

TAXATION OF INCOME FROM E-COMMERCE IN ETHIOPIA: A QUEST FOR INTEGRATING MODERN RULES OF TAXATION INTO ETHIOPIAN INCOME TAX SYSTEM.

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Abstract

With the advancement of technology, the traditional commercial environment has been changed to E-Commerce. This change has posed serious challenges to the traditional taxation regimes. To legalize and promote E-Commerce, Ethiopia has adopted the “Electronic Transaction Proclamation” and “Digital Strategy for Inclusive Prosperity 2025” in 2020. This would inevitably pose a challenge to the Ethiopian income tax regime. This article examined the taxation of income from electronic commerce under Ethiopian income tax legislation along with its gaps and opportunities for regulation. To accomplish this, it employed a doctrinal legal research methodology to examine the relevant provision of income tax law and selected double taxation agreements in Ethiopia. Accordingly, the finding of the article shows that neither the domestic law nor the bilateral tax treaties signed by Ethiopia have incorporated a rule for taxation of income from E-Commerce. Besides, the concept of permanent establishment as envisaged under Ethiopian income tax law does not apply to the taxation of E-Commerce. Hence, it is recommended that Ethiopia should integrate the modern rules for the taxation of income from E-Commerce into its income tax law and double taxation agreements.

Keywords: E-Commerce, Taxation, Double Taxation Agreement

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1. INTRODUCTION

With the advancement of the technology, the international business trend is changing. There was a paradigm shift as the traditional business trends, which require physical presence, have been replaced with virtual business transactions commonly called E-Commerce. As far as the definition of electronic commerce is concerned, there is no universally accepted definition. The United Nations Commission on International Trade Law has defined E-Commerce as “commercial activities conducted through an exchange of information generated, stored, or communicated by electronic, optical, or analogous means.”¹

The Organization for Economic Co-operation and Development (OECD) simplifies this definition by stating that E-Commerce is a commercial transaction “involving both organizations and individuals, that are based upon the processing and transmission of digitized data, including text, sound, and visual images and that is carried out over open networks (like the Internet).”²

E-commerce has significant effects on the economy and society.³ The issue of income taxation is one important sector of the economy where E-Commerce has far-reaching ramifications, making the process of taxing enterprises more difficult.⁴ The challenge in taxing income from E-Commerce is how to apply the existing tax laws and principles to E-Commerce transactions.⁵ International double tax treaties are based on the tenet that non-resident businesses must maintain a permanent establishment (PE) in their source country in order to be subject to tax there, and only to the degree that the earnings are attributable to the PE.⁶ Permanent establishment is primarily used to decide whether a Contracting State has the authority to tax the profits of an enterprise of another Contracting State.⁷

¹ Rifat Azam, “E-Commerce Taxation and Cyberspace Law: The Integrative Adaptation Model” (2007) 12 Virginia Journal of Law & Technology, 7.

² ‘OECD Annual Report 2007’ (OECD, 2007) <www.oeca.org> accessed 30 July 2020.

³ Mark Lubbock & Louise Krosch, *E-Commerce Doing Business Electronically: A Practice Guide* (2000).

⁴ *ibid.*

⁵ *ibid.*

⁶ Annet Wanyana Oguttu, ‘The Challenges of Taxing Profits Attributed to Permanent Establishments: A South African Perspective’ (2009) 21 Sa Merc Law Journal, 773.

⁷ Aiko Nakayama, ‘The Permanent Establishment Concept Under Tax Treaties and Its Implications for Multinational Companies’ (Master’s thesis, University of London, 2012).

In the pre-digital era, in 1927, the idea of a permanent establishment emerged when dealing with target markets placed reliance on physical premises.⁸ A permanent establishment is “A fixed place of business through which the business of an enterprise is wholly or partly carried on.”⁹ For the existence of permanent establishment, three elements, namely: “*fixed*”, “*place of business*” and “*carrying on activities wholly or partly at the fixed place*” should be cumulatively fulfilled. Fixed refers to the degree of permanency with respect to the taxpayer and the connection between the location of the business and a certain geographic point.¹⁰ Further, a facility used by an organization for conducting business, such as a set of premises or, in certain cases, machinery or equipment, is referred to as a place of business.¹¹ From this definition, it is apparent that the physical presence of the enterprise in the source state is mandatory.

However, doing business in e-commerce creates a setting where a company can essentially operate in any market jurisdiction, from anywhere in the world, which presents difficulties when trying to apply the treaty notion relating to a permanent establishment.¹² Because of the virtual environment in which they operate, E-commerce businesses don't fit the criteria for a fixed place of business in determining whether they have a permanent establishment in the jurisdiction where commercial operations have been undertaken.¹³ The issue here is that traditional tax laws, organizations, and concepts all revolve around the idea of geographical locations while E-commerce can operate in a virtual environment, where the concepts of geography, physical location, and territoriality have no or little significance.¹⁴

E-commerce presents enormous opportunities for business growth and the creation of jobs, but it may also result in a loss of tax revenue due to the intrinsically non-territorial nature of its digital

⁸Visesh Dhuldhoya, ‘Electronic Commerce and Principle of Permanent Establishment Under the International Taxation Law’ (2011) 37 International Tax Journal, 42.

⁹OECD Model Convention 2017.

¹⁰‘Commentary on OECD Model Convention of 2017 Update, Paragraph 16 to Art.7’ (OECD, 2017) <https://www.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2017_mtc_cond-2017-en> accessed 3 July 2020.

¹¹ibid.

¹²Jean Philippe Chetcuti, ‘The Challenges of E-Commerce to the Definition of a Permanent Establishment: The OECD’s Response’ (2002) <<http://www.inter-lawyer.com/lex-e-scripta/articles/e-commerce-pe.html>> accessed 31 March 2020.

¹³Visesh Dhuldhoya (n 8).

¹⁴Jean Philippe Chetcuti (n 12).

transactions. This is true at the sub-national, national, and international levels as well.¹⁵ This revenue loss is worrying to governments as most governments rely heavily on tax revenue as a source of funding for their fiscal programs. While there is some general agreement on how to approach international E-commerce transactions, efficient taxation of E-commerce remains an issue. Various policy interventions have been proposed to solve the challenges of taxing income from E-commerce.¹⁶ Some initiatives have been made under the OECD's guidance. The best examples are the Ottawa framework and the BEPS action plan. Three possibilities have been proposed by the BEPS action plan by the G-20 and OECD countries for the taxation of income from e-commerce: an equalization levy, a new nexus rule in the form of a significant economic presence, and withholding tax on specific types of digital transactions.¹⁷ Furthermore, various countries have taken unilateral action to regulate the taxation of income from E-Commerce.

When it comes to Ethiopia, the idea of E-commerce is still in its infancy stage. The main barrier to the growth of E-commerce in Ethiopia was the lack of a legal framework. Ethiopia has taken two key steps that legalize and advanced E-commerce just in 2020 to cope with the global business trends and digitalize its economy. The first measure is the adoption of the electronic transaction proclamation.¹⁸ This would solve the problem that underlies the absence of a legal framework that regulates E-Commerce. The second measure is adopting the strategy called “the digitalization of economy 2025” as a part of its prosperity plans.¹⁹ Adopting the proclamation that regulates electronic transactions and strategy on the digitalization of the economy has a tremendous role in enabling our country to share from the chalice of E-Commerce. Yet, the taxation of income from E-Commerce would inevitably pose a challenge to the Ethiopian income tax law. Since E-Commerce is in the infancy stage and even legalized in 2020, the traditional tax system that requires the physical presence of the businessperson may not fit for the taxation of income from E-Commerce.

¹⁵Peter Misiani Mwencha, ‘Taxation Of Electronic Commerce – A Commentary’ (2019) 1 Financing for Development, 76.

¹⁶ibid.

¹⁷‘Additional Guidance on the Attribution of Profits to Permanent Establishments, BEPS ACTION 7’ (OECD, 2018) <<https://www.oecd.org/tax/transfer-pricing/additional-guidance-attribution-of-profits-to-permanent-establishments-BEPS-action-7.pdf>> accessed 28 July 2020.

¹⁸Federal Electronic Transaction proclamation of Ethiopia 2020.

¹⁹‘Ethiopia Digital Strategy 2025’ (2020) <<https://tapethiopia.com/category/downloadable-pdfs>> accessed 3 July 2020.

Therefore, this article aims to examine the taxation of income from electronic commerce under Ethiopian income tax legislation, along with its gaps and opportunities for regulation. In order to accomplish this, it employed a doctrinal legal research methodology to examine the relevant provision of income tax law and selected double taxation agreements of Ethiopia. This methodology was selected as the objective of the paper is to investigate the pertinent provision of income tax law and double taxation agreements of Ethiopia in light of modern developments. The paper has used both Primary and secondary sources of data to make a qualified analysis. Accordingly, domestic laws like the old income tax proclamation, the new income tax proclamation, the new income tax regulation, selected double taxation agreements of Ethiopia, and OECD and UN model conventions constitute the primary source while Books, articles, journals, reports, unpublished materials, and internet sources are the secondary sources. Since most of the double taxation agreements of Ethiopia are similar concerning E-Commerce, exploring all is not necessary. Accordingly, double taxation agreements with China, Ireland, Singapore, and Cyprus are randomly selected.

The article is divided into five sections. The second section presents the challenges of taxation of income from E-Commerce and the viability of the traditional tax system in regulating the taxation of income from E-Commerce. The third section unveils the global initiatives to address challenges relating to the income from the business of E-Commerce. The fourth section analyses the Taxation of income from E-Commerce and the need for integrating rules for the Taxation of income from E-Commerce into the Ethiopian Income Tax System. Finally, the article ends with brief concluding remarks.

2. THE CHALLENGES OF TAXATION OF INCOME FROM E-COMMERCE, AND THE VIABILITY OF THE TRADITIONAL TAX SYSTEM IN REGULATING TAXATION OF INCOME FROM E-COMMERCE

The taxation of income from cross-border E-Commerce raises several legal issues. States have an economic interest such as increasing internet revenue when they impose a tax on E-Commerce.²⁰ There are arguments for and against the taxation of income from E-Commerce. The first line of argument tenaciously contends that E-Commerce should not be taxed. The accompanying point of

²⁰Paulos Biruk, *The Legal Architecture for Electronic Commerce In Ethiopia: Lesson From Eu Experience* (Anchor academic publishing 2015).

such views buttresses their points by equating the emergence of E-Commerce at a global level based on the development of the global free-market economic system and the idea of trade liberalization, which holds that restriction on the worldwide trade shall be minimized to the barest minimum.²¹ Thus, the government shall not intrude in the free trade environment created by Internet commerce or cross-border E-Commerce by imposing taxes.

On the contrary, those who argue for states' imposition of E-Commerce taxation contend that since the government has the functional role of regulating the playing field for any market, the intervention of the government to undergo its fundamental part of stabilizing economic problems is logical as Protection of E-Commerce security and any administrative interventions (including political reasons) into market on cyberspace is also due to sales tax from out of state customers.²² E-commerce should be taxed, just as traditional commerce. Equity, economic neutrality, and revenue considerations are used as justifications for taxing E-commerce.²³ *First*, "failure to impose the tax on online purchases would cause significant revenue losses for state and local governments".²⁴ *Second*, it is unfair to exempt electronic products and services from taxes when they are identical to products and services bought in physical stores. For instance, taxing the hard copy of the same book sold in a store but not the e-book that is downloaded directly from the internet is against the principle of fairness and neutrality.²⁵ *Third*, taxation should be economically neutral, i.e., it shouldn't affect how or where economic activity is conducted.²⁶ *Fourth*, E-commerce vendors have an unfair edge over conventional brick-and-mortar retailers if it is tax-free. This means that, in contrast, a large portion of E-commerce is in competition with vendors who would be disadvantaged by the preferential tax treatment of E-commerce.²⁷ While E-commerce has been taxed in Ethiopia as a conventional business transaction, the method has been flawed for a number of legal, infrastructure, and other technical reasons.²⁸

²¹ibid.

²²Jerry Allison, 'E-Commerce: Exactly What Is It?' (2014) <www.drjerryallison.hubpages.com> accessed 31 March 2020.

²³Subhajit Basu, "Relevance of E-Commerce for Taxation: An Overview" (2003) 3 GLOBAL JURIST TOPICS 18.

²⁴ibid.

²⁵Oduntan Olugbemi Adebayo, 'Taxation of Electronic Commerce: Prospect and Challenges for Nigeria,LL. B Long Essay' (University of Lagos 2010), 79.

²⁶Oduntan Olugbemi Adebayo (n 25).

²⁷ibid.

²⁸Andualem Temesgen, 'A Critical Assessment of the Application of Ethiopian VAT on E-Commerce' (Master's Thesis, Addis Ababa University 2018).

E-commerce appears to have many benefits, but it also presents a number of problems for the global, national, and subnational tax systems already in place.²⁹ E-commerce has disturbed the smoothness of tax rules and regulations designed by the tax authority.³⁰ Eliminating intermediaries, who are crucial for identifying taxpayers in business transactions, is one of the main issues that E-Commerce brings to tax regimes.³¹ This could result in less taxation, complicated tax administration, and weaker tax declaration.³² The challenge in taxing income from E-Commerce is how to apply the existing tax laws and principles to E-Commerce transactions.³³ The other challenge is how to decide the rules governing permanent establishment in E-commerce taxation. It became clear that a permanent establishment cannot operate without a fixed place of business. A physical presence in a foreign nation is additionally necessary for this fixed place of business. Finding a permanent establishment based on its conventional formulation is more challenging due to globalization, which is exemplified by the development of electronic commerce and allows significant business activities to occur in a source state without either physical or human intermediaries, such as brokers, distributors, or representatives.³⁴ This is due to the difficulty in establishing the traditional presumption of business operations in an E-commerce environment, which requires a physical location as the idea of tax jurisdiction that has thus far been linked to a physical/geographical connection.³⁵ Determining what constitutes a permanent digital establishment in various jurisdictions is quite difficult and ambiguous. In addition, there are no consistent guidelines in international law for making such a conclusion. As a result, the taxation of cross-border income from e-commerce is extremely complicated and difficult.³⁶

Although E-Commerce is regarded as a crucial tool for development and trade facilitation, its rapid expansion has sparked a global debate about the types of taxation regimes that should be used to limit the revenue losses that result from its use at the sub-national, national, and international levels

²⁹Jolanta Gałuszka, 'How to Tax E-Commerce - Global or National Problem?' (masters thesis, University of Economics In Katowice 2011).

³⁰Horn. P(, 'Taxation of E-Commerce'' (2003) 2 Journal of American Academy of Business 329.

³¹Richard Jones and Subhajt Basu, 'Taxation of Electronic-Commerce: A Developing Problem'' (2002) 16 International Review of Law Computers & Technology, 36.

³²Zheng Qin, *Introduction To E-Commerce* (Tsinghua University Press, 2009) 214.

³³Zheng Qin (n 33).

³⁴Suzette Wepener, 'The Impacts of Electronic Commerce on Permanent Establishment Definition' (Masters thesis, University of Capetown, 2016).

³⁵Zheng Qin (n 33) 214.

³⁶Paulos Biruk (n 20) 40.

without stifling its development.³⁷ Numerous reform proposals have been made in the literature on tax policy and law as the taxing of income from E-Commerce has generated significant controversy regarding the sustainability of the PE regulations.³⁸ The Organization for Economic Cooperation and Development (OECD), for instance, claims that the current tax system is appropriate for both online and physical business operations.³⁹ They have provided four primary justifications for their continued employment of the current permanent establishment principles, with considerable assistance from numerous academics (including some authors who advocate PE retooling): (1) The PE rules are conceptually sound; (2) The tax avoidance and revenue loss scenarios predicted by change advocates are not well supported by evidence; (3) The PE rules are strong and flexible enough to handle the challenges of e-commerce; and (4) Transfer pricing and other remedies are available to address any inefficiencies brought on by the current rules.⁴⁰ On the contrary, tax professionals are also advocates that the current tax laws are insufficient to handle the taxation of income from E-Commerce transactions as they were created at a time when there was no E-Commerce.⁴¹ There are assumptions that the government will incur a financial loss if current tax laws are applied to E-commerce.⁴²

3. GLOBAL INITIATIVE FOR ADDRESSING TAX-RELATED ISSUES IN E-COMMERCE

Due to technological development, identifying a permanent establishment for taxation has become more difficult when a firm operates in E-commerce. Governments around the world have struggled with the issues of the taxation of income from E-commerce.⁴³ Failure to safeguard the nation's tax base from E-Commerce challenges will lead to an unfair business environment for resident and non-resident companies⁴⁴, where non-resident companies can avoid income tax due to discrepancies between income tax legislation and the operations of an E-Commerce business. To

³⁷Peter Misiani Mwencha (n 15) 69.

³⁸Benjamin Hoffart, 'Permanent Establishment in the Digital Age: Improving and Stimulating Debate through an Access to Markets Proxy Approach' (2007) 14 *Northwestern Journal of Technology and Intellectual Property* 112.

³⁹Jeyapalan Kasipillai, & Razak.A.Salleh, 'Tax Considerations Involving Electronic Commerce' (Akauntan Nasional, 2000).

⁴⁰Gary D. Sprague & Rachel Hersey, 'Permanent Establishments and Internet-Enabled Enterprises: The Physical Presence and Contract Concluding Dependent Agent Tests' (2003) 38 *Ga. L. Rev.*, 311.

⁴¹Smith, G., *Internet Law and Regulation* (3rd edition, Sweet and Maxwell 2002).

⁴²Davis, A. & Chan, 'Taxation of Internet Commerce: Some Potential International Problem' (2000).

⁴³Jinyan Li, 'Protecting the Tax Base in the Digital Economy' (2014)

<http://www.un.org/esa/ffd/tax/2014TBP/Paper9_Li.pdf> accessed 31 March 2020.

⁴⁴ibid 28.

avert such challenges, the OECD has taken the lead in formulating the guiding principles and tax rules to govern the income tax treatment of cross-border E-Commerce transactions. Various approaches to the taxation of income from electronic commerce can be presented as follows:

A. Ottawa Framework

One of the top and most important organizations putting forward effort to address the tax difficulties coming from electronic transactions is the OECD.⁴⁵ The initial goal of the OECD's establishment was to support and encourage measures designed to achieve the highest levels of sustainable economic growth and growing standards of living in its member states in order to advance global economic development.⁴⁶ The first organization to create a framework for the taxation of income from E-commerce was the OECD. The Ottawa taxation framework criteria were enacted on October 8th, 1998. Since 1998, the Committee on Fiscal Affairs (CFA) of the OECD has worked to turn these principles into applicable worldwide recommendations.⁴⁷ To create a global tax policy, the OECD has in particular organized working committees. Accordingly, member nations developed the Ottawa taxation framework through their tax authorities. They all agreed that the taxation of E-commerce should follow five standard taxation principles.⁴⁸

The first principle, neutrality, asserts that taxation should aim to be fair and impartial between various E-Commerce platforms as well as between traditional and electronic forms of commerce.⁴⁹ Tax rates should be equivalent for taxpayers in comparable circumstances engaging in comparable activities. Efficiency is the second guiding principle. It states that taxpayer compliance costs and administrative costs for the tax authorities should be kept to a minimum. Certainty and simplicity make up the third principle. It states that in order to foster trust and simplicity, the tax laws should

⁴⁵Konstantinos Siliadis, 'Taxation of E-Commerce - A Task For Jugglers' (2008) 11 Masaryk University Journal of Law and Technology 143, 155.

⁴⁶'Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions' (OECD, 2001) <<http://www.oecd.org/ctp/consumption/Taxation%20and%20eCommerce%202001.pdf>> accessed 25 June 2020.

⁴⁷'The Economic and Social Impact of Electronic Commerce: Preliminary Findings and Research Agenda, OECD Digital Economy Papers No. 40'.

⁴⁸'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' (OECD, 2001) <<https://blog.cipit.org/2018/02/15/E-Commerce-and-the-law-in-kenya-taxation>> accessed 16 June 2020.

⁴⁹'Implementation Issues for Taxation of Electronic Commerce' (OECD, 2003) <<http://www.oecd.org/tax/consumption/5594899.pdf>> accessed 8 July 2020.

be unambiguous and simple to comprehend so that taxpayers may anticipate the effects of taxes in advance, including understanding when, where, and how taxes are to be accounted for.⁵⁰

The fourth principles are effectiveness and fairness. It stipulates that taxation should result in the appropriate tax at the appropriate time. Efforts should be made to reduce the possibility of tax evasion and avoidance while keeping preventative measures commensurate with the risks involved.⁵¹ Flexibility is the final principle. As a result, taxation systems need to be adaptable and dynamic to keep up with advancing science and commerce. However, there may be conflicts between these principles, and governments and businesses may have different opinions on how to balance and prioritize their application in different situations.⁵² That being said, implementing these principles to E-commerce should be planned to uphold national fiscal autonomy, ensure a fair distribution of the tax base from E-commerce among nations, and prevent double taxation and unintended non-taxation.⁵³ The difficulty Revenue authorities face is how to apply the general taxation rules in a situation that is changing quickly.⁵⁴

B. Virtual Permanent Establishment

A number of approaches have been put out to address problems that arise and lead to tax avoidance in order to overcome the challenges posed to income tax by businesses in E-Commerce. One suggestion is to include the phrase "virtual permanent establishment" in the definition of PE as it is currently understood. A virtual fixed place of business and a virtual agency are included in the concept of a virtual permanent establishment, which modifies the idea of a permanent establishment.⁵⁵ According to this theory's author, Luc Hinnekens, the taxation nexus for electronic

⁵⁰ibid.

⁵¹Sol Picciotto, *International Business Taxation, A Study In the Internationalization of Business Regulation* (Cambridge university press, 1992).

⁵²Steven Maguire, 'State Taxation of Internet Transactions, CRS Report for Congress (2013) <<https://www.reit.com/sites/default/files/media/2013/State-Taxation-of-Internet-Transactions.pdf>> accessed 31 March 2020.

⁵³'Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions' (n 47).

⁵⁴'Electronic Commerce: Taxation Framework Conditions, A Report by the Committee on Fiscal Affairs' (OECD, 1998).

⁵⁵'Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce? Final Report, 2005' (OECD, 2005) <<http://www.oecd.org/ctp/treaties/35869032.pdf>> accessed 31 March 2020.

commerce should instead be "the continuous commercially significant conduit of business activity" rather than a fixed place of business.⁵⁶

The virtual PE approach applies to the jurisdictional criterion for source-based taxation of profits.⁵⁷ Furthermore, according to Hinnekens, the modern PE definition should be "re-invented" to include the original concept of taxing based on economic allegiance and equivalence into internet commerce and set uniform standards for separating mainline commercial activity from ancillary business activity. Hinnekens proposed adding a special article to the existing treaties to grant the source state the authority to tax profits from businesses conducted over the Internet even in the absence of PE as long as they carry out their activity on its territory and expanding the PE definition of Art. 5 of the OECD Model Tax Convention to serve this purpose.⁵⁸ The main characteristic is that it involves adding to the traditional PE threshold by including a nexus for allowing source taxation of business profits even in the absence of a "fixed place of business."⁵⁹ Besides, abandoning the "fixed place of business" test as a sole threshold for source taxation was also suggested by Skaar as early as 1991.⁶⁰ The idea of a "virtual permanent establishment" has been taken into consideration in Spain, where it was put to the test in a 2012 Dell case.⁶¹ Accordingly, in Dell Products Limited's 2012 case, the Economical Administrative Central Tribunal of Spain decided that an online store qualifies as a permanent establishment in Spain.⁶²

There are a number of flaws with the virtual permanent establishment. Hinnekens acknowledges that further uncertainties may have developed as a result of virtual PE's re-invention of the taxation nexus and the need for a new methodology for calculating attributable profits. Thus, case law, administrative practice, guidelines, and benchmarks developed by the OECD Committee of Fiscal Affairs are necessary.⁶³ The viability of this idea has been criticized by other authors. Cockfield

⁵⁶Luc Hinnekens(, 'Looking for an Appropriate Jurisdictional Framework for Source-State Taxation of International Electronic Commerce in the Twenty-First Century' (1998) <<https://www.kluwer-lawonline.com/abstract.php?area=Journals&id=TAXI1998036>> accessed 28 July 2020.

⁵⁷ibid.

⁵⁸ibid.

⁵⁹Dale Pinto, *E-Commerce, and Source-Based Income Taxation* (IBFD publication 2003).

⁶⁰Arvid Aage Skaar (*Permanent Establishment – The Erosion of a Tax Treaty Principle* (Kluwer Law and Taxation Publisher 1991).

⁶¹Gary D.Sprague, 'Spanish Court Imposes Tax Nexus by Finding a Virtual Permanent Establishment' (2013) <<http://www.bna.com/spanish-court-imposes-n17179871765>> accessed 31 March 2020.

⁶²ibid.

⁶³Luc Hinnekens((n 57) 199.

has noted that a qualitative economic presence test is ineffective since the creation of a "virtual PE" necessitates the fulfillment of onerous requirements for businesses that are not certain if they should comply with such requirements.⁶⁴ Furthermore, it might be difficult to enforce such liabilities since no international tax authority is in charge.

Additionally, Cockfield emphasizes that tax authorities and courts from all over the world will evolve their view of the elements that satisfy the criteria for domestic source taxation. Capital-exporting nations will typically interpret the test more narrowly whereas capital-importing nations would typically read the variables broadly to allow their tax authorities to exercise jurisdiction over non-resident enterprises.⁶⁵ Kim David Lexner argues that this theory necessitates a physical presence by the vendor before he is subject to taxation, just as a "fixed place of business" does, because "you cannot have operations or systematic activities within a state without you or your employees or agents being present in that state."⁶⁶ Such kinds of controversy have led to BEPS action plan 1.

In the context of the discussion regarding the BEPS Action1, which addresses the Tax Challenges of the Digital Economy, the Virtual PE hypothesis was stated by the OECD as an alternative that was investigated in 2005 to adapt the current international tax rules to the digital economy, but it was left unmentioned as to whether the alternative was still viable in the current environment. In fact, the OECD concluded that such radical changes to international tax laws are not necessary in the paper titled "Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce?" published in 2005.⁶⁷ In addition, despite acknowledging that it is necessary to address the challenges of the digital economy, the OECD did not even touch upon the virtual PE theory in the "Addressing the Tax Challenges of the Digital Economy" report, which was published on September 16th, 2014, in the context of the action plan to address Base Erosion and Profit Shifting.⁶⁸

⁶⁴Arthur J. Cockfield, 'Reforming the Permanent Establishment Principle through a Quantitative Economic Presence Test' (2003) 37 Canadian Business Law Journal 417.

⁶⁵ibid.

⁶⁶Kim David Lexner, 'Selected Issues in the U.S.-Dk Tax Treaty: Permanent Establishment Concerning E-Commerce Transactions and the Distinction between Payment for Services and Payment for Intangible Property Rights' (2010).

⁶⁷'Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce? Final Report, 2005' (n 56).

⁶⁸'Addressing the Tax Challenges of the Digital Economy' (OECD, 2014) <http://www.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy_9789264218789-en> accessed 28 July 2020.

C. BEPS Action Plan proposal

Base Erosion and Profit Shifting (BEPS) is a term used to describe tax evasion tactics used by multinational enterprises (MNEs) to artificially move profits to low- or no-tax jurisdictions where there is little or no economic activity in order to reduce tax liability.⁶⁹ In September 2013, the OECD and the G-20 countries adopted a 15-point Action Plan with the main goal of addressing BEPS by MNEs.⁷⁰ From the 15-point Action Plan adopted by the OECD and G-20 countries, Action 1 is related to the challenges of taxing the digital economy.⁷¹ A report on the difficulties with taxing the digital economy was released by the OECD in 2015.⁷²

BEPS Action 1 did not offer any recommendations for how to specifically address the issues with the digital economy.⁷³ The OECD determined that it would be incorrect to "ring-fence" the digital economy as it is such a deeply ingrained component of the economy as a whole. Instead, the remaining BEPS measures, such as artificial PE status avoidance and transfer pricing regulations, would address the issues with taxing digital business models.⁷⁴ Accordingly, three options, namely: a new nexus based on non-physical significant economic presence, withholding tax, and equalization levy, were proposed to address the challenges of the taxation of the digital economy.⁷⁵ None of these three possibilities was, however, suggested for adoption.⁷⁶ The OECD instead advised that nations embrace the suggested alternatives while still adhering to any current treaty requirements. The OECD pledged to revisit taxes on the digital economy in 2020.⁷⁷ The OECD's work on BEPS has inspired the UN Committee of Experts on International Cooperation in Tax Matters' efforts to address the tax issues facing the contemporary economy. The committee has considered making roughly the same amendments to Article 5 of the UN Model Tax Treaty as the

⁶⁹'Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 – 2015 Final Report' (OECD, 2015) <<https://www.oecd.org/ctp/preventing-the-artificial-avoidance-of-permanent-establishment-status-action-7-2015-final-report-9789264241220-en.htm>> accessed 28 July 2020.

⁷⁰ibid.

⁷¹'Action Plan on Base Erosion and Profit Shifting' (OECD, 2013) <<https://www.oecd.org/ctp/BEPSActionPlan.pdf>> accessed 28 July 2020.

⁷²'Addressing the Tax Challenges of the Digital Economy, Action 1', (OECD, 2015) 111–112 <<http://www.oecd.org/tax/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report-9789264241046-en.htm>> accessed 28 July 2020.

⁷³Anton Baumann, 'Digital Economy: The Future of International Taxation of Business Income' (Masters thesis, Oslo University, 2017).

⁷⁴ibid.

⁷⁵'Additional Guidance on the Attribution of Profits to Permanent Establishments, BEPS ACTION 7' (n 17); ibid 7.

⁷⁶'Addressing the Tax Challenges of the Digital Economy, Action 1', (n 73).

⁷⁷ibid.

OECD did to Article 5 of the OECD Model Convention.⁷⁸ The three options proposed by the BEPS action plan are presented as follows:

i. A New Nexus Based on Non-Physical Significant Economic Presence

In the draft report for BEPS Action 1, the creation of a new nexus based on "significant digital presence" was covered. The idea is that a company with a digital and non-material business strategy would qualify for a PE if it maintained a "significant digital presence" in the economy of another country.⁷⁹ The OECD has proposed a potential change to the permanent establishment to incorporate the business activities carried out digitally.⁸⁰ Businesses that engage in digital activities in a nation are considered to have a taxable presence if they maintain a significant digital presence in the country's economy in which the business transacts.⁸¹ An effective digital presence would accommodate a business engaged in digital activities, where minimal physical elements are required in conducting business activities.⁸²

Experiences of Kenya, India, Israel, and the European Union can be mentioned as an example. Accordingly, In order to address the challenges of taxation of E-commerce by non-resident enterprises, changes to the Kenyan Corporate Income Tax Act that went into effect last November 2019 have introduced a significant economic presence (SEP).⁸³ The standard is that SEP is established when non-resident businesses offer resident Kenyans digital, technological, management, consulting, or professional services to the resident person in Kenya.⁸⁴ In 2016, India imposed a six percent equalization levy on the sums paid by Indian companies to non-residents who provided digital advertising services.⁸⁵ However, India added the Significant Economic

⁷⁸Committee of Experts on International Cooperation in Tax Matters, Fourteenth Session: Proposed Base Erosion and Profit-Shifting Related Changes to the United Nations Model Double Taxation Convention between Developed and Developing Countries' (ECOSOC, 2017) <http://www.un.org/esa/ffd/wp-content/uploads/2017/02/14STM_CRP7_BEPS.pdf> accessed 28 July 2020.

⁷⁹'BEPS Action 1: Address The Tax Challenges of the Digital Economy' (OECD) <<https://www.oecd.org/ctp/tax-challenges-digital-economy-discussion-draft-march-2014.pdf>> accessed 28 July 2020.

⁸⁰'Addressing the Tax Challenges of the Digital Economy' (n 69) 143.

⁸¹*ibid*, 144.

⁸²*ibid*.

⁸³Digital Economy Taxation Think Tank, Non for Profit Organization, African Route: Kenya Digital Tax & Nigerian Significant Economic Presence as Nexus for 2020 Digital Economy Taxation' (2020) <<https://det3.eu/news/nigerian-significant-economic-presence-route-nexus-for-2020-digital-economy-taxation/#pag>> accessed 31 March 2020.

⁸⁴*ibid*.

⁸⁵Rishi Kapadia, & Mohit Rakhecha('Digital Tax: Why India's Approach to Taxing Google, Facebook Needs to Align with International Approach' (2019) <<https://www.google.com/amp/s/m.economictimes.com/small-biz/legal/digital->

Presence (SEP) concept into its tax legislation in 2018 and acknowledged that virtual presence could constitute a nexus for the purposes of claiming taxable rights.⁸⁶ As a result, beginning from April 1, 2018, SEP is included in Section 9 of the Income-Tax Act, 1961 (the "ITA").⁸⁷ Additionally, the Israel Tax Authority has established a number of illustrative "digital factors" to serve as SEP for overseas businesses providing online and E-commerce services in Israel.⁸⁸ Furthermore, the European Union has recently released a directive that suggests taxing a significant digital presence. The EU wants to make a digital business' a taxable nexus based on its revenue, users, and contracts for digital services.⁸⁹

ii. An Equalization Levy

The feasibility of implementing an equalization levy was briefly covered in the BEPS Action 1 report. The concept is centered on establishing comparable market circumstances for domestic and overseas businesses. Depending on what the tax's primary goal is, the design of the tax could take a number of different forms.⁹⁰ Equalization levy on "hard-to-tax" digital business models could be designed by taxing every transaction between a domestic customer and a foreign supplier. The tax's reach, for instance, may be restricted to just include transactions performed online or with an electronic device.⁹¹ The equalization levy does tackle part of what is the problem of taxing the digital economy.⁹² However, it is not the end-all cure for digital taxation. In fact, the equalization levy was stated by the Economic and Financial Affairs Council of the European Union as a temporary solution until a more reliable and comprehensive framework was developed. It entails treating domestic and international businesses differently, which could hinder cross-border trade.⁹³ Consequently, it is unlikely to be the preferred solution in the long run.⁹⁴

tax-why-indias-approach-to-taxing-google-facebook-needs-to-align-with-international-approach/amp_articles/68329809.cms> accessed 31 March 2020.

⁸⁶ibid.

⁸⁷Delloite, 'Taxation of Non-Residents through a Significant Economic Presence: Widened Scope under the Indian Income Tax Law' (2018) <<https://www2.deloitte.com/in/en/pages/technology-media-and-telecommunications/articles/significant-economic-presence.html>> accessed 31 March 2020.

⁸⁸ibid.

⁸⁹ibid.

⁹⁰'Addressing the Tax Challenges of the Digital Economy, Action 1', (n 73).

⁹¹ibid 116.

⁹²Anton Baumann (n 74) 41.

⁹³ibid.

⁹⁴ibid.

The experience of India is a good example. Since 2016, India has advanced and implemented the Equalization Levy at a rate of 6% on payments made by Indian enterprises to non-residents who provide digital advertising services.⁹⁵ 6% of the gross value of any online advertising provided by foreign companies to Indian business consumers would be taxed. It is different from an Indian withholding tax in that it is applied on the gross value of payments, or the full and final tax, whereas an Indian source tax would include procedures to reimburse the taxpayer if the withholding tax exceeded the tax burden as calculated by the Indian government.⁹⁶

iii. Withholding tax on digital transactions

The prospect of extending withholding taxes to cover payments for digital transactions is another option to address the issues with E-Commerce and income.⁹⁷ A suggestion has been made to impose a final withholding tax on payments made by a resident for digital goods and services that the non-resident business has provided.⁹⁸ Since a PE would no longer be required for the right to tax such income streams, income from E-commerce is now taxable regardless of physical presence in the market jurisdiction. It is implemented by including a flat rate tax withheld by the citizen of the source state (the recipient of the digital service).⁹⁹ This strategy would involve maintaining the PE idea while changing how business profits are taxed by promoting the pooling of the tax base generated by electronic commerce.¹⁰⁰

Further, this strategy would require new definitions of what should be distinguished from other transactions as a "digital transaction" (or whatever terminology may be chosen). Given that the digital component is now essentially a part of every transaction, this could be a challenging process.¹⁰¹ To prevent mismatch setups, a common concept is necessary. If not, there is a potential for artificial avoidance, which would make the system more difficult to enforce. Additionally, this can result in double taxation.¹⁰² Due to its revenue-based nature (imposed on the transaction's gross

⁹⁵Rishi Kapadia, & Mohit Rakhecha((n 86).

⁹⁶'Government of India (Committee on Taxation of E-Commerce), Proposal for Equalization Levy on Specified Transactions' (2016) <<http://incometaxindia.gov.in/news/report-of-committee-on-taxa-tion-of-e-commerce-feb-2016.pdf>> accessed 28 July 2020.

⁹⁷Jinyan Li, 'Consumption Taxation of Electronic Commerce: Problems, Policy Implications, and Proposal for Reform' (2003) 38 Canadian Business Law Journal 446.

⁹⁸'Addressing the Tax Challenges of the Digital Economy, Action 1', (n 73) 55–56.

⁹⁹Luc Hinnekens((n 57) 195.

¹⁰⁰Dale Pinto (n 60) 27.

¹⁰¹Anton Baumann (n 74).

¹⁰²ibid 43.

value), the tax resembles an equalization levy. Similar concerns to those raised by the ability-to-tax principle are raised by this, with the potential for an excessively large tax burden on the enterprises.¹⁰³ It might also hinder the early development of start-up businesses, which typically incur significant losses during this start-up period.¹⁰⁴ The manner in which digital payments are processed is another potential enforcement-related challenge. Such transactions would presumably require the assistance of financial institutions as they are frequently done via credit cards or other electronic methods.¹⁰⁵ The prospect of anonymous payments could make it impossible to identify the source of revenue, even with the assistance of financial institutions. For instance, using a Virtual Private Network (VPN), which is a service that allows you to hide your whereabouts, could make it more difficult.¹⁰⁶ In light of this, it has been said that withholding tax from digital transactions is not a preferable strategy for addressing the long-term problems brought on by the digital economy.¹⁰⁷

Whatever it may be, the experience of Vietnam is a good example. A new tax administration law was adopted by the Vietnamese National Assembly on June 13, 2019, and it will have an impact on many non-resident businesses that use digital and E-commerce business models to sell products and services in Vietnam.¹⁰⁸ As a result, the new legislation has introduced a withholding tax to tax income obtained through electronic commerce, where payments to foreign businesses are subject to a withholding tax.

4. THE CURRENT LEGAL STATUS OF ELECTRONIC COMMERCE IN ETHIOPIA

In 1993, the UN Economic Commission for Africa (UNECA) established PADIS Net (Pan African Documentation and Information Service Network), a store-and-forward email service that connected daily via direct dial calls to Green Net's internet gateway in London. This marks the

¹⁰³ibid.

¹⁰⁴ibid.

¹⁰⁵'BEPS Action 1: Address The Tax Challenges of the Digital Economy' (n 80) 66–67.

¹⁰⁶Anton Baumann (n 74) 43.

¹⁰⁷ibid.

¹⁰⁸'Taxation of E-Commerce in Vietnam' (KPMG, 2019) <<https://home.kpmg/us/en/home/insights/2019/07/tmf-vietnam-taxation-e-commerce-transactions-remote-digital-sales.html>> accessed 31 March 2020.

beginning of the use of the internet in Ethiopia.¹⁰⁹ International organizations and NGOs, certain academics, individuals, and private corporations heavily utilized the facility as there was no alternative.¹¹⁰ E-commerce in Ethiopia has changed the way business is conducted over the last couple of years, thus people have begun conducting online transactions in the same way as traditional ones.¹¹¹ Ethiopia's technology environment is not advanced enough to support international e-commerce. Even using the internet for a business purpose is not good enough, let alone having good communication on social networks like Facebook.¹¹²

Even though it is still in its infancy in the country, E-commerce is rapidly growing in Ethiopia. Companies have expressed interest in conducting business online as internet users in Ethiopia have increased, despite the lack of an online payment system and a reliable delivery mechanism for things purchased online.¹¹³ Due to the rise in internet and E-Commerce usage in Ethiopia, the government will be under pressure to handle this kind of transaction by passing E-Commerce-related regulations as a result of economic changes brought on by globalization.¹¹⁴ The legality and validity of the information supplied in a form other than a standard paper document would be unknown in the absence of rules governing E-commerce and E-signature.¹¹⁵ In Ethiopia, those who conduct business in this fashion do so without receiving any guarantees or consumer rights protection. Because of this, there are fewer chances for the effective development of E-commerce.¹¹⁶

In addition, the lack of an E-Commerce legal framework could hinder the creation of innovative technological works, the infringement of intellectual property rights and trademarks, the growth of unfair competition, and the proliferation of cybercrimes.¹¹⁷ Further, it can make it difficult for foreign investors to take advantage of opportunities offered by our country. In such cases, the

¹⁰⁹“Internet from the Horn of Africa: Ethiopia Case Study”, (International Telecommunication Union, 2002) <<http://www.itu.int/osg/spu/casestudies/ETH-cs1>> accessed 3 July 2020.

¹¹⁰Lusy Kassa(, ‘NOC Launches 15m Br Electronic Card Fuelling System’ [2015] *Addis Fortune Magazine*<<http://www.Addisfortune.net/articles/ethiopias-tech-industry-emerges>> accessed 3 July 2020.

¹¹¹‘Can We Afford the Internet Shutdown in Ethiopia?’ *Addis Fortune* (Ethiopia, Addis Ababa) <<http://allafrica.com/stories/201706060615.htm>> accessed 3 July 2020.

¹¹²Paulos Biruk (n 20) 43.

¹¹³Tigist Ashenafi, ‘The Legality of E-Commerce and E- Signature Under Ethiopian Law’ (Masters thesis, Addis Ababa University 2017).

¹¹⁴*ibid.*

¹¹⁵*ibid*, 32.

¹¹⁶*ibid.*

¹¹⁷*ibid.*

government ultimately loses money from the electronic tax.¹¹⁸ Therefore, implementing the legal framework to ease the circumstances for electronic commerce and signatures would be the most beneficial course of action.¹¹⁹ To this effect, Ethiopia started its journey with the adoption of an electronic signature proclamation in 2018.¹²⁰ The adoption of an electronic signature proclamation is not sufficient for the promotion of E-Commerce. The adoption of the proclamation that regulates electronic transactions is mandatory. As has been mentioned, Ethiopia has made two big moves to legalize and advance E-commerce in 2020. The Ethiopian House of Peoples' Representatives passed the Electronic Transaction Proclamation at its session on May 29, 2020. This is the first step taken by the Ethiopian government.¹²¹ Articles 7 and 8 of the Proclamation stipulate that information in electronic form has the same legal standing as information in written documents. Additionally, as long as the conditions outlined in Articles 9 to 11 are met, it recognizes the legal validity of electronic signatures from signatories, electronic stamps, and witness signatures.¹²²

The second measure is that taken by Ethiopia is the adoption of a “Digital Strategy for Inclusive Prosperity 2025”.¹²³ The Digital Ethiopia Strategy 2025, which is in line with the nation's national development vision, policy objectives, and priorities, has been adopted by the Council of Ministers.¹²⁴ The Digital Transformation Strategy is a plan that helps to transform the dominantly analog economy into a digital economy, which is an economy mainly supported by the applications of digital technologies.¹²⁵ According to the strategy document, Ethiopia will move to a digitally enabled society through the Ethiopian Digital Transformation Strategy. This will enable more effective and inclusive interactions between citizens, governments, and businesses, which will accelerate Ethiopia's progress toward its national priorities.¹²⁶ The strategy's main goal is to establish an inclusive digital economy, so it suggests an inclusive digital economy strategy that

¹¹⁸ibid.

¹¹⁹ibid, 50.

¹²⁰Federal Electronic signature proclamation of Ethiopia 2018.

¹²¹Electronic transaction Proclamation No.1205/2020.

¹²²ibid.Art.9-11

¹²³‘Ethiopia Digital Strategy 2025’ (n 19).

¹²⁴‘Capital Ethiopia Newspaper’ <<https://www.capitalethiopia.com/interview/digital-ethiopia>> accessed 3 July 2020.

¹²⁵Interview with Abiot Bayou, ‘Interview with Capital Ethiopia’ (June 2020)

<<https://www.capitalethiopia.com/interview/digital-ethiopia/>> accessed 3 July 2020.

¹²⁶‘Ethiopia Digital Strategy 2025’ (n 19).

will help Ethiopia realize its larger development goals and ensure an internationally interconnected system that will strengthen Ethiopia's position in the local and global value chains.¹²⁷

5. THE NEED FOR INTEGRATING RULES FOR THE TAXATION OF E-COMMERCE INTO THE ETHIOPIAN INCOME TAX SYSTEM

A. Taxation of E-Commerce under the Income Tax Law of Ethiopia

As was previously said, there is debate in numerous countries on whether or not to tax electronic commerce. Although the process has been flawed for legal, infrastructure, and other technological reasons, E-commerce has been taxed in the Ethiopian context as a normal business transaction.¹²⁸ According to reports, the absence of a legislative framework for conducting an electronic business or financial payment system and a general lack of confidence in the security and dependability of E-Commerce transactions are the main causes of low E-Commerce transactions.¹²⁹ Against this backdrop, Ethiopia has taken various measures that legalize and promote E-Commerce. The adoption of the electronic signature proclamation in 2018¹³⁰, the approval of the Electronic Transaction Proclamation in May 2020¹³¹, and the development of the strategy entitled “Digital Strategy for Inclusive Prosperity 2025”¹³² are the prominent measures taken by the Ethiopian government to legalize and promote E-Commerce. This would inevitably increase E-Commerce. Additionally, the COVID-19 pandemic has changed the world unlike any other phenomenon perhaps since World Wars I and II. It has also demonstrated to Ethiopian consumers and regulators the importance of a strong and effective digital ecosystem, making it possible to pay bills using your devices and purchase goods and services online no more luxurious.¹³³

Once E-Commerce has been legalized, the next baffling question is whether Ethiopia can share the chalice of E-Commerce by acquiring the money that she ought to get from the taxation of income from E-Commerce. Taxation makes up a significant source of government revenue in most

¹²⁷‘Ethiopian Investment Commission Newsletter’ (17 June 2020) <http://www.investethiopia.gov.et/Weekly_News_Letter/7th-EIC-Newsletter-June-17-2020.pdf&ved> accessed 3 July 2020.

¹²⁸Andualem Temesgen (n 28).

¹²⁹Ayana Gemechu Bultum, ‘Factors Affecting Adoption of Electronic Banking System in Ethiopian Banking Industry’ (2014) 1 Journal of Management Information System and E-Commerce 3.

¹³⁰Electronic signature Proclamation No.1072/2018.

¹³¹Electronic transaction Proclamation No.1205/2020.

¹³²‘Ethiopia Digital Strategy 2025’ (n 19).

¹³³Anteneh Tesfaye, ‘Electronic Commerce Platform in Ethiopia’ <<https://www.google.com/amp/s/www.shega.org/amp/ecommerce-platforms-in-ethiopia>> accessed 3 July 2020.

countries¹³⁴ and constitutes a vital part of state and nation-building.¹³⁵ An effective tax system should, in theory, provide sufficient funds for basic government services while permitting regular economic activity within the bounds of international tax treaties and agreements.¹³⁶

When it comes to Ethiopia, there isn't a single piece of legislation covering the taxation of income from international E-commerce. Furthermore, neither Ethiopia's income tax proclamation nor regulation has provided rules for the taxation of income from electronic commerce. This would lead us to the general rule of taxation for non-resident persons. Concerning the income tax jurisdiction of Ethiopia, article 7 of Federal Income Tax Proclamation No.979/2016 has provided for global jurisdiction for residents and source jurisdiction for non-residents.¹³⁷ Accordingly, Ethiopia has a competency to tax the income of non-resident persons if and only if the source of their income is within the territory of Ethiopia. Yet, it is a fundamental tenet of international tax law that a source nation would only tax a foreign company's profits when it maintains a PE and only to the degree that those profits can be linked to the PE there.¹³⁸ Hence, the main concern is whether the traditional concepts of permanent establishment as envisaged under the income tax law of Ethiopia can be applied to the taxation of income from E-Commerce or not.

A geographic, physical location for the business to operate is one of the essential components for a permanent establishment, which is very challenging to ascertain when the business is conducted only through electronic means.¹³⁹ Because of this, international communities have offered a number of solutions to the problems associated with permanent establishments when it comes to taxation income from E-Commerce-related businesses. The Ethiopian income tax proclamation has defined permanent establishment as “a fixed place of business through which the business of an enterprise is wholly or partly carried on”.¹⁴⁰ From this article, we can easily understand that the definition given to the term permanent establishment under the Ethiopian income tax regime is similar to that of the OECD and UN Model Conventions.¹⁴¹ Among the elements of the

¹³⁴Richard Jones and Subhajit Basu (n 32).

¹³⁵Rifat Azam (n 1) 20.

¹³⁶Richard Jones and Subhajit Basu (n 32), 35.

¹³⁷Federal income tax proclamation of Ethiopia.

¹³⁸Federal income tax proclamation No 979/2016).

¹³⁹Leonardo F.M. Castro, ‘Problems Involving Permanent Establishments: Overview of Relevant Issues in Today’s International Economy’ (2012) 2 Global Business Law Review 150.

¹⁴⁰Federal income tax proclamation No 979/2016),.

¹⁴¹UN Model Convention 2017, Art.5(1); Federal income tax proclamation No 979/2016), Art.4(1).

definition of a permanent establishment, a place of the business test requires some physical existence in the source country. Besides, the concept of “fixed place” in Permanent establishment is challenging to apply in E-Commerce as companies located anywhere can conduct business everywhere.¹⁴² Hence, it is difficult to use the notion of a permanent establishment in the case of E-Commerce.

Not only this but also the VAT proclamation of Ethiopia can be mentioned to justify the assertion that taxation of income from E-Commerce is not covered within the ambits of permanent establishment. This is because the VAT Proclamation of Ethiopia provides that “the supply of goods and rendering of services is taxable if a non-resident carries it out through a permanent establishment in Ethiopia or through the Internet.”¹⁴³ From this article, we can easily understand that the supply of goods and services by non-resident enterprises is subject to VAT if the concerned activity is undertaken either in the form of Permanent establishment or *the Internet*. Accordingly, had the concept of permanent establishment extended to taxation of income from E-Commerce, providing *the internet* as an alternative requirement for imposing VAT on the supply of goods and services by non-resident enterprises would not be necessary. Hence, one can confidently argue that the definition of permanent establishment as envisaged under the income tax proclamation of Ethiopia did not extend to E-Commerce. Besides, no special rules for the taxation of E-Commerce have been provided under the Ethiopian income tax system.

As mentioned, the adoption of the legal framework on electronic commerce and the COVID-19 pandemic has been increasing the implementation of electronic commerce in Ethiopia. Here, due to the absence of a rule on the taxation of income from electronic commerce, Ethiopia would inevitably lose the revenue collected from the taxation of electronic commerce. According to the demand for E-Commerce development at a global level, it is crucially essential for Ethiopia to devise its E-Commerce taxation system to reap all the economic advantages of the development of cross-border E-Commerce in the country.¹⁴⁴ Since the traditional concepts contained in the definition of a permanent establishment are inadequate to deal with the ever-increasing growth of

¹⁴²Rifat Azam (n 1), 9.

¹⁴³Value Added Tax Proclamation of Ethiopia 2002.

¹⁴⁴Paulos Biruk (n 20), 41.

E-Commerce in the digital era, the rules governing the taxation of E-Commerce should be added under Article 4 of the Federal Income Tax Proclamation No.979/2016.

B. Taxation of Income from Electronic Commerce under Double Taxation Avoidance Agreements to which Ethiopia Is a Party

In this era of globalization, developing countries have resorted to double tax agreements to attract foreign direct investment. The extent to which a country's tax treaty policy favors developing countries or not depends upon the extent to which the government is prepared to adopt provisions from the UN model tax convention as opposed to the OECD model.¹⁴⁵ Developing countries, in particular, should carefully consider the design of their tax treaties to combat tax avoidance effectively without sacrificing foreign direct investment.¹⁴⁶ The Organization for Economic Cooperation and Development (OECD) notes that 'to encourage cross-border trade there must be certainty and stability in two key areas: permanent establishments and transfer pricing.'¹⁴⁷ By signing tax treaties, developing countries provide foreign investors with security and stability as regards the issue of taxation in addition to the relief from double taxation. Double tax treaties are international agreements between sovereign nations, which are subject to the general international law rules contained in the Vienna Convention on the Law of Treaties.¹⁴⁸

Ethiopia has been exerting efforts to attract foreign direct investment as an instrument for growth and development. The measures taken by Ethiopia towards attracting FDI include signing bilateral investment treaties (BITs) and double tax avoidance treaties.¹⁴⁹ With the primary objective of fighting double taxation and fiscal evasion, Ethiopia has taken unilateral measures such as foreign tax crediting and tax exemption.¹⁵⁰ In addition to the unilateral measures, Ethiopia has signed several bilateral double tax avoidance treaties with various countries. Accordingly, Ethiopia has

¹⁴⁵Lee-Ann Steen Kamp, 'The Permanent Establishment Concept In Double Tax Agreements Between Developed And Developing Countries: Canada/South Africa As A Case In Point' (2014) 13 International Business & Economics Research Journal 539.

¹⁴⁶ibid.

¹⁴⁷'OECD's Current Tax Agenda' (OECD, 2011) <<http://www.oecd.org/site/ctpfta/>> accessed 3 June 2020.

¹⁴⁸José Domingo Palomino Pérez, 'Are the LOB Provisions Efficient Measures to Prevent Tax Treaty Hopping by Taxpayers?' (Master's Thesis, Tilburg University 2017).

¹⁴⁹Martha Belete Hailu & Tilahun Esmael Kassahun, 'Rethinking Ethiopia's Bilateral Investment Treaties in Light of Recent Developments in International Investment Arbitration' (2014) 8 MIZAN LAW REVIEW.

¹⁵⁰Federal income tax proclamation No 979/2016),.

signed more than 25 bilateral tax treaties with other countries of the world.¹⁵¹ The scrutiny of these bilateral tax treaties reveals that Ethiopia has signed these bilateral tax treaties following the OECD Model Tax Treaty.¹⁵²

However, the status of the treaties differs in that some of the treaties are ratified by the two governments, and the ratification document is exchanged between the parties, while the Ethiopian government ratifies others and the rest are just signed by the respective higher official of the two governments.¹⁵³ There are only 11 tax treaties, which became effective on ratification by both governments and the exchange of ratification instruments.¹⁵⁴ The tax treaty between the FDRE and Italy, Egypt, India, Sudan, China, the French Republic, Turkey, the United Kingdom of Great Britain and Northern Ireland, the Kingdom of Netherlands, the Kingdom of Saudi Arabia, and the Republic of Ireland are in force at this time. From a legal point of view, these are the only tax treaties binding on Ethiopia and its counterparts.¹⁵⁵ The Ethiopian government ratifies the other tax treaties, which are around 13. Such treaties are not binding on Ethiopia since the Ethiopian government does not have any information about the status of the treaty on the side of the other state.¹⁵⁶ The rest, around eight tax treaties, have been signed but not ratified.¹⁵⁷ The structure of Ethiopia's tax treaties is more or less the same since Ethiopia has its own Tax Treaty Model that is presented to the other party when the need arises.¹⁵⁸

One of the double taxation and fiscal evasion agreements signed by Ethiopia is with China.¹⁵⁹ This double taxation agreement has no specific provision for the taxation of E-Commerce. The next question is whether the way the permanent establishment is defined under this double taxation agreement can extend to the taxation of E-Commerce or not. This double taxation agreement has

¹⁵¹Serkalem Eniyewu, 'Involving Constituent States in Negotiating Tax Treaties in Ethiopia' (Master's Thesis, Addis Ababa University 2017).

¹⁵²Aschalew Ashagre, 'A Note on Resolution of Tax Disputes Arising from DTTs and Implications for Developing Countries' (2019) 13 MIZAN LAW REVIEW 513.

¹⁵³Serkalem Eniyewu (n 153).

¹⁵⁴*ibid.*

¹⁵⁵*ibid.*

¹⁵⁶ Tax Treaties between the FDRE government and Kuwait, Russian Federation, Yemen, Algeria, Tunisia, Romania, South Africa, Israel, Czech Republic, Seychelles, Portugal, Peoples Democratic Republic of Korea, and United Arab Emirates are ratified.

¹⁵⁷ Tax treaties between the FDRE government and Palestine, Poland, Cyprus, Qatar, South Korea, Slovakia, Morocco, and Singapore are signed but not ratified.

¹⁵⁸Serkalem Eniyewu (n 153).

¹⁵⁹Agreement between the Federal democratic republic of Ethiopia and the government of the People's Republic of China for the avoidance of double taxation and prevention of fiscal evasion concerning taxes on income 2018.

inculcated the issues of permanent establishment under Article 5.¹⁶⁰ It provides that a “permanent establishment” is a fixed place of business through which the business of an enterprise is wholly or partly carried on.¹⁶¹ This definition is similar to that of the OECD and UN Model Conventions.¹⁶² As a result, the physical presence of the business is required for the existence of a permanent establishment as both the "a place of the business" and "a fixed place" tests demand physical presence in the source country. Consequently, it is challenging to apply in E-commerce as companies located everywhere can virtually conduct business anywhere in the world.

Ethiopia’s other double taxation treaty was signed in 2016 with the Government of the Republic of Singapore.¹⁶³ Like that of the double taxation agreement between Ethiopia and China, this double taxation agreement has no specific provision for the taxation of E-Commerce. Besides, the definition of permanent establishment as envisaged under this double taxation agreement is similar to that of the double taxation agreement between Ethiopia and China.¹⁶⁴ Hence, the definition of permanent establishment as envisaged under the Ethio-Singapore double taxation agreement cannot extend to the taxation of E-Commerce. Again, the double taxation agreement between Ireland and the government of Ethiopia is also exactly similar to that of a double taxation agreement between Singapore and Ethiopia.¹⁶⁵ The same is true for the double taxation agreement between Cyprus and Ethiopia.¹⁶⁶

Generally, all double taxation agreements signed by Ethiopia are devoid of the rules for the taxation of E-Commerce. All double taxation agreements have no specific provision for the taxation of E-Commerce. Besides, the definition of permanent establishment as envisaged under all double taxation agreements cannot extend to the taxation of E-Commerce, as the physical presence of the business is mandatory. This is attributed to the fact that the double taxation agreements of Ethiopia have concluded based on the old version of the OECD and UN Model

¹⁶⁰ibid.

¹⁶¹ibid.

¹⁶²UN Model Convention; ibid.

¹⁶³Agreement between the Republic of Singapore and the Federal Democratic Republic of Ethiopia for the avoidance of Double Taxation and the Prevention of Fiscal Evasion concerning Taxes on Income 2016.

¹⁶⁴See Art.5 (1) of both double taxation agreements between Singapore and Ethiopia and Ethio-China double taxation agreements.

¹⁶⁵Convention between Ireland and the Federal Democratic Republic of Ethiopia for the avoidance of double taxation and the prevention of fiscal evasion concerning taxes on Income 2014.

¹⁶⁶Convention between the Republic of Cyprus and the Federal Democratic Republic of Ethiopia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion concerning taxes On Income 2015.

Convention, which are ignorant of the issues of taxation of E-Commerce. The old version of both the OECD and UN Model Convention has updated and proposed various rules for the taxation of E-Commerce. Besides, some countries like South Africa and Rwanda have renegotiated their bilateral taxation treaties so that it enables them to cope with the currently circumventing complexities of technological advancement. Accordingly, it is recommendable for Ethiopia to integrate rules for the taxation of income from electronic commerce into its double taxation agreements through renegotiation, termination, or amendment.

CONCLUDING REMARKS

The traditional business trends that require the physical presence of the business have been replaced with the new paradigm called E-Commerce. There is no universally accepted definition for the term E-Commerce. E-commerce is the undertaking of business activities through the Internet, wholly or partly. However, the path of E-commerce is not all the way easy. Along with this, there are various issues. One such issue is taxation. The conventional tax principles, laws, and institutions dwell on the principle of physical locations or geographical attachment, while E-commerce can be undertaken in a virtual space where the principles related to geography, physical location, and territoriality have no or little value. Hence, it is hard to trace and could potentially lead to tax revenue losses at national and international levels. To do away with such kinds of perplexities, various policy interventions have been proposed. Accordingly, the Ottawa framework, virtual permanent establishment theory, and BEPS action plan proposal, namely: equalization levy, new nexus rule in the form of a significant economic presence, and Withholding tax, are the major global initiatives on the taxation of electronic commerce. Furthermore, various countries have taken unilateral action to regulate the taxation of income from E-Commerce.

Coming to the context of Ethiopia, the approval of the Electronic Transaction Proclamation in May 2020 and the adoption of the strategy entitled “Digital Strategy for Inclusive Prosperity 2025” are the prominent measures taken by the Ethiopian government to legalize and promote E-Commerce. This would inevitably enhance the development of electronic commerce. At the same time, Ethiopia should reap the revenue from the taxation of income from electronic commerce. Yet, neither the domestic law nor the bilateral tax treaties signed by Ethiopia have incorporated a rule

for the taxation of income from E-Commerce. Based on the conclusion mentioned above, the following are my recommendations.

- ✓ As the absence of rules for taxation of income from cross-border E-commerce leads to a revenue loss, Ethiopian should incorporate the rule for the taxation of income from E-Commerce into income tax proclamation or regulation. Accordingly, as it is proven to be a proper mechanism for the taxation of income from electronic commerce, I recommend Ethiopia to adopt the Significant Economic Presence rules for the taxation of income from E-Commerce.
- ✓ Further, as integrating significant economic presence through the amendment of income tax proclamation or regulation may take time, it is recommendable for Ethiopia to draw a lesson from India and use an equalization levy as a temporary measure for the taxation of income from electronic commerce
- ✓ Finally, since all bilateral tax treaties of Ethiopia are devoid of rules for the taxation of income from electronic commerce, it is difficult for Ethiopia to impose income tax on cross-border electronic commerce. Hence, it is recommended that Ethiopia revisit its bilateral tax treaties and integrate rules governing the taxation of income from E-commerce via renegotiation, amendment, or termination.