47</sup> For example, covid-19 has also put the spotlight on the e-commerce sector into the urban mainstream where small and big shops ranging from Hotels to small shops are now setting up shop on social media pages, telegram channels, and e-commerce sites at an accelerated pace.<sup>48</sup> Taking advantage of the unique value proposition

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<sup>42</sup>Tian & Stewart, 2008, this book was written in 2008 and it said that it was 30 years so as of 2021 it will be 42 years.

<sup>43</sup> ibid

<sup>44</sup> ibid

<sup>45</sup> Remarks by DG Azevêdo, Director-General World Trade Organization. Entire speech Available at [https://www.wto.org/english/news\\_e/spra\\_e/spra260\\_e.htm](https://www.wto.org/english/news_e/spra_e/spra260_e.htm)

<sup>46</sup> Interview made to Dr. Abiyot Bayou, digital transformation program office main director at INSA, on the question how do you evaluate the electronic commerce practice in Ethiopia

<sup>47</sup> ibid

<sup>48</sup> ibid

e-commerce offers to maintain social distancing, a flurry of new start-up's in the e-commerce space that aims to disrupt the market are popping up while those who have been around for a while are aggressively expanding all with the aim of making the shopping experience of urban dwellers online. After COVID 19, suddenly buying good and service online and paying your bills via your devices is not a luxury any more. The prime minister office has sent a message to concerned organs to work for expansion of digital economy especially, e-commerce.<sup>49</sup> In addition last year, in November the Director of the Trade Registration & Licensing Office said 'any company can use modern technology such as giving online delivery services to widen their source of income. NBE also working on another directive called "Payment System Operator" that will regulate Payment Aggregators, online payment processors, non-ban Payment instrument Issuers directives that allows to open the mobile money and finch space for non-banks and MFIs is issued now automated teller machines (ATM), payment switch operators, PoS Operators, m-PoS operators.<sup>50</sup>

Most companies, associations, individuals, organizations in Ethiopia have set up websites which provides information about the organizations and their products. In my observation Majority of the platforms are Business to Consumer E-commerce sites while a few of them also serve Businesses along the side. For example, Addis delivery, Zmall, asbeza, dibulo, hello market addismercato, dh Africa e-shop, mercato online burndo, qefiramobile banking, CBE birr, you tube, e-filing etc. are some of the typical instances of transaction of ecommerce existed in Ethiopia.<sup>51</sup> These platforms deliver goods and services, but there are only few sites where financial transactions are completed. As reports show, the main reasons for low e-commerce transactions are due to the absence of legal framework for completing an electronic business or financial payment system, stringent exchange control regulations, low internet usage due to lack of adequate telecom facilities, and over all lack of confidence in the security and reliability of e-commerce transactions<sup>52</sup>. But recently, the ministry of information technology has enacted electronic transaction proclamation named as proclamation number 1205/2020. And there is

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<sup>49</sup> Interview with Dr. Mandefro Eshete, Legal Directorate director of INSA, August 28/2020

<sup>50</sup> *ibid*,

<sup>51</sup> Full information is found on what service they deliver and relevant information about the platform

<sup>52</sup> Interview with Dr. Abiyot Bayu, Digital Transformation Main Manager, INSA, August 26/2020



digital transformation draft strategy of 2025 and to realize this, the ministry of innovation and information technology has started working on 18 months of project as a foundational strategy whose focus is on setting infrastructure development for ecommerce transaction.<sup>53</sup> Ethiopian development strategy plan could also help to the growth of financial development system in the country. In addition to the recent e-commerce transaction proclamation the government has also enacted several compartmentalized pieces of legislations relevant to e-commerce. The National Payment System proclamations, the Electronic Signature proclamations and the Value Added Service directives of Ministry of IT and communications are good examples.

The proclamation number 1205/2020 is established primarily to create more secured legal environment, which facilitates the use of electronic transactions by citizens.<sup>54</sup> And it doesn't deal other issues arises in relation to e-commerce, such as taxation. But as I said earlier, through the drafting process there has been raised to use all in one approach, it is because of jurisdiction issue raised unsolved.<sup>55</sup>

So since, the development of e-commerce is at inevitable through the encouragement made to the sector by the government and the influence of the globalization, the challenge it poses to the taxing regimes should be given due concern. The following discussion is devoted to the discussion of electronic commerce regulation under Ethiopian law

#### **2.4. Regulation of e-commerce in Ethiopia**

#### **2.5. Policy and Strategy Related to E-commerce**

Some of the policies and strategies do have a direct relation to e-commerce and others do have an indirect relationship. Seen from taxation viewpoint, however, all fail in that none of the policies and strategies including the one and the only Draft national e-commerce policy; address the issue of taxation of e-commerce. The draft national e-commerce policy has been recently adopted by the MCIT. It represents the first comprehensive policy on e-commerce in the

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<sup>53</sup> *Supra* note at 49

<sup>54</sup> See the preamble of the proclamation on its first paragraph

<sup>55</sup> *Supra* note at 49

Ethiopian history.<sup>56</sup> Although it is a delayed response to the demands of e-commerce in the country, formulation of the policy is a step forward in its self. The draft policy appreciates the existence of e-commerce platform in the country and the global trends towards e-commerce which Ethiopia should not be an exception.<sup>57</sup> At now, both the government and the private sector have no alternatives other than to move in the direction of e-commerce and adopt the emerging new technologies to modernize their commercial service delivery.

### **2.5.1. Review of the Legal framework on E-commerce**

The obvious legal document that comes in to one's mind in dealing with e-commerce is the civil code. The civil code was enacted in the pre-technological era before the establishment of e-commerce. Thus it is primarily designed to facilitate transaction that is purely paper based. But it doesn't mean that it doesn't have application on e-commerce. And it would not be surprising that issues arise in e-commerce would not be answered by consulting the civil code. And it is not expected the legislature of 1960's to foresee such technological changes including the initiation of e-commerce. But we can see some provisions which could have e-commerce implication. The Civil Code under Art 1792(1) & (2) provides a rule as to contracts made between absent parties stating that, a contract made between absent parties shall be deemed to be made at the place where and time when the acceptance was sent to the offeror and a contract made by telephone shall be deemed to be made at the place where the party was called. The issue will be should we maintain the cited Civil Code provision to e-commerce transactions that could be made over several electronic mediums? The logical conclusion shall be in the affirmative with *mutatis mutandis*, having the necessary changes being made, to each electronic medium of communications.<sup>58</sup> The other issue that should be discussed is whether electronic contracts are recognized under the civil code. As per art.1678 of the civil code, form is one of the essential conditions for the valid existence of a contract as a matter of exception. However; this is true whenever the law prescribes a contract to be made in a certain form. So we can conclude that the civil code can be applied to electronic contracts with the exception of those contracts for whose

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<sup>56</sup> *Ibid*

<sup>57</sup> *Ibid*

<sup>58</sup> Legal Aspects of Electronic Commerce: The Case in Ethiopia p.30 <http://www.abysinnialaw.com>

validity the law has prescribed special form. With the exception of these contracts, as stipulated under art.1719, no special form is required and the choice as to the form is left to the decision of the contracting parties. The other law that should be discussed is commercial code which was enacted in 1960 before the Internet itself came into existence. This shows us the enactment of the law is to govern trading activities that takes place in the physical world. All the listed acts of commerce in the Code can be of susceptible to e-commerce and demand the application of e-commerce law.

The other law that has ecommerce implication is the national payment system is relatively modern in recognizing some aspects of e-commerce. For instance, under art 2(1), it recognizes electronic data,<sup>59</sup> under art.2 (9) it recognizes electronic communication and under art.2 (11), it recognizes for the first time electronic signature. Art.21 especially deals with electronic communication and states that;

“Where any law provides that information or any other matter shall be in writing, such requirement shall be deemed to have been satisfied if such information or matter is rendered or made available in an electronic form and accessible so as to be usable for subsequent reference.”<sup>60</sup>

The first attempt to formulate legal framework on e-commerce goes back to 2010 when the MCIT develops the first draft e-commerce bill. The Draft E-transaction Law of 2014 is the second e-commerce law in the country. This draft was prepared by the MCIT in 2014 and contains only 27 articles.

During the time of writing this research, the proclamation number 1205/2020 is the final efforts of the governments in adopting a law that govern e-commerce law. The proclamation is adopted by the MCIT and is cited as electronic transaction proclamation. It totally contains 4 parts and 46 articles. In the opinion of the researcher, this proclamation is more relevant law which deals with e-commerce at least in covering issues in e-commerce. The proclamation in its definitional part

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<sup>59</sup>National Payment System Proclamation, 2011, Federal NegaritGaetta, Proc.No.718, 17th year, No.84, article 2(1).[herein after, Proc.No.718/2011.]See art.2(1)

<sup>60</sup>Proc.No.718/2011, art. 21(1)

shows that the law addresses issues related to activities conducted over computer networks and includes ecommerce and electronic government services.<sup>61</sup> And during the enactment process, there was an effort to make more comprehensive to follow all in one approach but issue of jurisdiction has been raised and the issues left to specific sectors to settle through directives and regulations. And the government is engaged on advocacy works.<sup>62</sup> Part I comprising of one article deals with the nomenclature of the proclamation and definition of terms. Part II devoted to deal with the legal requirements and outcome, signature, admissibility and evidentiary weight given to electronic messages in general and contains five subsections and it is the broad part of the legislation. It among other things states that the law is only applicable to e-commerce transaction that takes place within the territory of Ethiopia. When we come to taxation, under article 16, in transactions that require a payment if it is made by electronic means it is taken as the requirement under the law is fulfilled and has equal weight with receipts made in writing. So this provision has direct implication to taxation. And it is stated that when a law requires receipt if it can be made in an electronic way and fulfilled all the elements of paper based receipt and is accessible and intelligible it can get legal recognition. So the equal recognition of electronic messages to paper based receipts shows the adherence of neutrality principle in the law.

## **2.6. Taxation of e-commerce in general**

### **2.6.1. The development of e-commerce taxation**

The rapid growth of e-commerce, especially the sale of goods and services over the internet, has fuelled a debate about the taxation regimes to be used. The shift from a physically oriented commercial environment to a knowledge-based electronic environment poses serious and substantial issues in relation to taxation and taxation regimes. Tax administrations throughout the world face the formidable task of protecting their revenue base without hindering either the development of new technologies or the involvement of the business community in the evolving and growing e-market place<sup>63</sup>. Concerns of governments Centre on the impact of e-commerce on

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<sup>61</sup>Article 2{19} of the proclamation

<sup>62</sup>Supra note at 49, he told me that he was the member of the drafting committee.

<sup>63</sup> Mark G. Simkin, (E-mail: simkin@equinox.unr.edu), University of Nevada, Reno Graham W. Bartlett, (E-mail: ecbartlett@aol.com), University of Nevada, Reno J. P. Shim, (E-mail: jshim@cobilan.msstate.edu), Mississippi

the state and local revenue. Many feel that e-commerce transaction should not be tax-free. Others believe that existing tax policies should apply with equal strength to Internet commerce, and that all economic transactions should be taxed the same, regardless of the form, intellectual content, or place of origin. Perhaps the most commonly-cited argument why Internet sales should be taxed is that failing to do so creates unfair advantages for e-commerce firms over main-street businesses. These advantages not only include the benefits that accrue from the ability to sell “cheaper” (i.e., “on-taxed”) products, but also the advantages of simplified record keeping and reporting-hardly tax-neutral policy.<sup>64</sup> A second argument is the fact that e-commerce is itself big business and that potential tax revenues are likely to be substantial.<sup>65</sup> Leaving e-commerce from taxation would create revenue erosion to the government. Some scholars also argue that Internet taxes are desirable because they impose taxes on those individuals most able to pay them.<sup>66</sup> The opponents of the above argument support the idea that the Internet should be an international tax-free zone.

### **2.6.2. Why Taxing E-commerce?**

Inevitably, when one considers the issues around the taxation of e-commerce, one will be confronted by the question: why tax the e-commerce at all? The answer to this question is neither simple, nor is it one to be made based on emotional considerations. An enquiry into the question can be approached by arguing both sides of the divide and thereafter taking the side that based on the evidence adduced, is noteworthy and holds more merit. According to Wiseman, the current debate on Internet taxation has placed an onus on scholars to establish why electronic commerce should or should not be taxed.<sup>67</sup> In this case, Wiseman believes that the Internet has a ubiquitous presence that cannot be ignored; its taxation therefore calls for increased attention on the subject matter.<sup>68</sup> To start with the first and the prominent arguments propounded by the pro-taxation

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State University International Business & Economics Research Journal, Volume 1, Number 261 Pros And Cons Of E-Commerce Taxation

<sup>64</sup>*Ibid*

<sup>65</sup>*Ibid*

<sup>66</sup>*Ibid*

<sup>67</sup>Wiseman AE The Internet Economy: Access, Taxes, and Market Structure 2ed (2010) 92

<sup>68</sup>Morris IJ ‘Creating an Online Internet Tax: A Complex Construction?’ (2004) 2 Northwestern Journal of Technology and Intellectual Property 8

group is the revenue loss. E-commerce venture is growing in a promising rate and different data indicated that it is causing government revenue loss. For instance as researches indicated the global market for e-commerce in 1998 was estimated 26 billion\$ and by 2010 this had become 572 billion\$.<sup>69</sup> Jones and Basu considered the question on whether e-commerce should be taxed in depth. They were of the opinion that a very simple answer to the question could be that until someone comes up with a better idea, taxation is the only practical means of raising the revenue to finance government spending on the goods and services that most of us demand. However, it should be acknowledged that establishing an efficient and fair system is far from simple. They raise a valid point in that at the heart of this issue lies the fact that governments want to tax electronic commerce to raise revenue to sustain government expenditure especially in the face of shrinking traditional tax base. In most countries taxes are the principal source of government revenue, accounting on average for about 80% of total revenue.<sup>70</sup> And, this coupled with the promising growth of e-commerce, taxing e-commerce would be essential for government revenue especially for developing countries where tax is said to be the largest source of government revenue.

The second reason is equity or fairness. This justification is all about the need to level the playing field between conventional and e-commerce venture. And, tax is one of the tools used to level the play field. Accordingly, if e-commerce is not taxed it will put the conventional business venture in a disadvantaged position. And, this becomes worse as e-commerce has an already advantage of convenience to customers in terms of time and accessibility.

The third reason goes to the fundamental principle of tax equity. The principle of tax equity among other things advocates equal taxes for business alike.

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<sup>69</sup>Subhajitbasu, International taxation of E-commerce: persistent problems and possible developments, p.1

<sup>70</sup>Kirimiti and NarmataAgrawa, 'Impacts of E-commerce on Taxation,' International Journal of Information and Computation Technology, Vol.4, No.1, 2014, PP. 99-106, at p.101.[here in after Kirimiti and narmata, Impacts of E-commerce on Taxation,] p 5

While some advocates claim that tax-free Internet commerce amounts to mass tax evasion, others believe that there are benefits and reasons to not tax the Internet.<sup>71</sup> But the world is moving to tax e-commerce and especially, the emergence and development of cross-border e-commerce let the world to take different legal and policy measures.

### **2.6.3. Contemporary policy and legal measures in the world**

There are many Global Initiatives for Addressing Tax-Related Issues in E-commerce. Among the initiatives the OECD Guideline is a widely accepted standard for the modern e-commerce taxation rules. This is so because several countries are harmonizing their laws towards these guidelines.<sup>72</sup> OECD has been doing different reform efforts in the realm of taxation. Particularly, in relation to taxation of e-commerce, it appears to be the sole organization in stipulating guidelines and the introduction of reform measures.

The other measure taken in the world is by European Union. The EU has embarked upon its works on e-commerce in 1997.<sup>73</sup> But, its regulation on the VAT starts in 1967 with the promulgation of the six directives.<sup>74</sup> The directives only provide the skeleton and left many things such as the coverage and rate issue for the decision of the member countries.<sup>75</sup>

The OECD's general success with e-commerce tax reform demonstrates the OECD's ability to act as a kind of informal (lower-case) world tax organization, which emphasizes deliberation, consensus-building and the use of non-binding mechanisms such as the OECD model tax treaty.<sup>76</sup> Moreover, the OECD's success suggests that calls for a more formal (upper-case) World

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<sup>71</sup>Isidro IM 'Internet Taxation: Which side are you on?' available at <http://www.powerhomebiz.com/vol4/internet-taxation.htm> (accessed 28 July 2020)

<sup>72</sup>ECD (2020), OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors – July 2020, OECD, Paris. [www.oecd.org/tax/oecd-secretary-general-tax-report-g20-finance-ministers-july-2020.pdf](http://www.oecd.org/tax/oecd-secretary-general-tax-report-g20-finance-ministers-july-2020.pdf) accessed on August 30<sup>th</sup>

<sup>73</sup>H26k29.p.90.me. Kham Tipmart, International taxation of e-commerce, LLD ,Dissertation, Niigata University, 2015,School of Modern Society and Culture, 2015,[Unpublished, available at law library], p.90

<sup>74</sup>*Id*, 54

<sup>75</sup>*Ibid*

<sup>76</sup>*Ibid*

Tax Organization, which could impose binding tax rules on participating nations, may be misplaced.<sup>77</sup>

## **2.7. The OECD Taxation Framework Conditions**

E-commerce transactions are a challenge in tax policy, because they can lead to debate in the taxation and double tax authorities, until the Organization for Economic Co-operation and Development (OECD) regulates them in the Tax Treaty.<sup>78</sup>

The OECD was founded on September 30 1961.<sup>79</sup> However, it can be traced back to First World War.<sup>80</sup> After the ravaging effects of the war, the organization for European economic cooperation {OEEC} was established in 1948 to spearhead the US funded marshal plan, with the aim of reconstructing war-torn Europe.<sup>81</sup> In view of the success of the OEEC, and future prospects in a global arena, the US and Canada joined the OEEC member states in signing the OECD convention on 14 December 1960.<sup>82</sup>

OECD has been doing different reform efforts in the realm of taxation. Particularly, in relation to taxation of e-commerce, it appears to be the sole organization in stipulating guidelines and the introduction of reform measures.<sup>83</sup> In order to address these e-commerce tax challenges, the OECD has taken the lead role in establishing the guiding principles and tax rules to govern the tax treatment of international e-commerce transactions.<sup>84</sup>

### **2.7.1. Background to the OECD Taxation Framework Conditions**

Digitalization has a wide range of implications for taxation, impacting tax policy and tax administration at both the domestic and international level, offering new tools and introducing

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<sup>77</sup> *Ibid*

<sup>78</sup> Cockfield, A. J. (2006) 'The rise of the OECD as informal 'world tax organization' through national responses to e-commerce tax challenges', Yale Journal of Law & Technology p139

<sup>79</sup> Love P 'The OECD's origins in the trenches' available at <http://oecdinsights.org/2014/11/11/the-oecd-origins-in-the-trenches/> (accessed 20 July 2020)

<sup>80</sup> *ibid*

<sup>81</sup> OECD 'History' available at <http://www.oecd.org/about/history/> (accessed 29 July 2020)

<sup>82</sup> OECD 'History' available at <http://www.oecd.org/about/history/> (accessed 29 July 2020)

<sup>83</sup> D.j.Francoijis, How Can the International Problem of Taxing E-commerce Best be Solved, p.5.

<sup>84</sup> *Supra* note at 68



new challenges.<sup>85</sup> As a result, the tax policy implications of digitalization have been at the Centre of recent global debate over whether or not the international tax rules continue to be fit for purpose in an increasingly changing environment.<sup>86</sup> The OECD responded forthwith to the tax challenges through its fiscal affairs committee.<sup>87</sup> Through the finance ministers of its member countries, the organization has adopted what is known as the Ottawa taxation framework conditions in 1998, just a few years after the advent of e-commerce. Particularly, in relation to taxation of e-commerce OECD appears to be the sole organization in stipulating guidelines and the introduction of reform measures.

### **2.7.2. The Pillar Elements of the OECD Taxation Framework**

The OECD taxation framework, the Ottawa taxation framework condition highlighted a number of items for further work. These pillar elements are discussed as follows.

#### **2.7.2.1. Taxpayer service**

Revenue authorities should make use of the available technology and harness commercial developments in administering their tax system to continuously improve taxpayer service.<sup>88</sup>

Member countries are encouraged to develop systems for accepting tax returns through new technologies and for receiving automated payments of social security, payroll taxes and similar deductions.<sup>89</sup> Member countries are encouraged to develop interactive telephone answering systems for standard inquiries.<sup>90</sup> Creation of a dedicated OECD group to take forward, through exchange of experiences and information, successful practices in developing taxpayer service.<sup>91</sup>

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<sup>85</sup> OECD (2019) ‘‘ tax and digitalization,’’ OECD going digital policy note, OECD, Paris, [www.oecd.org/going-digital/](http://www.oecd.org/going-digital/) /tax and digitalization.pdf

<sup>86</sup> ibid

<sup>87</sup> Basu global taxation of e-commerce, p.244

<sup>88</sup> A Report by the Committee on Fiscal Affairs, as presented to Ministers at the OECD Ministerial Conference, ‘‘A Borderless World: Realizing the Potential of Electronic Commerce’’ on 8 October 1998

<sup>89</sup> Implementation of the Ottawa taxation framework conditions, the 2003 report p.7

<sup>90</sup> ibid

<sup>91</sup> ibid

### **2.7.2.2. Tax administration, identification and information needs**

Revenue authorities should maintain their ability to secure access to reliable and verifiable information in order to identify taxpayers and obtain the information necessary to administer their tax system.<sup>92</sup> International consensus and guidance issued on requirement for internet business identification, transaction record keeping and accountability of electronic payment systems and verification requirements for customer status and jurisdiction.<sup>93</sup>

### **2.7.2.3. Tax collection and control**

Countries should ensure that appropriate systems are in place to control and collect taxes.<sup>94</sup> International mechanisms for assistance in the collection of tax should be developed, including proposals for an insert of language in the OECD Model Tax Convention. Voluntary compliance encouraged through development of simplified registration for non-resident suppliers required to collect VAT/GST.<sup>95</sup>

### **2.7.2.4. Consumption taxes**

Rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place and an international consensus should be sought on the circumstances under which supplies are held to be consumed in a jurisdiction.<sup>96</sup> There exist agreed place of consumption. Where business and other organizations within a country acquire services and intangible property from suppliers outside the country, countries should examine the use of reverse charge, self-assessment or other equivalent mechanisms where this would give immediate protection of their revenue base and of the competitiveness of domestic suppliers. Countries should ensure that appropriate systems are developed in co-operation with the WCO and in consultation with carriers and other interested parties to collect tax on the importation of physical goods, and that such systems do not unduly impede revenue collection and the efficient delivery of products to consumers. The taxation framework conditions concluded that the

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<sup>92</sup> [www.oecd.org/taxation/implementation-of-the-ottawa-taxation-framework-conditions-the-2003-report](http://www.oecd.org/taxation/implementation-of-the-ottawa-taxation-framework-conditions-the-2003-report), p. 3

<sup>93</sup> *ibid*

<sup>94</sup> *ibid*

<sup>95</sup> *Ibid* at p.8

<sup>96</sup> *Ibid*

consumption tax rules for cross-border electronic commerce trade should result in taxation in jurisdiction in which consumption take place.<sup>97</sup> Taxation at place of consumption promotes certainty and prevents double taxation or unintentional non-taxation where two jurisdictions employ non-compatible place of taxation rules {i.e. at source and at destination}

### **2.7.3. Principles of e-commerce taxation**

There are principles of international taxation, some of which ‘are basic principles of tax theory and policy, although they have a specific meaning in the international taxation context and in particular within the taxation of e-commerce’. These tax principles can generally be categorized in one of two ways, namely, those dealing with efficiency and those dealing with fairness. Application of the two categories is usually in pursuit of the protection of various interests; and therefore no tax system can be efficient while at the same time being completely fair. Despite tax principles having only an advisory character, they have been instrumental in the development of local regulatory frameworks. According to Basu, there is a general consensus in the area of public finance that a tax system should be designed according to the principles of neutrality, efficiency, certainty, simplicity, effectiveness, fairness and flexibility.<sup>98</sup> In order to address e-commerce tax challenges, the OECD has taken the lead role in establishing the guiding principles and tax rules to govern the tax treatment of international e-commerce transactions.<sup>99</sup> Under the auspices of the OECD, member countries through their tax authorities came up with the Ottawa Taxation Framework in which a consensus was arrived at that the conventional taxation principles (neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility) should also be applied to the taxation of e-commerce.<sup>100</sup> The principle of efficiency will be discussed first.

#### **2.7.3.1. Efficiency**

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<sup>97</sup>OECD{2001}, Taxation and Electronic commerce; implementing the Ottawa taxation framework conditions, OECD publishing, Paris, <http://doi.org/>

<sup>98</sup> Supra note at

<sup>99</sup> Supra note at

<sup>100</sup>Organization for Economic Co-operation and Development (OECD) (2001) Tax administration aspects of electronic commerce: responding to the challenges and opportunities: a report from the forum on strategic management to the committee on fiscal affairs

Tax efficiency minimizes the cost of complying with the tax code by reducing its administrative burden and by minimizing any distortions in the economy caused by the tax. Reducing the administrative burden not only benefits the taxpayers but also the economy since tax collection is not an objective of tax policy, but simply a requirement. The efficiency principle encompasses notions of both fiscal efficiency and economic efficiency.<sup>101</sup> ‘Fiscal efficiency looks at any system that can be administered as a low and cost-free process, while economic efficiency considers the maximization of economic output given the resources at the disposal of the community.’<sup>102</sup> Efficiency in tax therefore heavily connected to compliance costs. An efficient tax system must therefore ensure that compliance costs for the taxpayer and administrative costs for the tax authorities are minimized as far as possible. Looked at through this prism of cost minimization, a tax should be able to leave economic behavior unaffected. From a practical standpoint, if governments were to avoid distortion in economic behavior and not tax the Internet, governments in the future would be unable to realize substantial revenues to fund socially useful expenditure without generating considerable inequity. Despite being efficient, a tax must also be neutral.

### **2.7.3.2. Principle of tax neutrality**

Tax neutrality is a widely accepted concept in principle. In principle, tax neutrality requires that taxation rules should not affect economic choices.<sup>103</sup> Business decisions should be motivated by economic rather than tax considerations. The principle of tax neutrality therefore belongs to the efficiency category.<sup>104</sup> In essence, the same taxation principles that apply to income from conventional ways of conducting business should also apply to income from e-commerce transactions.<sup>105</sup> Chan believes that if conventional taxation principles are applied to e-commerce transactions, this would place e-commerce at a competitive disadvantage relative to other modes of commerce, defeating one of the purposes of an equitable tax system.<sup>106</sup> Chan argues that the

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<sup>101</sup> Basu S (2007) 82

<sup>102</sup> *ibid*

<sup>103</sup> Basu S (2001) 10.

<sup>104</sup> Choudhary V (2011) 3

<sup>105</sup> *Supra* note at 103

<sup>106</sup> Chan CW (1999) 24

‘practical application of the principle of tax neutrality, then, would be a position that no ‘new’ taxes should be placed on e-commerce transactions’<sup>107</sup>.

Chan’s averments are debatable, as counter-arguments can be raised against them. To begin with, the current non-taxation of electronic commerce could be viewed as a violation of the principle of tax neutrality, as for example, a specific good or service sold in a brick and mortar institution is subject to tax while the same product or service sold online is not subject to tax. This distortion tilts the scales in favor of a particular economic choice, namely purchasing a product or service online.<sup>108</sup> Another argument could also be that ‘the same principles of taxation should apply to all forms of business, while addressing specific features that may otherwise undermine an equal and neutral application of those principles’.<sup>109</sup> Therefore, for the principle of neutrality to be given effect on the e-commerce landscape, electronic commerce must be taxed, not by new tax or additional taxes, but by adapting existing tax rules and principles to treat the income earned from income earned through electronic transaction similarly to from existing channels of commerce.<sup>110</sup> This must however be done bearing in mind any issues that may affect the neutrality of such a tax..The principles of certainty, simplicity, flexibility, and effectiveness will now be considered.

### **2.7.3.3.Certainty, simplicity, flexibility and effectiveness**

Tax rules should be clear and simple to understand, so that taxpayers know where they stand. A simple tax system makes it easier for individuals and businesses to understand their obligations and entitlements. Taxation should be as simple as possible.<sup>111</sup> Taxpayers want a degree of certainty when they conclude their transactions. Tax rules should be clear and simple in order to facilitate this degree of certainty, particularly with regard to tax consequences. This therefore includes the knowledge of how, when and where a transaction would be taken into account. Furthermore, costs of compliance and administration ought to be practical. Where the costs of

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<sup>107</sup> *ibid*

<sup>108</sup> OECD ‘Addressing the Challenges of the Digital Economy’ (2014) OECD Publishing 30

<sup>109</sup> *ibid*

<sup>110</sup> Dunahoo C ‘Electronic Commerce and Tax Neutrality: Current Vat Issues’ available at <http://www.ilpf.org/events/jurisdiction/presentations/dunahoopr.htm> accessed 29 June 2015

<sup>111</sup> Mc Lure CE (2000) 2

enforcing a particular policy are not practical, then there will be a need to reengineer the policy. The systems for taxation should be flexible and dynamic in order to guarantee that they remain at par with the developments in commerce and technology. A tax should also be effective. Taxation should bring about the right amount of tax at the right time. The potential for evasion and avoidance should be minimized and counteracting measures should be proportionate to the risks involved. Despite being efficient, taxes must also be fair. Next the principles of equity and fairness will be discussed.

#### **2.7.3.4. Equity and fairness**

Equity and fairness means that the tax burden should be based on the taxpayer's ability to pay.

Equity in simple terms is what society deems to be fair. There are two types of taxpayer equity, namely, horizontal equity and vertical equity. In simple terms, horizontal equity is satisfied when people with an equitability ability to pay a tax end up paying the same tax.<sup>112</sup> Conversely, vertical equity is fulfilled when people with a 'greater ability to pay end up paying the appropriate amount more than people with a lesser ability to pay'.<sup>113</sup> From an e-commerce perspective, the application of taxpayer equity would imply that transactions conducted online should therefore be treated as equally as transactions that were effected in a brick and mortar institution.

'The principle of equity is often viewed as a fairness principle.' A tax should inherently be perceived as fair, despite the subjectivity associated with the word 'fairness'.

#### **2.7.4. The Implementation of the OECD Taxation Framework Conditions**

As it is discussed above, the OECD with its long and success of developing practical solutions to international tax issues reacted quickly and by 1998 had agreed Ottawa taxation framework

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<sup>112</sup>Basu S (2007) 86

<sup>113</sup> Ibid at 82

conditions. These set out a number of principles that governments should adopt in their approach to taxation of the emerging sector.<sup>114</sup>

The OECD Model Tax Convention aims to champion, ‘clarify, standardize, and confirm the fiscal situation of taxpayers who are engaged in commercial, industrial, financial or any other activities in other countries through the application of identical solutions’.<sup>115</sup> Generally, the Model Tax Convention of the OECD attempts to provide a common set of rules that national jurisdictions can follow to escape the possibility of double taxation of income and capital, and stimulate cross-border investment and trade.<sup>116</sup>

#### **2.3.4. Applying the broad concepts, purposes and principles of taxation to e-commerce**

It is generally agreed that taxes should, to the extent possible and consistent with other goals, be economically neutral and compliance friendly. The taxation principles which guide governments in relation to conventional commerce should also guide them in relation to electronic commerce. There are principles of international taxation, some of which ‘are basic principles of tax theory and policy, although they have a specific meaning in the international taxation context and in particular within the taxation of e-commerce’. These tax principles can generally be categorized in one of two ways, namely, those dealing with efficiency and those dealing with fairness. There is a general consensus in the area of public finance that a tax system should be designed according to the principles of taxation that are discussed above i.e. principle of neutrality, efficiency, certainty, simplicity, effectiveness, fairness and flexibility.

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<sup>114</sup>[www.oecd.org/taxation/implementation](http://www.oecd.org/taxation/implementation) of the Ottawa taxation framework conditions the 2003 report, p. 3

<sup>115</sup>Cited Kobetsky M (2011) 153

<sup>116</sup>Jackson JK OECD Initiative on Tax Havens (2010) ch 1

## **Chapter three: Taxation of electronic commerce in Ethiopia in light of the OECD taxation framework conditions; issues and challenges**

### **3.1.Introduction**

Since e-commerce has got a legal protection through the proclamation its development is inevitable. And it is said that those who were engaged on conventional way of trading are changing their mode of trading to electronic one so it is obvious that revenue erosion could occur. So business income taxation regime of a country should accommodate electronic commerce.

This section is devoted for the discussion of the taxation of business incomes derived from electronic transactions and checking the laws whether accommodate taxation of electronic commerce and they are compatible to the OECD taxation. The application of the income tax proclamation, which is enacted to tax for the conventional business mode, would not be without challenges and the issues related with the application of the law on e-commerce transaction will be seen in detail.

### **3.1.The Development of e-tax in Ethiopia**

Tax compliance is of paramount importance for the government to provide public goods and reallocate wealth.<sup>117</sup>

An electronic tax system is an online platform that enables the taxpayer access tax services through the internet.<sup>118</sup> Such services include registration for a tax identification number, filing of returns and registration of a payment and compliance certificate application. Globally, the tax environment is changing rapidly, and an electronic tax system is a modern way of tax authorities interacting with taxpayers.<sup>119</sup>

The Ethiopian revenue and tax authority {ERCA} has started training middle income tax payers on its e-file system as of October 14, 2003, so that they can start declaring their taxes

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<sup>117</sup>Jayawardane, 2016

<sup>118</sup>Wasao (2014)

<sup>119</sup>Muturi and Kiarie, 2015)



online.<sup>120</sup>The service started as a pilot project by the authority in 2010 which allows customers to inform their taxes via the internet and the authority will send them a print out with a code, through which they can come to the office to pay.<sup>121</sup> E- File is under the e-tax project of ERCA, which seeks to automate all tax filing in the country by allowing tax payers to declare their taxes remotely through [www.etax.gov.et](http://www.etax.gov.et).<sup>122</sup> Under the e-file tax payers file online can only be accepted at ERCA office.<sup>123</sup> E-tax, however, eventually include e-payment, which will let taxpayers pay taxes through any bank after filing documents online. And one of the officials told me that big tax payers branch of ERCA has set up many training on e-tax and e-payment through its department of education, training and information delivery department.<sup>124</sup> This can show us there is only development regarding e-file and e-payment system and this shows there is infant development regarding electronic taxation.

Tax authorities need to focus on increasing electronic tax system usage and ensure that there is further training of taxpayers on the importance of tax compliance as well.

### **3.2. Taxation of E-commerce in Ethiopia**

Technological developments in electronic commerce over the past several years have strained the ability of the tax authorities to apply existing principles and concepts to tax persons on the resulting income. Before attempting to analyze the Ethiopian electronic commerce taxation framework, it is important to check whether the e-commerce business at this stage in and e-commerce in general should be taxed or not. Different scholars and tax officials have different view on the issue.

The first group, the pro-taxation group, believes that e-commerce should be taxed just like regular commerce. Arguments for taxing e-commerce are based on equity, economic neutrality, revenue, and simplicity of compliance and administration. First, failure to impose the tax on

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<sup>120</sup> Addis fortune gazzetta, published on October 27, 2013 { volume 14 ,no 704 }

<sup>121</sup> ibid

<sup>122</sup> ibid

<sup>123</sup> Interview made to Teresa ensesu,

<sup>124</sup> Interview made to big tax payers education, training and information delivery department team leader EndaleignAsrat, made on august 24 on how the technology of ERCA is treating ecommerce taxation?

online purchases would cause significant revenue losses for the state. Second, if e-commerce is given a no-tax status, then businesses can locate themselves in states where there is no for electronic purchases, thus making the loss of tax revenues a bigger problem. Differential taxation can also keep businesses from adopting the best business practices. In the case of companies with both traditional and online operations, the need to avoid nexus may prevent some otherwise desirable business practices.

Accordingly, the respondents were divided into two groups in answering to this question, Interviewees from the academia and practice. To start with, one of the PhD student in bahirdar university who has LLM in tax law and very interested in the area of e-commerce law states that before arguing on whether e-commerce should be taxed or not and criticizing the laws of income taxation in light of e-commerce transactions we should have a policy document which will answer the question how is the government approaching e-commerce. So to tax or not to tax should be the issue of the policy document. So the government should have a long term strategy before resolving the issue legally. And he argues that dealing on the issue is not the sole responsibility of ERCA, so the solution is not only enacting a law but there should be taken a role based measure such as having strategy and setting infrastructure. Finally he argues that setting a regulatory framework is a long term process and the Ethiopian current structure lacks infrastructure, coordination among stakeholders and strategy to tax ecommerce.<sup>125</sup> And by now Ethiopia cannot tax e-commerce. And he further told me than after the infrastructure to tax is set there should be a legal framework and it should be evaluated based on the basic taxation principles, such as, from principle of efficiency point of view questions like is it efficient to tax e-commerce from the administrative cost and compliance cost point of view. He gave me you tube as an example, he called them you tubers, who are using you tube company so here questions how can the authority assess the income you tubers get from the you tuber companies? It is difficult we don't have infrastructure and institutional set up even readiness tax e-commerce in general. So as it is in infant stage, at least, we should not discourage innovation and finally he

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<sup>125</sup> Interview made with zerihun , holds LLM in tax law and interested in the area interview made on august 15, 2020

argues to leave out e-commerce untaxed for this time. At least there should be given a grace period until the government deliver sufficient environment for the business.

A basic principle of taxation is economic neutrality <sup>126</sup>and it is difficult to argue that web-based vendors deserve the advantage of a tax holiday versus their bricks and mortar competitors. If e-commerce is not taxed consistently with other forms of commerce, market distortion and consequent inefficient allocation of resources would arise. <sup>127</sup>But the writer is against the above argument since leaving e-commerce untaxed would raise issues of equity and fairness also arise.

The other respondent from INSA states that government should tax e-commerce. He states that the government is creating favorable infrastructure for citizens to transact electronically. The enactment of electronic transaction proclamation is supportive to the above assertion. And he told me that most of the e-commerce traders were traders who were conducting their trade using the conventional way. So definitely there could occur erosion of tax base, which would decrease government revenue. The researcher is of the opinion that, e-commerce should be taxed in Ethiopia for the following basic reasons. The first reason is that income from whatever source from whatever form should be taxed. And secondly, from equity principle of taxation if untaxed it would violate fairness and equity principle of taxation. And since businesses are in transition to digital if it leaved untaxed tax base would be eroded and finally revenue erosion would come and economic damage would occur.

### **3.3.The business income taxation regime framework conditions Possible Problems and Challenges Ahead its Application on E-commerce Transactions**

When we see taxation of e-commerce, there are different laws that should be discussed. And laws of taxation that are enacted to govern business income taxation should be given due concern. Therefore, the following discussion is devoted to analysis of laws related to e-commerce and other laws that are applicable to tax incomes from businesses.

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<sup>126</sup>Committee on Fiscal Affairs (1998), *Electronic Commerce: Taxation Framework Conditions*. Paris: OECD, Directorate for Financial, Fiscal and Enterprise Affairs, October 8

<sup>127</sup>Salter, Sarah W (2002), 'E-Commerce and International Taxation', *New Eng. Journal of Int'l & Comp Law*, 8 (1) pp 6-17

### 3.4. Electronic transaction proclamation

Ethiopia has adopted the Electronic Transaction Proclamation which has 46 provisions, gives legal recognition to electronic commerce and electronic government.<sup>128</sup>The Proclamation which is drafted by the Ministry of Innovation and Technology is approved by the Ethiopian Parliament.

The Proclamation, which has 46 provisions, gives legal recognition to electronic commerce and electronic government. As per the provision of Articles 7 and 8 of the Proclamation information which is in electronic form has the same legal validity as information contained in written document. The Proclamation also gives legal recognition to electronic signature of the signatories, electronic stamps and electronic signature of witnesses as long as the requirements that are stated under its Articles 9 to 11 are fulfilled.

Article 16 of the Proclamation has given legal recognition to electronic receipts as long as e-receipt is prepared in a form of electronic message, the electronic message fulfills the contents of paper based invoice and the electronic message is traceable, reachable and readable where it is needed for future comparison of such e-receipt.

The conclusion of contracts electronically is given legal recognition by Article 17 of the Proclamation. The Proclamation has also given acknowledgement to publication of laws electronically and has established Electronic Federal NegaritGazeta and Archives of Federal Electronic Laws under its Articles 18, 36 and 37. There are also provisions that are aimed at the protection of the consumers who will engage in e-commerce as can be seen from Articles 28 to 34 of the draft Proclamation.

Finally, the provisions of Articles 41 to 46 of the Proclamation deals with miscellaneous issues and gives mandate to the Council of Ministers and the Ministry to issue Regulations and Directives.

When we come to taxation issue, we can get some articles which have tax implications. Under article 16 of the proclamation, electronic receipts and payments made electronically have equal status with those made in writing. So principle of non-discrimination is enshrined under the proclamation. But as far as how should it be taxed is concerned, there exist no provision which directly deals about taxation. One of the drafters of the proclamation told me that, there was an issue raised to follow all in one approach, all laws

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<sup>128</sup>Article 2{19} of the electronic transaction proclamation, no. 1205/2020

including taxation should be enacted in a comprehensive way but question of jurisdiction raised and then specific issues are left to special regulatory organs to enact regulations and directives on their specific issues.<sup>129</sup> And like other issues taxation issue was left to ERCA to formulate a directive.<sup>130</sup> So we cannot say that this law answers question raised for taxation of electronic commerce.

### 3.3.2. The income tax proclamation

Every business is legally required to pay tax. In Ethiopia the income tax proclamation number 979/2016, is the proper law to levy a tax on individuals and businesses. Countries levy tax on incomes earned based on two types of tax systems, scheduler and global. The characterization of an amount as business income is important in both scheduler and global income tax systems. A gain may thus be income from business if it arose from a transaction that was entered into by the taxpayer with a business or profit-making intention.<sup>131</sup> So the most important thing in every tax system, which imposes business income tax, is to define what business income tax is. In tax statues, the expression ‘business’ is used in the sense of an occupation or profession, which occupiees time, attention and labor of a person, normally with the objective of making profit.

The current income tax proclamation of Ethiopia under Article 2(6) also highlights the term ‘business’ as any industrial, commercial, professional or vocational activity or any other activity recognized as trade by the Commercial Code of Ethiopia and carried on by any person for profit.

Thus, business income or business profit includes any income which is derived essentially from business activity or any activity recognized as trade. Taxable business income is the amount of income or profit from business activity which is subject to business income. As I have said earlier, there has been enacted a proclamation to give e-commerce a legal recognition and e-commerce is expanding from time to time.

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<sup>129</sup> *Supra note at 49*

<sup>130</sup> *ibid*

<sup>131</sup> *Rutledge v. Commissioner*, 14 T.C. 490 (1929); *Martin v. Lowry* [1927] A.C. 312

As reports shows, individuals and businesses buy more goods and services online both from local and foreign suppliers.<sup>132</sup> According to the 2015 UN report, in the years of 2009 business-consumer e-commerce sales in Ethiopia is 0.02 billion and in the years of 2010 is 0.03 billion and increase by the year 2011 the business of ecommerce to 0.04 billion end of the year 2012 business of e-commerce growth is 0.06 billion dollar.<sup>133</sup> And different business institutions such as hotels, shops, financial institutions are engaging in e-commerce activities.

So to protect revenue erosion it is must to levy tax on online transactions. The income tax proclamation imposes an obligation to pay income tax on every individual if such income is declared as taxable income. With regard to the imposition of tax the proclamation adopted a taxation model is based on two fundamental principles as connecting factors: residence of the taxpayer and the source of income. Income tax applies to residents with respect to their worldwide income, and non-residents with respect to their Ethiopian-sourced income.<sup>134</sup> The law regards as residents; a resident individual, a resident body and federal government, regional states and city governments. For an individual to be regarded as resident he should either has a domicile in Ethiopia, is a citizen of Ethiopia who is a diplomat or a consular or similar official posted abroad and individual who is present in Ethiopia continuously or intermittently, for more than 183 days in one year period. A resident is a body that is incorporated or formed in Ethiopia or has its place of effective management in Ethiopia. A resident company is a company that is resident body. Any person who is not resident in Ethiopia is a nonresident.<sup>135</sup>

Article 6 the proclamation lists types of incomes which are considered as Ethiopian source income. Business income derived by a resident of Ethiopia is considered Ethiopian source income except to the extent of income which the resident generated through a permanent establishment outside Ethiopia.<sup>136</sup> While business income derived by a nonresident through a business conducted by permanent establishment of the nonresident in Ethiopia, disposal in

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<sup>132</sup>UNCTAD, E-commerce in the Least Developed Countries E-commerce and Development Report, New York and Geneva, 2001, Part Four, P. 192, <<http://unctad.org/en/Docs/ecdr01p4.en.pdf>> (Accessed 30 July 2020)

<sup>133</sup>UNCTAD, Information Economy Report 2015: Unlock the Potential of E-Commerce for Developing Countries, New York and Geneva, Sales No. E.15. II.D.1, 2015, P. 25

<sup>134</sup>Federal Income Tax Proclamation, Federal NegaritGazeta, No 979/2016, article 5 & 6

<sup>135</sup> *ibid.* Art 5/1,2,5,6,7

<sup>136</sup> *id.* Art 6/2

Ethiopia by nonresident of goods or merchandise of the same or similar kind to disposals by a nonresident through a permanent establishment in Ethiopia or any other business conducted by a nonresident in Ethiopia through a permanent establishment in Ethiopia the same or similar kind as that conducted by a nonresident through a permanent establishment in Ethiopia.<sup>137</sup>

Permanent establishment (PE) is a fixed place of business which generally gives rise to income or value-added tax liability in a particular jurisdiction.

In Ethiopian law, Permanent Establishment is defined “as a fixed place of business through which the business of a person is wholly or partly conducted”<sup>138</sup>. The proclamation lists; “a place of management, branch, office, factory, warehouse, workshop, a mine site, oil or gas well, quarry or other place for the exploitation for extraction of natural resources, and the furnishing of service” to be specifically regarded as permanent establishment.<sup>139</sup> The proclamation also defines the so called project PE for a building site or place where construction and/or assembly works are carried out and agency PE for agent of independent status<sup>140</sup> and provides specific requirements to be met.

The proclamation addresses the issue of double taxation in chapter five which is titled international tax law. The chapter empower the ministry of finance and economic cooperation to conclude international tax treaty for the avoidance of double taxation<sup>141</sup> and a rule which govern foreign tax credit for income tax paid in foreign countries.<sup>142</sup> So this provisions discussed above are designed to tax the traditional way of doing business. So we can say that e-commerce taxation is not properly regulated.

However, due to the absence of proper regulation and enforcement problems, most online transactions simply escape taxation.

E-Commerce would definitely challenge the taxing regimes of nations. Some of the conceptual challenges thrown by e-Commerce are how to characterize income and the

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<sup>137</sup>*Ibid. Art 6/ 3*

<sup>138</sup>*Ibid. Art 4/1*

<sup>139</sup>*Ibid. Art 4/2*

<sup>140</sup>*Ibid Art. 4/4,5*

<sup>141</sup>*Ibid. Art 49*

<sup>142</sup>*Ibid. Art 45*

approach towards residence-based and source-based taxation approaches.<sup>143</sup>The difference between residence and source based taxation poses a challenge in the e-commerce. For instance, the Income tax proclamation of Ethiopia has the scope of application to residents of Ethiopia with respect to their worldwide income and to non-residents with respect to their Ethiopian source income.<sup>144</sup>Thus, characterization of the source of income in e-commerce especially in the case of cross border-e-commerce cases could be a daunting task to the tax collecting authorities.

### **3.5. Examining laws of business income Taxation of Electronic Commerce in light of OECD taxation framework conditions**

As repeatedly said, the advent of e-commerce has posed a challenge to the current tax system and one of such challenges is pertaining to taxation of income from e-commerce ventures and the challenge basically stems from the fact that the current income tax system bases itself on geographical location or physical presence while e-commerce takes place in virtual space wherein geography or physical presence has no or little place. Having this general remark, the following part is devoted to deal with specific challenges in the sphere of income tax in the e-commerce business and to see in light of the OECD taxation framework conditions.

#### **3.5.1. Permanent Establishment**

As discussed earlier, laws for taxing business profits use the concept of permanent establishment as a basic nexus/threshold rule for determining whether or not a country has taxing rights with respect to the business profits of a non-resident taxpayer.

The ability of a state to claim its share of income from an enterprise engaged in e-commerce depends upon its ability to establish that the entity has a sufficient presence in the state to justify the exercise of taxing authority.<sup>145</sup> The rise of e-commerce seriously challenges the concept of PE for determination of the source of income.<sup>146</sup> Multinational corporations have traditionally required some type of physical presence within foreign markets in order to engage

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<sup>143</sup>Kirti and Namrata Agrawal, 'Impact of E-commerce on Taxation' <<https://www.ripublication.com/irph/ijict-sph/ijictv4n/spl-16.pdf>> accessed 30 July 2020

<sup>144</sup>Federal Income Tax proclamation, 2016, Proc No 979, Fed Neg Gaz., Year 22 No. 104, Art. 7(1)&(2)

<sup>145</sup> Global Perspectives on E-Commerce Taxation Law Subhajit Basu Queen's University Belfast, U, p.118

<sup>146</sup> ibid



in significant business activities. With the development of the Internet, online retailers can accomplish much of their sales and advertising strategies via a website that transfers transaction costs to customers. An Internet website allows an enterprise to interact directly with its customers<sup>147</sup> thus eliminating the necessity for having the presence of intermediaries a given jurisdiction.<sup>148</sup>

In the pursuit of establishing how the principle of permanent establishment is handicapped by digital transactions, we can consider the issue considered by the OECD which brought about a fragmented opinion. The issue is whether the use of computer equipment for electronic commerce constitutes permanent establishment in the country where the computer is located.<sup>149</sup>

According to the OECD; “an Internet website, which is a combination of software and electronic data, does not in itself constitute tangible property. It therefore does not have a location that can constitute a ‘place of business’ as there is no ‘facility such as premises or, in certain instances machinery or equipment as far as the software and data constituting that website is concerned.”<sup>150</sup>

In the conventional tax parlance, business profits of non-resident corporations are taxed in the source country whenever there is a permanent establishment. Permanent establishment is understood as a fixed place of business through which the business of an enterprise is wholly or partly carried on. Contrary to this, the advent of the Internet makes it possible to conduct business in the virtual space without fixed and specific locations or e-commerce enterprise can undertake business with very limited physical presence in any particular consumer’s country. Thus, in the age of e-commerce it is possible to conduct business in any country without the need to have any sort of physical presence. So, the fundamental principle of permanent establishment which asserts that to conduct business in a given country, you need to have

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<sup>147</sup>Suddards op cit note 36 at 255; R Buys R & F Cronjé F Cyber law: The Law of the Internet in South Africa 2 ed (2004) at 307

<sup>148</sup>Arnold & McIntyre op cit note 3 at 153; AW Oguttu & B Van der Merwe ”Electronic Commerce: Challenging the Income Tax Base” (2005) 17 SA Mercantile Law Journal at 85-86

<sup>149</sup>Feinschreiber & Kent ‘GIIC recommends E-commerce taxation and tariff modifications’ (2001) 3 Corporate Business Taxation monthly

<sup>150</sup>Par 42.2 of the OECD Commentary on article 5

presence in that country rendered obsolete in the context of e-commerce as in e-commerce business can be undertaken everywhere by being located anywhere.

Before addressing the issue of permanent establishment principle in Ethiopia it will be important to look at the legal framework for e-commerce in Ethiopia. In this regard the Electronic Signature Proclamation<sup>151</sup> is important law which opens up a new era for commercial transactions by equally treating electronic signature and electronic messages with hand written signatures and documents under art 5(1) and 6(1). It explicitly recognizes the legal effect, validity and admissibility of electronic signature and electronic message by affirming that the mere fact of its being electronic message shall not deprive it of such effects. Where the law requires information to be made in writing, it is deemed to have been made in the same form if it is made in electronic form and is accessible for subsequent reference under art 5(2) and 6(2). In effect it has repealed several laws, regulations and practices that mandatorily require handwritten signature and document such as the provisions of the 1960 civil code on contracts and wills and the provisions of the commercial code that require writing and signature.<sup>152</sup> The National Payment System proclamation<sup>153</sup> is another important law which recognizes the legal validity and admissibility of electronic records and electronic signatures in relation to transfer of funds. Article 21 (1) of the proclamation reads: “Where any law provides that information or any other matter shall be in writing, such requirement shall be deemed to have been satisfied if such information or matter is rendered or made available in an electronic form and accessible so as to be usable for subsequent reference”. As such it can be said that there is a sufficient legal framework in Ethiopia for companies and individuals to conduct business through e-commerce and this can help to boost e-commerce in the country.

E-commerce is still at infant stage and rarely used in Ethiopia. This is due to lack of IT infrastructures and Ethiopian banks do not issue credit cards. But there is recently, directive on mobile money is enacted by NBE and only lately the local financial institutions have started

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<sup>151</sup>Electronic Signature Proclamation, Federal NegaritGazeta, No 1072/2018

<sup>152</sup>WossenyelehTigu and Abraham Rega, Regulation of E-Signature in Ethiopia, 2018. at 3(april 10,2020 ] at [www.mtalawoffice.com/legal-updates/entry/regulation-of-e,signiture-in -Ethiopia](http://www.mtalawoffice.com/legal-updates/entry/regulation-of-e,signiture-in -Ethiopia)

<sup>153</sup>National Payment System Proclamation, Federal NegaritGazeta, No.718/2011,

using primary internet transactions through mobile and card banking services. The main platforms to shop online are; merkato online, Qefira.com, Shegr.net, and Delala, all of which are market places. The number of internet users and the culture of using social networks like; Facebook, Twitter and Instagram in the country are increasing from time to time.<sup>154</sup> Giant e-commerce companies like Alibaba are making necessary preparation to invest in the country. The current law governing the administration of income tax in Ethiopia is The Federal Income Tax Proclamation number 979/2016.<sup>155</sup> The proclamation imposes an obligation to pay income tax on every individual if such income is declared as taxable income.<sup>156</sup> With regard to the imposition of tax the proclamation adopted a taxation model is based on two fundamental principles as connecting factors: residence of the taxpayer and the source of income.<sup>157</sup> Income tax applies to residents with respect to their worldwide income, and non-residents with respect to their Ethiopian-sourced income. The law regards as residents; a resident individual, a resident body and federal government, regional states and city governments. For an individual to be regarded as resident he should either has a domicile in Ethiopia, is a citizen of Ethiopia who is a diplomat or a consular or similar official posted abroad and individual who is present in Ethiopia continuously or intermittently, for more than 183 days in one year period. A resident is a body that is incorporated or formed in Ethiopia or has its place of effective management in Ethiopia. A resident company is a company that is resident body. Any person who is not resident in Ethiopia is a nonresident.<sup>158</sup>

Article 6 the proclamation lists types of incomes which are considered as Ethiopian source income. Business income derived by a resident of Ethiopia is considered Ethiopian source income except to the extent of income which the resident generated through a permanent establishment outside Ethiopia.<sup>159</sup> While business income derived by a nonresident through a business conducted by permanent establishment of the nonresident in Ethiopia, disposal in

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<sup>154</sup>SocietyGeneral , Ethiopia: the Market, July, 2020 Available at <https://import-export.societe.generale.fr/en/country/ethiopia/ecommerce>

<sup>155</sup>Federal Income Tax Proclamation , Federal NegaritGazeta, No 979/2016

<sup>156</sup>id. Art 9

<sup>157</sup>id. Art 5&6

<sup>158</sup>id. Art 5/1,2,5,6,

<sup>159</sup>id. Art 6/2

Ethiopia by nonresident of goods or merchandise of the same or similar kind to disposals by a nonresident through a permanent establishment in Ethiopia or any other business conducted by a nonresident in Ethiopia through a permanent establishment in Ethiopia the same or similar kind as that conducted by a nonresident through a permanent establishment in Ethiopia.<sup>160</sup>

Permanent Establishment is defined “as a fixed place of business through which the business of a person is wholly or partly conducted”.<sup>161</sup> The proclamation lists; “a place of management, branch, office, factory, warehouse, workshop, a mine site, oil or gas well, quarry or other place for the exploitation for extraction of natural resources, and the furnishing of service” to be specifically regarded as permanent establishment.<sup>162</sup> The proclamation also defines the so called project PE for a building site or place where construction and/or assembly works are carried out<sup>163</sup> and agency PE for agent of independent status<sup>164</sup> and provides specific requirements to be met.

The proclamation addresses the issue of double taxation in chapter five which is titled international tax law. This chapter has important provisions which empower the ministry of finance and economic cooperation to conclude international tax treaty for the avoidance of double taxation<sup>165</sup> and a rule which govern foreign tax credit for income tax paid in foreign countries.<sup>166</sup>

Ethiopia has signed some bilateral double taxation treaties with different countries and it will be important to look how some of these treaties address the issue of PE. UK/Ethiopia Double Taxation Convention<sup>167</sup> defines permanent establishment as “a fixed place of business through which the business of an enterprise is wholly or partly carried on.”<sup>168</sup> The convention lists; “a

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<sup>160</sup>:id. Art 6/3

<sup>161</sup>:id. Art 4/1

<sup>162</sup> id. Art 4/2

<sup>163</sup> Id at art 4/3

<sup>164</sup> Id at art 4/4,5

<sup>165</sup>:id. Art 49

<sup>166</sup>:id. Art 45

<sup>167</sup>UK/Ethiopia Double Taxation Convention, Signed in London on 9 June 2011, entered into force on 21 February 2013 (April 12, 2020 ) Available at [http://www.into-sa.com/uploads/download/file/213/DTAA\\_Ethiopia\\_-\\_UK\\_2013\\_.pdf](http://www.into-sa.com/uploads/download/file/213/DTAA_Ethiopia_-_UK_2013_.pdf)

<sup>168</sup>:id. Art 5/1

place of management, branch, office, factory, commercial warehouse, workshop, a farm or plantation, a mine site, oil or gas well, quarry or other place for the exploitation for extraction of natural resources, and the furnishing of service” to be especially regarded as permanent establishment.<sup>169</sup> The same definition and a list of the same examples are adopted in the Convention between Israel and Ethiopia<sup>170</sup> and in the convention between Netherland and Ethiopia.<sup>171</sup> The only difference I observed by going through these conventions is that in the convention with Italy and Netherland, in the annexed protocol states that relevant OECD commentaries on matters agreed on by the convention can be used for interpretation,<sup>172</sup> while there is no such thing in the convention with UK. All of the three conventions discussed have no provision which specifically address e-commerce.

The definition of permanent establishment under the Ethiopian income tax proclamation as well as other tax laws and even in bilateral double taxation treaties is the traditional definition which requires physical presence through either fixed place of business or some form of employment/ agency. This traditional concept of PE in our law which requires physical presence is no longer adequate or workable to address taxation of e-commerce and this makes it impossible to apply.<sup>173</sup> By application of the current laws we may tax some companies which are physically attached to the country living other out of the scope. Thus, laws in relation to PE both in domestic laws and bilateral treaties need to be changed in order to address e-commerce. To address the matter in a

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<sup>169</sup>id. Art 5/2

<sup>170</sup>Convention between the Government of the State of Israel and the Federal Democratic Republic of Ethiopia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed January 1, 2008. Art 5 ((April 12, 2020 ) Available at [https://mof.gov.il/chiefecon/internationaltaxation/doclib/ethiopia\\_eng.pdf](https://mof.gov.il/chiefecon/internationaltaxation/doclib/ethiopia_eng.pdf) [hereinafter Israel/Ethiopia Double Taxation Convention]

<sup>171</sup>Convention between the Kingdom of the Netherlands and the Federal Democratic Republic of Ethiopia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Agreement Of 10th August, 2012, Art 5 (<http://internationaltaxtreaty.com/download/Netherlands/dtc/Netherlands-Ethiopia-DTC-Aug-2012.pdf>[hereinafter Netherland/Ethiopia Double Taxation Convention]

<sup>172</sup>See Israel/Ethiopia Double Taxation Convention, Protocol, 6 at 25, see also Netherland/Ethiopia Double Taxation Convention, Protocol, part 1, at 20

<sup>173</sup>Interview with yishakfikadu, former lecturer in law and LLM holder in tax law, August 10/2020

comprehensive way Ethiopia needs to work with other countries in international frameworks to come up with effective and sufficient international taxation agreement.<sup>174</sup>

It is apparent that the definition of PE in our law is not able to address electronic transactions. Furthermore, the manner in which the income tax proclamation approaches taxation of electronic exchange as well as the mechanisms of regulating and detecting the income individuals or enterprises generate through such transactions so as to identify the tax payers and tax their income accordingly is not sufficiently addressed and clearly regulated.<sup>175</sup> However, the income tax proclamation has one important provision to tax incomes generated without having PE, under art 63, which provides that any income that is not taxed under one of the 5 schedules as provided in the proclamation and is Ethiopian source income will be taxed at 15% from the gross income. If the existence of such transaction and the income gained from such transaction is proved by sufficient evidence it can be taxed accordingly. However in e-commerce transactions involving nonresident with no permanent establishment in the country applying the income tax proclamation is difficult. Proving the existence of and the parties too such transactions, the income generated from such transaction and identifying the individual who is legally liable to pay the tax is impossible, because there is no monitoring mechanism put in place for such transactions. Using withholding mechanism or reverse taxation can also make no difference since the individual selling the product or even the purchaser may not be registered as tax payers in the country thus have no legal obligation to pay tax.<sup>176</sup> There are only some enterprises registered as e-commerce business enterprises in the country and they pay taxes. However, in order to collect legally required income tax from e-commerce we need to adopt technological software's that can detect and report such transactions for ERCA by providing electronic invoice for each transaction conducted, in the future.<sup>177</sup> The incorporation of e-receipt and e-payment under the electronic transaction proclamation is a way forward.

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<sup>174</sup> id

<sup>175</sup> Interview with Melese, Legal Expert at ERCA, on the challenges of establishing Permanent establishment in case of e-commerce in Ethiopia, august15, 2020

<sup>176</sup> Interview with KasahunDememe, Investigation Auditor at ERCA, on the challenges of establishing Permanent establishment in case of e-commerce in Ethiopia, august 20, 2020

<sup>177</sup> Interview made to TeressaEnsessa, large tax payers branch manager

The bilateral double tax treaties Ethiopia has signed with several countries are not drafted with an intention of regulating e-commerce thus it is impossible to apply them in case of e-commerce.<sup>178</sup> However, currently the ministry has observed the existence of such problems and it is updating the model being used to make it applicable to incomes generated through e-commerce as well as other online business that are conducted in Ethiopia without having physical presence.<sup>179</sup>

Ethiopian legal rules both in the income tax proclamation and double taxation treaties discussed above, provides that permanent establishment is the minimum threshold requirement in order to exercise taxation power over Ethiopian source income gained by a nonresident. The definition of PE in our laws is more concerned with existence of physical presence in certain place at which an income generating business activity is conducted and such place should have a known established location somewhere in Ethiopia. This definition of PE in the Ethiopian is similar to the definition in OECD and UN model conventions, as such the challenge addressed in relation to determining PE in case of e-commerce in relation to the two model conventions are equally applicable in Ethiopia. The problem is further aggravated in Ethiopia due to absence of official clarifications or commentaries on the application of the PE in relation to e-commerce as in the case of OCED Clarification discussed above. Furthermore there is no; subsidiary law enacted on the basis of the income tax proclamation to address the application of PE on e-commerce, there is lack of judicial precedents/ judgments and judicial interpretation on the subject matter and as Ethiopia is not member of the OECD there is no legally established procedure to use important international documents on the issue like OCED clarification on the application of article 5 on e-commerce. Ethiopian tax laws do not provide specifically for business transactions in the technological age. In relation to e-commerce it is very difficult, or even impossible, to apply the definition of PE in our law in order to link a transaction or an income generated in Ethiopia as a taxable income especially in those cases where a nonresident conducted business online.

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<sup>178</sup> id  
<sup>179</sup> Ibid

At this point in time, due to the underdevelopment and infancy of e-commerce in Ethiopia, tax revenue losses associated with e-commerce and its contribution to the economy of the country and financial transactions associated with it may have not been well studied and accorded much attention. However, in order to achieve the economic development goal the country is aspiring the role of ICT has been noted and several works have been done by the government to develop this sector of the economy. In line with these developments the country needs to the use of e-commerce and utilize the new opportunities and advantages created with it. This will help to encourage domestic investment, entrepreneurship and it can serve as a tool to attract foreign direct investment.

But still, the global nature of e-commerce may have made Ethiopian market open to several foreign companies to conduct on line business without the need of having any physical or legal presence in the country. Unless such companies are made legally liable to pay tax with respect to income they generate in Ethiopia, it can have a deteriorating effect to the domestic economy especially for those domestic business engaged in similar economic activity because they cannot resist the competition with such foreign suppliers who are not required to pay taxes.

With the current trend of rapid technological advancement and ever growing culture of globalization, the development and proliferation of the e-commerce industry in the Ethiopia's economy is inevitable and unavoidable reality in the near future. In order to embarrass this economic sector and to benefit from the same introducing various policy, infrastructural and legal changes is mandatory. One of such areas that need immediate consideration and change is adjusting the definition of PE in our tax laws to make it applicable in relation to e-commerce. It should be noted that, the existing tax laws must, as far as possible, be used to tax e-commerce transactions in order to maintain the core principle of tax neutrality. In order to apply these laws on those e-commerce suppliers that conduct business without any physical presence in the country, it is important that Ethiopia legislation rules regarding PE follows international trends (like OECD Clarification on Article 5) and is updated in order to ensure accurate, fair and correct taxation collections. Despite introducing changes in its domestic legislations and bilateral treaties Ethiopia has to participate at the international level to address several problems in the area of e-commerce taxation. This will help the country to find a PE model that works in Ethiopia and at the same time addresses the global e-commerce taxation problem.



From the above, it can be concluded that it is difficult to tax such business with such understanding of the concept of permanent establishment for attributing a tax nexus for e-commerce purposes and this is the challenge posed to the current tax principle.

### 3.5.2. The power to tax or jurisdictional issues

Taxing power refers to the ability of a government to impose and collect taxes. Business income is usually taxable somewhere. Under traditional principles of taxation, when a business is conducted within a country, normally that country has jurisdiction to tax the business' income. For income from international transactions, the ability to tax requires some extra steps of analysis. Countries generally follow two approaches: 'source-based taxation' (also referred as 'territorial taxation principle')<sup>180</sup> and 'residence- based taxation'.<sup>181</sup>

The key issue that the Internet poses for tax policy is not so much its potential to create a world without borders but rather to create a world of only borders – a world in which everyone is as responsive to local taxation as people who live on geographic borders.<sup>182</sup>In legal terminology, „jurisdiction“ describes the legal authority of the state. The scope of that authority is manifest either in terms of a “prescriptive jurisdiction, the power to legislate or otherwise prescribe legal rules; or enforcement jurisdiction, the power to apply such rules through judicial or executive action”<sup>183</sup>

The power to tax, sometimes referred as the jurisdiction to tax, is a concept that is central to the issue of taxation. At the risk of stating the obvious, tax is truly jurisdictional. A country only has the power to tax the income from a particular transaction if it can establish a connection, or a tax nexus, between itself and the income.<sup>184</sup> So far, there are two principles used to establish nexus between the tax payers or the income and taxing country. These principles are known as the

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<sup>180</sup>Charles E. McLure, Jr., U.S. Tax Laws and Capital Flight from Latin America, 20 U. Miami Inter-Am.L.Rev.321, 324(1989)

<sup>181</sup>Other criteria such as citizenship, domicile, center of economic interest, may also be used as a basis for tax liability

<sup>182</sup>Goolsbee, Austan (2001), 'The Implications of Electronic Commerce for Fiscal Policy', Journal of Economic Perspectives, 15

<sup>183</sup>Gordon, Suzanne E (2001), Changing Concepts of Sovereignty and Jurisdiction in the Global Economy: Is there a Territorial Connection? Working Paper Series 1, The Canadian Centre for German and European Studies p.137

<sup>184</sup>Oguttu AW & Van der Merwe B (2005) 305

source and residence principle. Countries usually use either the resident or source principle or both. The first principle proposes that the source of the transaction is the connecting factor; and thus persons are taxed on income that originates from their territorial or geographic confines. In terms of the residence principle a State to tax its citizens on their world-wide income meaning incomes irrespective of where it is earned. This is based on the principle of permanent establishment and the other thing worth noting is that the residency principle is highly intertwined with geographical or physical presence in the country. In the absence of this, the country may still impose tax using the principle of territoriality or source. Accordingly, the country from within the income is derived from its border has the right to tax such income. The justification for source taxation is that the source country has contributed in the process of the production of the income. But employing this principle leads to a conflict of jurisdiction or to what usually called double taxation. The source of this mainly is source-source, residence-residence, and source-residence conflict. In resolving this, countries adopt unilateral, bilateral and multi-lateral solutions. Coming to e-commerce, it poses a challenge to the tax jurisdiction of states. E-commerce changes the way business takes place and this at least makes it necessary to review the long-standing principles in relation to tax jurisdiction. When we come to e-commerce the above principles poses challenges. When we see the source principle, countries should have the right to tax incomes derived from their borders or within their territory irrespective of who earned such income. So, the income should be derived from sourced state. Therefore we can say that source rule is based on the presumed existence of nexus between the income and the country. This is problematic, however, in that geographical presence or physical location has no or limited, if any, place in the eyes of e-commerce and this is because e-commerce is operated in virtual space where physical or geographical locations has nothing to help to undertake the business. This makes the assumption of tax jurisdiction through the application of source rule difficult if not impossible. The challenge of e-commerce is also noticed in the residence principle. The main challenge in this regard is the identification and determination of residence of e-commerce operators. Under the residence principle, it's taxed where the person earning the income resides, for example the home country of the road building company. The demands of some physical facility under residence rule are the challenge in e-commerce.

### **3.5.3. Characterization of Income**

One of the most important issues in the areas of e-commerce taxation is the characterization of income derived from the sale or transfer of intangible goods or services. So who is entitled to tax revenues generated by electronic transactions is the characterization of income, a context in which e-commerce pushes the principles and rules of international taxation to their logical limits and beyond.<sup>185</sup> Under existing international tax treaty rules, each category of income has its own source.<sup>186</sup> It is, therefore, crucial to define the character of income from electronic transactions. Characterization of income has a far-reaching importance in relation to double taxation or conflict of jurisdiction for the power to tax bases on the nature or type of the income. Moreover, characterization of income has also a lot to do with the characterization of the e-commerce transaction especially in relation to good vs. service vs. intangible distinctions. Characterization is, therefore, essential because of different tax treatment it entails. Going to the detail, income generated from commerce as Basu, noted can be divided in to two main categories, i.e., business profit and royalties. And, this would bring different tax treatment. So, if a country from which the income is sourced could establish a permanent establishment, such income would be taxed as a business profit but in the absence of permanent establishment such income may be subject to withholding tax scheme if for instance treated as royalties. Apart from this, the classification of digital products is also one of the challenges worth considering. For instance, a customer can buy a book from online marketing and the good may be delivered physically but let us further assume that the book is delivered online to the customers drive and let u39 customer bought the book from an online library through subscription. In such cases there are about three different options available to the above hypothetical situation. It can be thus, considered as a good, intangible and service and this all brings a different sort of tax consequence. A good may be subject to VAT by the importing country in so far as a permanent establishment does not exist, in case it is intangible, a royalty may be applicable and lastly, if it is treated as a service, may the taxability would be at stake at all. Be that as it may, the classification of the product and the characterization of the income have a great implication to the current tax system and this is because the current tax law is rooted in the production and distribution of physical

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<sup>185</sup> supra note 57,p. 128

<sup>186</sup> Ibid

products. Eventually, Basu explained characterization of income will have two problems. Firstly, different countries may impose different taxes on the same electronic transaction in that way affects the decision where to establish because of tax incentive. Secondly, the difference tax ascribed to the same product purchased by conventional and e-commerce means will result in inequitable treatment. Therefore, characterization of income will result in significant different tax treatment.

### **3.6. Summarizing Major Challenges in enforcing Taxation of Electronic Commerce in Ethiopia**

#### **3.6.1. Legal challenges**

There is a global consensus that any taxation of global e-commerce must be fair, equitable and neutral in its application, but the dilemma that subsequently arises is the establishment of a taxation framework that actually is able to meet these criteria.<sup>187</sup>

##### **3.6.1.1. Absence of sufficient legal framework**

Recent years witnessed an intense development of e-Commerce and its technologies. As discussed earlier, the development of e-commerce has posed a variety of challenges to the current legal and institutional frameworks especially true in the sphere of taxation. The history of the Internet in Ethiopia is less than two decades old. Like many other countries, the Ethiopian government has come to recognize the need to establish a policy framework for electronic commerce and is determined to create an environment that is conducive to the development of electronic commerce. The Ethiopian government sees ICT as central to the country's development, to enhance the provision of information and services to its citizens and as a tool of poverty reduction.<sup>188</sup> Having recognizing the need to regulate the sector, many related legislations are being enacted. The enactment of several legislations relevant to e-commerce such as the electronic transaction proclamation, The National Payment System proclamations, the Electronic Signature proclamations and the Value

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<sup>187</sup>Borkowski SC (2000) 1

<sup>188</sup> The Federal Democratic Republic of Ethiopia, The National Information and Communication Technology Policy and Strategy, Addis Ababa, August 2009, p. 2

Added Service directives of Ministry of IT and communications are good examples to the above assertion.

As far as the Ethiopian law is concerned, currently during the writing of this research, there has been enacted electronic transaction proclamation. But it doesn't deal about particular issues such as tax.<sup>189</sup> In relation to tax, the current tax laws do not make a clear reference to e-commerce. This is because the laws are enacted taking into account the traditional mode of transaction.

One of the drafters of the electronic transaction proclamation told me that, there was a need to follow all in on approach, to enact all the issues related to e-commerce in a comprehensive legislation but question of jurisdiction raised and the issue left to specific regulatory authorities to govern through directives or regulations.<sup>190</sup>

As said well in the preceding discussion of this research, business income taxation of e-commerce has raised many issues from taxation point of view. There are a lot of issues to be addressed as discussed above such as permanent establishment, characterization of income and income tax jurisdiction issues. So, in Ethiopia there are no such laws that help respond the issues in e-commerce taxation. However, if we look our tax laws, some provisions scattered here and there may be applicable to e-commerce but this does still mean that the country has a sufficient legal framework.

As expounded earlier, the government so far has come up with three draft e-commerce laws starting from 2010 to 2018 and at now the 2020 electronic transaction proclamation got into force and proclaimed as 1205/2020. As far as taxation is concerned the 1205/2020, the proclamation does not make clear indication to taxation of e-commerce. So it is not contestable to say that there should be legal framework for taxation of e-commerce.

All of my interviews there should be a legal framework to tax business income of e-commerce and they responded as to different approaches. And ERCA should enact regulations and

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<sup>189</sup>Electronic transaction proclamation no.1205/2020. 26<sup>th</sup> year no.57

<sup>190</sup>Supra note 49,

directives on the issue of taxation.<sup>191</sup> As far as the law of business income taxation law is concerned there are different views given.

The first option is that the regulation of taxation of e-commerce could be done by amending the existing laws and providing a special section to the taxation of e-commerce or providing amendment to the existing laws in the context of e-commerce. He argued that the laws should be amended so that they would make income from e-commerce subject to taxation. He further said that E-commerce is a not a new business; rather anew way of doing businesses. So, it does not need to be treated separately; but it is true that it has peculiarities and such could possibly be addressed in that way.

The other option is that it is appropriate if it is governed by independent or separate proclamation governing the taxation of e-commerce in Ethiopia.<sup>192</sup> He raises many issues related to it. When we see the depth of the law it is shallow when we see from the principles of taxation point of view.

My view is that the e-commerce law, currently, the electronic transaction law should prescribe the general framework like it does for consumer protection.<sup>193</sup> Since the income tax laws are enacted taking into consideration the traditional ways of trading it is better to have a separate legislation governing e-commerce taxation.

### **3.6.1.2. Gaps in the Income Tax Proclamation**

The income tax proclamation, proclamation no. 979/2016 is the operative law currently.<sup>194</sup> Even though, this proclamation comes in to existence after the evolution of e-commerce, it fails to deal with taxation of e-commerce. So the following part is devoted for the discussion of issues in relation to e-commerce taxation.

#### **3.5.1.2.1. Permanent Establishment and the Challenges in relation to E-commerce in Ethiopia**

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<sup>191</sup>Supra note 52

<sup>192</sup>Interview with yishakfekadu, lecture of Law, debrebirhan University, School of Law, on how should be the regulation of taxation of e-commerce be governed, August 16, 2020

<sup>193</sup> The proclamation through Article 28-34 has a consumer protection provisions.

<sup>194</sup>Federal Income Tax Proclamation, 2016, Federal NegaritGazette, Proc. No. 979, 22nd Year, No. 104 [Here in after, Proc. No. 979/2016

The income tax proclamation has dealt the issue of a permanent establishment under art 4 and the definition is forwarded in a similar with the one by OECD UN. As we have briefly discussed under the second chapter, the doctrine of permanent establishment is at the basis of tax jurisdiction. Especially it is relevant in dealing with a collection of non-resident business and this is because that it serves as a nexus between the source country and the income generated. Article 6 the proclamation lists types of incomes which are considered as Ethiopian source income. Business income derived by a resident of Ethiopia is considered Ethiopian source income except to the extent of income which the resident generated through a permanent establishment outside Ethiopia.<sup>195</sup> While business income derived by a nonresident through a business conducted by permanent establishment of the nonresident in Ethiopia, disposal in Ethiopia by nonresident of goods or merchandise of the same or similar kind to disposals by a non-resident through a permanent establishment in Ethiopia or any other business conducted by a nonresident in Ethiopia through a permanent establishment in Ethiopia the same or similar kind as that conducted by a nonresident through a permanent establishment in Ethiopia.<sup>196</sup>

The article further, states things that are specifically treated as a permanent establishment. Thus, it states that the following are treated to be a permanent establishment.<sup>197</sup>

A. A place of management, branch, office, factory, warehouse, or workshop, but does not include an office that has a representation of the person's business as its sole activity;<sup>198</sup>

B. A mine site, oil or gas well, quarries, or other places of exploration for, or extraction of, natural resources;<sup>199</sup>

C. The furnishing of services, including consultancy service, by a person, including through employees or other personnel engaged by the person for such purpose, but only when activities

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<sup>195</sup> *ibid.* Art 6/2

<sup>196</sup> *ibid.* Art 6/ 3

<sup>197</sup> *Ibid.* Art. 4.

<sup>198</sup> *Ibid*, art. 4(2)(a]

<sup>199</sup> *Id.*, art. 4(2)(b]

of that nature continue for the same or a connected project for a period or periods aggregating more than one hundred eighty-three days in any one year period.<sup>200</sup>

The definition of a permanent establishment is attached to a geographical understanding or some sort of physical presence of assets and activities. This traditional concept of PE in our law which requires physical presence is no longer adequate or workable to address taxation of e-commerce and this makes it impossible to apply in the context of e-commerce especially in the case of fully digitalized e-commerce. In e-commerce, a business can be done everywhere by being anywhere as it transcends territorial boundaries and the physical presence or a geographical requirement has no or little value. So, the requirement of fixed place by definition fails to accommodate the nature of e-commerce. As I said earlier this definition of PE in the Ethiopian is similar to the definition in OECD and UN model conventions, as such the challenge addressed in relation to determining PE in case of e-commerce in relation to the two model conventions are equally applicable in Ethiopia. The problem is further aggravated in Ethiopia due to absence of official clarifications or commentaries on the application of the PE in relation to e-commerce as in the case of OCED Clarification discussed above. Furthermore there is no; subsidiary law enacted on the basis of the income tax proclamation to address the application of PE on e-commerce, there is lack of judicial precedents/ judgments and judicial interpretation on the subject matter and as Ethiopia is not member of the OECD there is no legally established procedure to use important international documents on the issue like OCED clarification on the application of article 5 on e-commerce. Ethiopian tax laws do not provide specifically for business transactions in the technological age. In relation to e-commerce it is very difficult, or even impossible, to apply the definition of PE in our law in order to link a transaction or an income generated in Ethiopia as a taxable income especially in those cases where a non-resident conducted business online

### **3.6.1.3.Source and Residence Principle and challenges in Ethiopia**

If a country considers a certain income as taxable when such income arises within its jurisdiction, the principle is source rule. In contrast, under a residence-based system, a country asserts jurisdiction to tax the worldwide income of its residents, regardless of source.<sup>201</sup>

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<sup>200</sup>Id., art. 4(2)(c]



In the case of a company this is usually the place where the company is 'incorporated, registered', or has its 'place of central management and control.

Article 7 of the proclamation state Ethiopia follows the two principles. Art. 7 of the proclamation provide that the proclamation is applicable to residents of Ethiopia regarding their worldwide income<sup>202</sup> and to non-residents with respect to their Ethiopian source income.<sup>203</sup> To begin with, the proclamation under art 5(5) goes on to state that, a resident body is a body that is incorporated or formed in Ethiopia or has its place of effective management in Ethiopia. This is another sign that the proclamation fails in the context of e-commerce. It is apparent that the requirements are only suitable for traditional businesses that are associated with a physical location. For instance, if we look at the requirements of effective management in Ethiopia, it demands that business need to have their effective management in Ethiopia in order to be considered as a resident of Ethiopia and this effective management is located in the geographical location of Ethiopia. Businesses in e-commerce usually do not have such set up especially those engaged in the sale of digital products. In such case, their effective management remains to be on the internet and specifically, their effective management may on the Ethiopian website or server and this is how their location is identified. The incorporation or formation requirement also does not work in the context of e-commerce. This is because; their association with a certain country is due to the server or website they use.

In conclusion, creating a physical location nexus with Ethiopia seems to be idealistic when it comes to identification of residency of e-commerce business.

Therefore, using the residence requirements as stipulated in the proclamation, it becomes difficult, if possible at all, to identify and determine the residency of business in e-commerce.

### **3.7. Institutional Challenges in Tax Administration**

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<sup>201</sup>Taxation of e-commerce from a global perspectivesubhajitbasua thesis submitted in partial full fulfillment of the requirements of Liverpool john moors university for the degree of doctor of philosophy p.35 march 2003.

<sup>202</sup> Supra note., art.7(1)

<sup>203</sup> Supra note,art.7(2)

Committee on Fiscal Affairs (CFA) had formulated the Taxation Framework Conditions that were welcomed by OECD Ministers at the Ottawa conference,<sup>204</sup> and that have since been generally accepted worldwide as providing a sound basis for ongoing work. Therefore, Tax administrations should encourage the use of new assurance technologies, Tax administrations should also engage with software developers, Tax administrations should encourage business to adopt strong authentication measures using technologies. Tax administrations should continue to monitor new standards from standard setting bodies, best practices. So the following problems are encountered in Ethiopian tax administration institution and stakeholders ahead of ecommerce taxation and development of ecommerce in general.

### 3.7.1. Lack of Awareness

Awareness is the state of being conscious of something. Awareness creation regarding the issues in e-commerce plays a key role in addressing the apprehensions in relation to taxation of e-commerce.

Therefore it is basic to know how much we know or aware of the subject matter. From the interviews I made different organizations such as INSA, ERCA, and they are of course aware of e-commerce and know that many individuals and organizations are engaging in e-commerce business and that they are not paying taxes for the income they earned but they thought that it is the duty of these actors to report to the tax office as to they are engaging in taxable activity.<sup>205</sup> I have asked him as to what they understand by taxation of e-commerce and they responded that: "It is a new thing that our institution recently undertakes and it is all about taxation through the electronic way. Also, it is one of the issues brought by the tax administration proclamation and so far, it is only implemented to Large Tax Payers in some parts of Addis Ababa." And I got only a single individual who come to our office to report an income which he earned through

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<sup>204</sup> OECD (1998), "Electronic Commerce: Taxation Framework Conditions", a Report by the Committee on Fiscal Affairs, as presented to Ministers at the OECD Ministerial Conference, "A Borderless World: Realizing the Potential of Electronic Commerce" on 8 October 1998. See <[http://www.oecd.org/daf/fa/E\\_COM/frameworkke.pdf](http://www.oecd.org/daf/fa/E_COM/frameworkke.pdf)>.

<sup>205</sup> Interview made to ,teressaensesu, ministry of revenue ,large taxpayers branch office manager, made on august 22,2020 on why there is no developed ecommerce taxation?

e-commerce so that it will be taxed.<sup>206</sup> And another interviewee told me that to report those incomes generated through e-commerce is the duty of ethio-telecom, since it is this organ which is controlling the internet which is the medium for the transaction.<sup>207</sup>

Out of 3 respondents from ERCA, of course three of them are aware of e-commerce and some issues of taxation of e-commerce. And other respondents from INSA are also familiar with the concepts. But he told me that they roughly know the existence and they don't know specific issues attached to it. So the tax administrator is now aware of the issues and the state of e-commerce in Ethiopia. Some respondents who are familiar with e-commerce from ERCA believed it is not the sole duty of ERCA to bring e-commerce traders in to the tax system. In some cases, the fault does not belong to them. The concerned organ has to create awareness. Lack of awareness in relation to ICT in general and E-commerce has been identified before ten years as a challenge to the development of the sector and but the challenge is not solved after a decade of recognition of the problem. My respondent from INSA told me that Lack of awareness is a typical problem that we encounter in dealing with e-commerce but we are trying our best by organizing training and workshops aimed at awareness creation but, the stakeholders are not cooperative, and for instance, ERCA did not appear in any of the pieces of training or workshops that we have prepared so far despite our repeated invitation.”<sup>208</sup>

The problem here is that the experts consider e-commerce as a new business, but, it is not a new business rather, it is a new way of doing business. In e-commerce what is being undertaken is similar to traditional business except that it is through the electronic way. Anyway, lack of awareness about e-commerce and the issues in the taxation of e-commerce is one of the challenges I have noticed.

### **3.7.2. Lack of Necessary Technology**

Legal rules and principles have an interactive, dynamic and complex relationship with technological developments. Tax authorities may need to promote the use of internet technologies

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<sup>206</sup> ibid

<sup>207</sup> Supra note 49

<sup>208</sup> Supra note 52

to perform functions that protect these objectives.<sup>209</sup> For example, technological solutions could: (a) identify the location where the purchaser of information good resides; (b) automatically charge, assess and remit taxes on information good transactions to lower compliance costs; and (c) employ online extranets to enhance information exchange among sub-federal and federal tax authorities.<sup>210</sup>

However, in Ethiopia, the respondent from ERCA provides that; “Technology is one of the critical challenges and the tax administrators don’t have advanced technology to follow up the traditional business modality let alone to have technology that can fit to e-commerce<sup>211</sup> and even those organs who have inherent institutional duty, like the MCIT and INSA, do not yet place such technology so far.<sup>212</sup> So, currently, even if we develop a legal framework to tax e-commerce, which is not the case, placement of necessary technology is impossible so far.<sup>213</sup> Actually, to the best of my knowledge, ERCA is not making ready itself and it does not even know what sort of technology is needed. Besides, the internet penetration and connection problem are also another impediments.”<sup>214</sup>

In connection to this, the large taxpayer’s branch office manager has mentioned that placing such technology is not an easy task even there don’t have any movement to do so. The technology we have established for e-tax is facing so many challenges such as system compatibility, as it is placed by foreign companies, network, and awareness problem. So, for e-commerce, I think it would be a long way to go and need efforts and cooperation beyond ERCA. From these, we can learn that, in Ethiopia, e-commerce transactions are out of the purview of the tax administrator. . So, the technology issue will be solved in the years to come, hopefully. But, still, a lot is expected from the concerned organ.

### **3.7.3. Lack of Skilled Human Resource**

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<sup>209</sup> Supra note at 57, p.285

<sup>210</sup> ibid

<sup>211</sup> Interview made to ,teressaensesu, ministry of revenue ,large taxpayers branch office manager, made on how do you evaluate the technology of the tax administrators to tax ecommerce?

<sup>212</sup> ibid

<sup>213</sup> ibid

<sup>214</sup> ibid

As discussed repeatedly, ecommerce technologies are changing the way that work tasks are conducted and thus have significant implications for a need skilled human resource functions.

The other problem that I got from my interview is lack of human resource. According to the view of one of the respondents from education and training department of ERCA told me that there is no any trained personnel to give training on issues of e-commerce let alone to give training for other stakeholders.<sup>215</sup> He told me that we are arranging training totaxpayers' one-filing. He also told me that, when it comes to e-commerce, the issue will come worse, because, there is nothing done so far, we are not familiar with it and with the technological issues. And the department of education, training and information delivery department has not made any training on issue of e-commerce and there is no one equipped with the required technological skill in relation to e-commerce.<sup>216</sup>

This is one of the challenges for e-commerce and the tax authority need to arm itself with the necessary skilled staffs. Actually, the MCIT host so many skill oriented raining but, the tax administrator so far failed to participate in the pieces of training and even the experts don't hear about the training.<sup>217</sup> However, such pieces of training are ways of creating skilled human power. And one of my respondents from INSA told me that the Ethiopian government has agreed a memorandum of understanding with the ALIBABA Company among the pillar elements of the MOA to train Ethiopian experts in Alibaba University in electronic transactions is the notable one.<sup>218</sup> So it can be said that the government is trying to resolve the issue of lack of skilled human power, though it is not enough.

#### **3.7.4. Lack of Cooperation among stakeholders**

Having sufficient promotion for e-commerce demandsthe collaboration of as many institutions. In the Ethiopian context, it involves the MCIT, INSA, Ethio-telecom , ERCA and others. Some

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<sup>215</sup>Interview made to EndaleignAsrat, education and training department head, at ERCA large tax payers branch

<sup>216</sup> ibid

<sup>217</sup> ibid

<sup>218</sup>Supra note 52

of the e-commerce activities such as those made in SMS<sup>219</sup> by ethio-telecom are not taxed.<sup>220</sup> This is because ethio-telecom does not give information to ERCA. The trend is, Ethio-telecom gets commission from such SMS based businesses but telecom only pays tax from the commission they get but it doesn't try to disclose the income generated by that SMS Company.<sup>221</sup> This is one instance which shows lack of cooperation among the two organs. And there should have a comprehensive law to govern e-commerce business which can give role based duty to all stakeholders and can keep the coordination of all concerned organs.<sup>222</sup> Let alone to exist coordination among this stakeholders but also each of the organs doesn't know what is being done by the other.<sup>223</sup>

However, in Ethiopia, it is characterized by fragmentation of regulation and competition. For instance, both MCIT and INSA had enacted e-commerce law and currently. And the law is not comprehensive enough to govern the duties of other e-commerce concerned organs such as ERCA. This creates a duplication of effort and shows the existence lack of cooperation fragmentation of regulation. The other thing rose by the respondents in the ERCA, for instance, they are not aware of the situational analysis report conducted by the INSA. This is another way of showing non-cooperation among the stakeholders. The other instance is non-participation during the drafting process of the e-commerce law. As outlined in the second chapter of this research, there have been two draft e-commerce laws in Ethiopia and the one which is ratified is 1205/2020 it is only that touches some concerns of tax. But, in all two draft and the ratified proclamation laws, ERCA and other institution did not take part in it but MCIT have sent invitation letter repeatedly to the concerned institutions such as ERCA<sup>224</sup> but they have never shown up. This may be the reason that the e-commerce laws do not appear to be comprehensive or make reference to other existing laws such as tax laws. So, there should be a collaboration and cooperation among organs.

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<sup>219</sup> Told me that there are some SMS based business which delivers different information such as sport, science and other professional services.

<sup>220</sup> Id at supra note 95

<sup>221</sup> ibid

<sup>222</sup> ibid

<sup>223</sup> supra note at 97

<sup>224</sup> Supra note 52.

## **CHAPTER FOUR: CONCLUSION AND RECOMMENDATIONS**

### **5.1. Conclusion**

E-commerce can provide cheap and fundamentally new way of conducting commercial transactions. Due to these advantages it is becoming one of the largest industries in the world. By the medium of internet e-commerce takes place in the global environment making transnational appearance of business in different jurisdictions an easy task.

The current international tax system was constructed with a view to regulating tangible goods, and is falling short in the face of emerging global trends, such as, trade goods and (especially) services and trade over the Internet. As regards revenue, it has been established that taxes should inherently be fair and equitable. Not taxing the Internet goes against the international tax principle of neutrality; not taxing the Internet places sellers operating out of brick and mortar establishment at a disadvantage.

This has fueled a debt among several countries as to which taxation regime has the right is to tax such incomes.

When we come to Ethiopia, e-commerce has got the attention of the government policy since 2006. Yet, the government has failed to place the necessary legal, institutional and technological platform to that end.

The thesis discussed the various issues related to business income taxation of electronic commerce and OECD taxation framework conditions as a mirror to evaluate Ethiopian laws and practices of business income tax of electronic transactions. In doing so, it tried to show how the existing legal regime relating to business income tax in Ethiopia will be applicable for taxation of e-commerce. As far as business income is concerned there are issues to be raised when the current income tax law is applied, The definition of PE in the Ethiopian income tax proclamation and some bilateral double taxation treaties to which Ethiopia is a party discussed in this paper have similar definition of PE with the definition provided by OECD model conventions. Thus it is the traditional definition that requires some sort of physical presence to establish existence of

PE. This makes it clear that it is impossible to prove the existence of PE in e-commerce transaction involving nonresidents by applying the principles of PE in our law. There is no important measure taken by the Ethiopian legislature to mold this traditional concept of PE, so as to make it cope up with the development of technology and to make it applicable to e-commerce. Therefore, it is impossible for Ethiopia government to exercise its taxation power over Ethiopian source income generated by a nonresident by the use of e-commerce without any physical presence in the country. As the development of e-commerce is at its infant stage of development in Ethiopia, the tax revenue losses associated suffered may have not been studied and given much attention and any organ of the government have data on the revenue generated by such transactions. However the development and the proliferation of e-commerce industry in the countries future is inevitable reality, since we cannot escape from globalization. Thus in order to benefit from the obvious advantages of this industry and to collect legally payable tax by the government it will be mandatory that the definition of PE in Ethiopian laws has to follow international trends (like OECD Clarification on Article 5) so as to make it applicable to e-commerce and it has to be updated in order to ensure accurate, fair and correct taxation collections. The concept of PE in our laws has to be updated in a way that is sufficiently enough to address e-commerce domestically and from international perspective.

The other most significant challenges have been the problem of applying source and residence rules to goods purchased over the Internet. It must be investigated how the power to tax can be established more effectively in the digital biosphere. Electronic commerce is therefore changing business frontiers, not only in Ethiopia, but globally. There is now an increasing appetite to conduct business electronically rather than physically because of the inherent advantages ecommerce do have.

The other issue, for which the paper attempted to provide an analytical answer, is whether the current tax laws and principles in Ethiopia are adequate to tax e-commerce. Particularly, under the income tax proclamation, the understanding of permanent establishment and the source-residence principles requires some physical facility or geographical presence, which is of no help as regards to e-commerce. Characterization of income of e-commerce is not dealt with the income tax proclamation.



The other concern is to check whether there exist any administrative and institutional readiness and cooperation among the concerned organs to tax e-commerce in Ethiopia or not and the research has answered this question based information gathered through interviews. Finally, the thesis demonstrated that, current income tax and tax administration laws, and institutions are highly affected by the advent of e-commerce and the challenge lies. Nonetheless, it has seen that there are many practical questions that do not find answers in the current business income taxation structure. In practice, e-commerce taxation especially for business income taxation of ecommerce purpose is not given due attention. Correspondingly, it emerged that there was a lack of proper and adequate resources, and their usage. The Tax Authority doesn't have a follow up mechanism for the transactions. Similarly, including the absence of legal framework for completing an electronic business, lack of effective online payment system currently working in the international level, and stringent foreign exchange regulations are important barriers to the development of e-commerce in Ethiopia. As a result of that, the state continues to lose potential tax revenues from this sector. Among the constraints for development of e-tax are lack of commitment by the government, low level of awareness, technological backwardness, lack of coordination among stakeholders and infrastructural deficit are the notable ones.

As a result, failure to tax the internet would then lead to inefficiency and market distortion, for which there is no justification to e-commerce preferential tax treatment. Furthermore, failure to tax the Internet would result in the erosion of local tax bases and the shifting of these profits to other jurisdictions.

With the fact that the understanding of the current tax system bases itself with geographical or territorial principle while in e-commerce, such thing as territory or physical presence has no or little place. To be specific, in the realm of income tax, the understanding of permanent establishment, residence-source principle, and characterization of income are highly challenged ones, among them permanent establishment has been given due consideration in this thesis.

In this study, the researcher finds that e-commerce in general, has tried to be regulated recently on May 23<sup>rd</sup> 2020 and taxation issue is left out of the ambit of the proclamation. The respondents from ERCA, INSA, MCIT, and Ethio-telecom revealed that there exist lack of awareness regarding e-commerce and the taxation issue. No one from the tax administrator noted the issues in the taxation of e-commerce.

The last but not the least question addressed in the study is as to what measures should be taken so as to overcome the challenges of business income taxation of e-commerce in Ethiopia and the paper consults the OCED taxation framework conditions. So as to curb the problems identified in this paper the following recommendation is given.

## 5.2. **Recommendation**

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

□The definition of Permanent Establishment in our laws has become outmoded and impossible to apply for e-commerce. Thus, it is mandatory that the definition of PE in Ethiopian laws has to redefine in a manner that goes with international trends so as to make it applicable to e-commerce and it has to be updated in order to ensure accurate, fair and correct taxation collections. A clear provision on whether web sites and/or servers will be considered to be permanent establishment should be issued.

□In bilateral double taxation treaties to which Ethiopia is a party the definition of PE needs to clearly establish their application with respect to e-commerce, thus the definition of PE in these documents has to be changed to include e-commerce.

□Ethiopia has to participate at the international level in efforts to come up with effective and comprehensive international business taxation law because it will help Ethiopia in addressing its taxation issues from global perspectives.

□ Better collaboration and networking between government departments like INSA, Telecommunication, and ERCA is required so that the presence of online businesses can be monitored. This cautious step of the Tax Authority should be made to work togetherwith such group of actors in order to disclose e-commerce transactions that take place within their networks. In doing so, there is need to develop a comprehensive human resource development program and create an awareness to all stakeholders including ERCA officers and taxpayers on conception of e-commerce taxation. This should be done in different conferences and trainings.

A major obstacle to the development of e-commerce in Ethiopia is the limited availability of credit cards and a nationwide credit card system. There should be made radical improvement on the e-payment system of the country.

To resolve the problems of identification of the identity and location of the parties, certain methods should be designed. Hence, the Ethiopian Tax Authority should investigate ways to verify and obtain accurate information as to the party's identity and location. Particularly, the use of technologies for tax administration and collection should be used towards identifying not just the parties but also other details of the e-commerce transactions thereto.

An efficient international cooperation that assists the administration of business income is key aspect in e-commerce situation. Unless such cooperation is forthcoming, e-commerce will cause a potential erosion of tax base for the government. To ensure such co-operation it will be necessary to create separate unit within the Tax Authority for information exchange. Broad consensus on the type of information to be exchanged and compatibility in laws relating to banking secrecy would assist in preventing erosion of tax base.

The role of the government should only be leveling the playing field and it should be private led and the role of the government should only be establishing legal and regulatory mechanism.

E-receipt mechanism should be developed, awareness creation, digital by design and the proclamation recommended for the enactment of 8 directives.

There is growing realization and acceptance that without appropriate policy interventions, the tax base erosion that has been underway for many years is expected to persist as e-commerce usage continues expanding across the globe. Policy makers will therefore be forced to rethink their tax policies in order to come up with a feasible way of taxing e-commerce activities at local/state, national and international level without stifling its progress. So there is a Need for tax policy reforms to be made.

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### **Appendices**

Interview Questions to Academicians;

1. How do you understand E-commerce?
2. There are different views as to e-commerce should be taxed or not, what is your view?
3. How do you see the adequacy or otherwise of the Ethiopian income tax Laws in the context of e-commerce?
4. Do you think there is any administrative or institutional readiness and structure tax e-commerce?
5. What measures should be taken to make taxation of e-commerce effective in Ethiopia?

Interview Questions to officials and experts of ERCA and INSA

1. How do you understand E-commerce?
2. Do you think it exists in Ethiopia?
3. Does the country have a policy on e-commerce taxation?
4. Do you think the country is losing revenue from e-commerce taxation?
5. Do you think the current income laws are adequate to tax e-commerce?
6. Did you participate in the e-commerce law drafting process?
7. What is e-tax and is there such trend in Ethiopia.