POLICY AND LEGAL FRAMEWORKS OF DOUBLE TAXATION AVOIDANCE TREATIES IN ETHIOPIA: FLAWS IN THE MAKING

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Abstract

Countries enter into bilateral agreements for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital. Such agreements are commonly referred to as Double Taxation Treaties (DTTs). The history of double taxation treaties in Ethiopia can be traced back to 1971 when Ethiopia entered into a double taxation avoidance treaty with Italy for income from commercial air transport. Since then, Ethiopia has entered into various tax treaties with many developed, developing and even least developed countries (LDCs). The present article is devoted to analyse the policy and legal framework of double taxation avoidance treaties to which Ethiopia is a party. It employs a qualitative research methodology in identifying the policy and legal framework of Ethiopia's double taxation treaties. The article argues that the existing general policy and legal framework are limited in scope and is not well organized as is the case with the Ethiopian tax system in general. Hence, the need to have a comprehensive, stand-alone and well-organized policy and legal framework for double taxation issues.

Keywords: Double Taxation, Double Taxation Avoidance Treaties (DTTs), Ethiopia, International Tax Law, Policy and Legal framework

INTRODUCTION

Over the last three decades, the environment in which tax systems operate has changed dramatically. The globalization and digitalization of the world economy have substantially increased the geographic mobility of the tax base. Multinational Enterprises (MNEs) operating in multiple countries have become the major players in international trade and tax treaties were crucial for their business.

The development of tax treaties was a critical stage of the evolution of the international taxation system in the twentieth century.[1] The origins of the existing treaty models are to be found in the work of the League of Nations just after the end of World War I.[2] The evolution of the international taxation system has brought two dominant models of tax treaty: the

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[1] JEFFREY OWENS, TAX POLICY IN THE 21ST CENTURY: NEW CONCEPTS FOR OLD PROBLEMS:EUI Working Paper, Global Governance Programme, RSCAS 2013/05, (2013).

[2] Bret Wells And Cym H. Lowell, 'Income Tax Treaty Policy In The 21st Century: Residence Vs. Source', 5 *COLUMBIA JOURNAL OF TAX LAW*, (2013).

Organization for Economic Cooperation and Development (hereinafter OECD) and the UN models.[3] While the OECD model, the most dominant and widely used model, is advocated and used by developed countries, the UN model is mainly preferred by developing countries.[4]

The OECD model focuses on residence as the basis of tax jurisdiction while the UN model supports source based tax jurisdiction.[5] The difference between the two models stems from the broad and narrow definitions attached to such concepts as permanent establishment and the rate on passive income taxes like taxes on dividends, royalties, and interest. While countries use either of these two models that suits their preferred policies, the OECD model is by far the most popular model of the existing double taxation avoidance treaties.[6]

Double Taxation Avoidance Treaties are aimed at devising mechanisms of avoiding double taxation in cross border transactions.[7] The treaties are also used to prevent double non-taxation or what is commonly called 'fiscal evasion'.[8] This is what the double taxation treaties that Ethiopia has entered into are aimed at.

Ethiopia has undertaken various economic and foreign relations policy reforms, especially after the country's economic shift towards free market economic system in 1991. A lot has been done to make the economic system favourable and open for various players– private, public, domestic and foreign investors. As part of these vast multi-dimensional reforms, the country has undertaken a series of tax reforms especially since 2002.

These reforms were necessary to make the tax system effective, efficient and conducive for investment.[9] Alongside with the reforms on the domestic tax system, the country's foreign tax relation has also been on a move towards reforms and successive negotiations. As a result, the country has entered into various tax treaties with many countries. There are outstanding important issues as to whether Ethiopia has designed a sound policy and legal framework on how to negotiate and when to negotiate double taxation avoidance treaties.

The article is organized into four main parts. The first part presents the general introduction and frames the issues that the article seeks to address. The second part deals with the conceptual issues on what double taxation avoidance treaties are and their objectives. The third part is devoted to dealing with Ethiopia's double taxation avoidance treaties, historical development of DTTs in Ethiopia, their objectives, policy and legal framework. The fourth and final part provides concluding remarks and recommendations.

1. DOUBLE TAXATION TREATIES (DTTs) IN GENERAL

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[3] REUVEN S. AVI-YONAH, DOUBLE TAX TREATIES: AN INTRODUCTION, (2009). Also available at https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1131&context=book_chapters.

[4] BRIAN J. ARNOLD & MICHAEL J. MCINTYRE, INTERNATIONAL TAX PRIMER, 2nd ed, Kluwer Law International, (1995).

[5] *Id*.

[6] *Id*, at 1.

[7] REUVEN S. AVI-YONAH, *Supra* note 3, at 2.

[8] *Id*. *See* also BRIAN J. ARNOLD & MICHAEL J. MCINTYRE, *Supra* note 4, at.

[9] FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA,*GROWTH AND TRANSFORMATION PLAN* (GTP) (2010/11-2014/15), volume I, Addis Ababa, 2010, at 28; *See* also Preamble of the *Federal Income Tax Proclamation* of *Ethiopia*, Federal Negarit Gazetta, Proc No. 979/2016.

Tax law is a dynamic area where politics, law, economics, commerce and accountancy intersect. It is renowned for its complexity and intricacy; typically, the income tax law (or general tax code if applicable) is the longest law that a country can have.[10] It is a fascinating mix of history, compromise and political rhetoric.[11] Any change to a tax law almost inevitably involves winners and losers and so all tax reform is almost always controversial. It is no wonder that tax law has become increasingly complex given the ceaseless quest for greater efficiency in this era of globalization characterized as the information age.

International trade has existed since the birth of nations, but there has been an accelerating growth not only in trade but also in finance and investment especially after World War II.[12]Jurisdiction to impose income tax is based on either the relationship of the income (tax object) to the taxing state (commonly known as the source or *situs* principle) or the relationship of the taxpayer (tax subject) to the taxing state based on residence or nationality.[13] Under the source principle, a State's claim to tax income is based on the State's relationship to that income. For example, a State would invoke the source principle to tax income derived from the extraction of mineral deposits located within its territorial boundaries. Source taxation is generally justified on the ground that the State has contributed to the creation of the economic opportunities that allow the taxpayer to derive income generated within the territorial borders of the State.[14]Jurisdiction to tax is also about power and sovereignty, and a State generally has the power to tax income if the assets and activities that generated it are located within its borders.

Residence principle, on the other hand, is a State's claim to tax income based on its relationship to the person deriving that income.For example, a State would invoke the residence principle to tax wages earned by a resident of that State without reference to the place where the wages were earned. In general, a State invokes the residence principle to impose tax on the worldwide income of its residents. Basing the tax on the taxpayer's overall capacity to pay, without reference to the source of income, is consistent with most theories of distributive justice.[15]

Double Taxation Treaties (DTTs) are based on either of these two principles. A widely-accepted definition of DTTS is the one supported by the OECD model tax convention which defines DTTS as conventions between two countries entered into for the purpose of avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital.[16] This is favored by most countries in their double taxation agreements. The following elements can be extracted from this general definition:

I. Double taxation treaties are bilateral as they represent a bargain between two countries. The fact that they are bilateral makes them similar with that of Bilateral Investment

[10] PETER HARRIS AND DAVID OLIVER, INTERNATIONAL COMMERCIAL TAX, Cambridge University Press, 2010, at 1.
[11] *Id*.
[12] Victor Thuronyi, Tax Law Design And Drafting, volume 2, International Monetary Fund: 1998, at 2, available at https://www.imf.org/external/pubs/nft/1998/tlaw/eng/index.htm.
[13] UN,United Nations Manual For The Negotiation Of Bilateral Tax Treaties Between Developed And Developing Countries, 2016, at 9.
[14] *Id.*
[15] *Id.*
[16] OECD, Model Tax Convention On Income And On Capital, Condensed Version, 22 July 2010.

Treaties (BITs). However, at the same time they are also different as DTTs unlike BITs do not contain Most Favored Nation (MFN) clauses which in turn make them non-transferable to third countries.[17] One thing that should be born in mind at this juncture is that there are some efforts towards making multilateral tax treaties despite the fact that their impact has been modest.[18] The Nordic nations[19] are worth mentioning at this instance, which has entered into a multilateral agreement in matters concerning tax administration.[20] Another instance here is the convention on mutual administrative assistance in tax matters, which was drawn up within the Council of Europe based on a draft prepared by the committee on fiscal affairs, which entered into force on 1April, 1995.[21] The General Agreement on Tariffs and Trade (GATT), as renegotiated in 1994, and the General Agreement on Trade in Services, both of which were consolidated as part of the Agreement Establishing the World Trade Organization (WTO) in 1994, contain some important provisions relating to income taxation as disguised trade barriers or as export incentives.[22]

II. Double taxation treaties are negotiated to avoid double taxation and to prevent fiscal evasion or double non-taxation. DTTs serve the purpose of facilitating trade and investment. However, there are differences between and among treaties as to their purposes. While some treaties aim at eliminating double taxation only, others aim at eliminating double taxation and the prevention of fiscal evasion.[23]

III. The taxes covered under DTTs are taxes on income and capital. Article 2 of the Model Treaty reads as follows:

> 1. This Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.
>
> 2. There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

The contracting parties will decide which taxes to cover in their agreement. Some countries agree on income tax only while others agree on both tax from income and capital.[24]

1.2. Objectives of Double Tax Treaties

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[17] REUVEN S. AVI-YONAH, *Supra* note 3, at 2.
[18] BRIAN J. ARNOLD AND MICHAEL J. MCINTYRE, *Supra* note 4, at 93.
[19] Members of the Nordic Convention are Denmark, Finland, Iceland, Norway and Sweden and the Convention is concluded in 1983 and replaced in 1987, 1989 and 1996.
[20] OECD, *Supra* note 16, at 16; See also BRIAN J. ARNOLD AND MICHAEL J. MCINTYRE, *Supra* note 4, at 93.
[21] *Id.*
[22] *See* BRIAN J. ARNOLD AND MICHAEL J. MCINTYRE, *Supra* note 4, at 93.
[23] OECD, *Supra* note 16; UN, *Supra* note 13.
[24] OECD, *Supra* note 16.

The general objective of tax treaties is facilitating cross-border trade and investment by eliminating tax impediments to cross-border transactions.[25]The general objective needs to be supplemented by specific operational objectives for its realization. The following are some of the specific operational objectives: -

Eliminating double taxation: this is the most important operational objective of double taxation treaties. This objective can be drawn from the fact that a number of substantive provisions of most tax treaties are geared towards achieving this operational objective. Tax treaties contain 'tie-breaker rules' to choose between the countries of residence of the tax payer for purposes of the taxation. The treaties also provide relief mechanisms either by way of foreign tax credit or an exemption for the foreign–source income.

The OECD modelDTT,the main model for developed countries, reduces tax on royalties to zero but has a positive rate on interest and dividends.[26] The UN model DTT, the main model for developing countries, has higher rates of source-based taxation on passive income (like taxes on dividends, royalties, and interest) and a lower permanent establishment threshold for active income and tends to shift tax revenues from the source to the residence country.[27]

This DTT structure works well if the flows of income are reciprocal, but creates a problem for developing countries.[28] In a reciprocal situation, residents of country A derive income from sources from country B and residents of country B derive income from sources of income from country A. In the absence of the DTT, country A will tax country B residents' source income and country B will tax country A residents' source income.

The DTT shifts the taxation of some categories of income, particularly passive income, from the source to the residence country. Under the DTT, country B will not tax passive income that goes to country A residents and country A will not tax passive income that goes to country B residents.[29] As long as the capital flows are more or less reciprocal, the DTT reduces the administrative burden of imposing the withholding of taxes, and the net revenue is more or less the same. The amount that country A loses by not imposing the withholding of taxes is regained by not having to give credit for the taxes imposed by country B on the income its own residents earn abroad.If the investment flow only goes one way, then it is much harder to get into a DTT because a DTT will always transfer revenue from country A to country B.Thus, developing countries have traditionally avoided entering into DTTs with developed countries because the DTTs lead to a loss of tax revenue on their side.[30]

Some developed countries such as Germany, Sweden, and Japan had extensive DTT networks with developing countries because they were willing to provide tax-sparing credits (credits for taxes that would have been collected at source but are given tax holiday). The United States, unlike other developed countries, refuses to grant tax-sparing credits in its DTTs. As a result, it had few DTTs with developing countries until the 1990s.However, the situation has

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[25] BRIAN J. ARNOLD AND MICHAEL J. MCINTYRE, *Supra* note 4, at 95.
[26] *Id.*
[27] *Id.*
[28] REUVEN S. AVI-YONAH, *Supra* note 3.
[29] *Id.*
[30] *Id*.

changed somewhat in recent years.[31] One reason for the recent expansion in US DTTs with developing countries is that the DTT provides certainty for US investors regarding the tax law of the other country, and most developing countries consider US DTTS to their benefit to encourage American investment. Another reason is that DTTs generally include an exchange-of-information provision that allows the developing country to obtain information exchanged from the United States, and developing countries have increasingly been interested in trying to tax capital invested by their rich residents overseas.[32]

Prevention of fiscal evasion: Thisis another equally important operational objective of tax treaties. Prevention of fiscal evasion is a counter-balance for the elimination of double taxation.[33] Unlike elimination of double taxation which is found in a number of substantive provisions of tax treaties, prevention of fiscal evasion is, however, an explicit objective of most tax treaties.[34]

Eliminating discrimination against foreign nationals and non-residents: This is an ancillary objective of tax treaties apart from the above two operational objectives. The principle is that countries have absolute power to have whatever tax treatment they want to have. As such, they have also similar power to treat non-residents more harshly than they do on their residents. But this may have an adverse effect on the countries' endeavor towards attracting foreign investment. For this reason, countries as far as they want to have an internationally competitive tax system need to adjust their treatment of non-residents equally with those of residents. As part of this effort, countries include non-discrimination clause in their bilateral tax treaties. The most important type of legal protection against discrimination for tax purposes is the non- discrimination article of bilateral tax treaties.[35] The OECD model has as its central purpose the avoidance of discrimination between residents and non-residents and the promotion of national treatment of non-residents for tax purposes.[36]Not all countries follow this however. Canada is an example where national treatment of non-residents is not the rule.[37] Canada instead agrees to grant Most Favored Nation treatment (MFN) which means that residents of a treaty country are treated equally but not necessarily equal with residents.

Facilitating exchange of information between contracting states: Tax authorities of a given country often experience extreme difficulty in obtaining information concerning the foreign activities of residents let alone verifying that the information is correct.[38] In such circumstances there comes a need for exchange of information with the other contracting state. Here lies the importance of tax treaties, even for developing countries in case where the investment flow is one way traffic. It enables countries to control their overseas residents for tax purposes and prevention of fiscal evasion. It seems for this reason that the OECD comes up with

[31] *Id*, at 4.
[32] *Id.*
[33] BRIAN J. ARNOLD AND MICHAEL J. MCINTYRE, *Supra* note 4, at 96.
[34] *Id*.
[35] *Id*, at 117.
[36] *See* Art 24 of the OECD Model Tax Convention. OECD, *Supra* note 16.
[37] BRIAN J. ARNOLD AND MICHAEL J. MCINTYRE, *Supra* note 4, at 118.
[38] *Id*, at 98.

a provision devoted thereof.[39]The same regulation is also found in the UN model tax convention.[40]

Facilitating tax sparing agreements: this is not a widely-agreedobjective. It is applied in some countries such as Germany, Sweden, and Japan.[41]

Facilitating dispute resolution: this is a clause included in tax treaties in case there exists a dispute between the contracting states on one hand and on the side of the tax payer on the other hand. Article 25 of the OECD model treaty is devotedfor this purpose.[42]

2. POLICY AND LEGAL FRAMEWORKS OF DOUBLE TAX TREATIES IN ETHIOPIA

a. Historical Development of Double Tax Treaties in Ethiopia

The history of double taxation treaties in Ethiopia is traced back to 1971 when Ethiopia entered into double tax avoidance treaty with Italy for income from commercial air transport.[43] According to AtoWassihun Abate, who was the lead treaty negotiator and Director of the Legal Department at the then Ministry of Finance and Economic Development, the reason that necessitated the then Ethiopia - Italy tax treaty was to relieve Ethiopian Airlines from paying double tax for the service it gave from Ethiopia to Italy and vice versa.[44] As can be envisaged from the title of the 1971 treaty between Ethiopia and Italy, it was not a comprehensive treaty as it limited its scope to revenue from commercial air transport only. Later the two countries have entered into a comprehensive tax treaty on April 08, 1997.[45] From the first treaty onwards, Ethiopia has entered into several double taxation avoidance treaties with several countries. The second tax treaty, Agreement on Avoidance of Double Taxation of Enterprises Operating Aircraft, was entered into with Indiaon 25 November, 1976.[46] Ethiopia and India have subsequently entered into a comprehensive tax treaty on 25 May, 2011:'Agreement between the governments of the FDRE and the Republic of India for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on income.[47] The 'Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital'entered into with Kuwait on 14 September, 1996, is the third treaty of the

[39] Art 26 of the OECD Model Tax Treaty. OECD, *Supra* note 16.
[40] Art 26 of the UN Model Tax Convention., UN, *Supra* note 13.
[41] REUVEN S. AVI-YONAH, *Supra* note 3, p.4
[42] Art 25 of the OECD Model Tax Treaty. OECD, *Supra* note 16.
[43] Ethiopia – Italy Agreement For The Avoidance Of Double Taxation On Revenue Resulting From The Exercise Of Commercial Air Transport, Thursday, November 25, 1971.
[44] Interview With Ato Wassihun Abate, Interview held on 16/04/2005 E.C.
[45] ETHIOPIA- ITALY "CONVENTION FOR THE AVOIDANCE OF DOUBLE TAXATION WITH RESPECT TO TAXES ON INCOME AND THE PREVENTION OF FISCAL EVASION", April 08, 1997. *See* also Proclamation No. 95/1998.
[46] ETHIOPIA – INDIA, AGREEMENT ON THE AVOIDANCE OF DOUBLE TAXATION OF ENTERPRISES OPERATING AIRCRAFT, November 25, 1976.
[47]AGREEMENT BETWEEN THE GOVERNMENTS OF THE FDRE AND THE REPUBLIC OF INDIA FOR THE AVOIDANCE OF DOUBLE TAXATION AND PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME, May 25, 2011.

count that is broadening its double tax treaty network.[48] This treaty seems a comprehensive tax treaty as it encompasses avoidance of double taxation and prevention of fiscal evasion with respect to taxes from income and on capital.

Ethiopia has entered into double taxation avoidance treaty with Saudi Arabia on 26 October, 1999 'Agreement for Reciprocal Exemption of Taxes and Customs Duties on the Activities of Air Transport Enterprises of the Two Countries.'[49]This was followed by the 'Agreement for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital' signed between Ethiopia and the Russian Federation on 26 November, 1999. [50] The Ethio- Russia agreement was later ratified by Proclamation No. 223/1993. The double taxation avoidance treaty with Yemen was the next treaty entered into by Ethiopia on 01 February, 2001 for the avoidance of double taxation with respect to taxes on income.[51]

The next double tax avoidance treaty where Ethiopia is a party is the one signed between Ethiopia and Algeria on May 17, 2002 for the avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income and capital.[52] Ethiopia has also entered into double tax avoidance treaties with Tunisia on 23January, 2003, with Romania on 06November, 2003, with South Africa on 17 March, 2004, with Israel on 02 June, 2004, with Turkey on 02 March, 2005, with Sudan on 25 February, 2006, with Egypt on 01 January, 2009, with Chile on 14 May, 2009, with United Kingdom on 09 June, 2011.[53]

b. Objectives of Double Tax Treaties in Ethiopia

The objectives of double taxation treaties in Ethiopia are not different from the objectives of doubletax treaties in general, i.e., the facilitation of international trade and investment by the removal of procedural and substantive tax barriers. Foreign investment plays significant role in the economic development of countries and Ethiopia is not an exception.

Recognising that foreign investment plays an important role in the development endeavor of the country, the Ethiopian government has entered into several tax treaties as mentioned above. Ethiopia is creating a favorable investment climate to attract foreign investment and one of the measures taken is the signing of tax treaties is to avoid double taxation.[54]

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[48] ETHIOPIA KUWAIT AGREEMENT FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND ON CAPITAL, September 14, 1996.

[49] ETHIOPIA – SAUDI ARABIA, "AGREEMENT FOR RECIPROCAL EXEMPTION OF TAXES AND CUSTOMS DUTIES ON THE ACTIVITIES OF AIR TRANSPORT ENTERPRISES OF THE TWO COUNTRIES", October 26, 1999.

[50] ETHIOPIA – RUSSIA AGREEMENT FOR THE AVOIDANCE OF DOUBLE TAXATION WITH RESPECT TO TAXES ON INCOME AND CAPITAL, November 26, 1999.

[51] ETHIOPIA – YEMEN AGREEMENT FOR THE AVOIDANCE OF DOUBLE TAXATION WITH RESPECT TO TAXES ON INCOME, February 01, 2001. See also Proclamation No. 979/2016.

[52] ETHIOPIA- ALGERIA, AGREEMENT ON THE AVOIDANCE OF DOUBLE TAXATION & PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL, May 17, 2002.

[53] Federal Democratic Republic Of Ethiopia Ministry Of Foreign Affairs, archives also available at http://www.moFA.org.et.

[54] Ministry of Finance and Economic Development, Description Prepared by The Ministry Of Finance And Economic Development To The Fdre Parliament For The Approval Of The Treaties Made By Ethiopia With Uk And Seychelles, at1, para 4.

The express objectives intended to be achieved by Ethiopia's double tax treaties are creating a favourable investment climate and attracting foreign direct investment.[55] However, that is not the only reason for entering into a double taxation treaties. Behind the agreement for the avoidance of double taxation are political objectives. The political objectives are evident in those treaties entered into with countries having no or negligible economic tie to Ethiopia.[56] The double tax treaties made with North Korea, Slovak Republic, and Romania are examples of tax treaties that are mainly made for political purposes. There is no investment flow coming from these countries to Ethiopia.[57]

If one looks at some of the double tax treaties entered into by Ethiopia, one can see the contents of the preambles are not similar in all the treaties. For example, the tax treaty between Ethiopia and China clearly states that the objective of the treaty is the respective country's desire to avoid double taxation and to prevent fiscal evasion.[58]There are also other objectives intended to be addressed by the treaty such as avoiding discrimination (Article 24), exchange of information (Article 26) and administrative cooperation (article 25).[59] On the other hand, from the reading of the preamble of the Ethiopia-Turkey double tax avoidance treaty, it can be said that the only purpose of the treaty is the purpose of the avoidance of double taxation.[60] However, in the body of the treaty, there are provision referring to the prevention of fiscal evasion as well.[61]

As can be seen from almost all treaties Ethiopia has entered into, it can be said that their objective is similar if not identical except for some differences in the kind of taxes covered, i.e., whether the taxes are on income, on capital or on both. This is so because while some of the treaties cover both taxes on income and on capital, others on the other hand, contain taxes on income only where the treaty with Egypt is the example for the latter case.[62]So at least theoretically, it seems sound to say that what generally are objectives of international double tax treaties seem to be the objectives of Ethiopia's double tax treaties too.

That being said as to the objectives of double tax treaties in Ethiopia, one thing seems worth mentioning at this juncture, that is the issue of tax sparing agreement.[63] According to Ato

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[55] Interview With Ato Gochu Sintayehu, a senior legal expert at the Ministry of Finance and Economic Development and who is one of the negotiating team of tax treaties for Ethiopia; interview held on 16/04/2005 E.C.

[56] Interview With Ato Abiyi Minwuyelet, legal expert and tax treaty negotiator at the ministry of finance and economic development, interview held on 16/04/2005 E.C.

[57] *Id*.

[58] AGREEMENT BETWEEN THE GOVERNMENT OF THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA AND THE GOVERNMENT OF THE PEOPLES' REPUBLIC OF CHINA FOR THE AVOIDANCE OF DOUBLE TAXATION AND PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME Ratification Proclamation No.749/2012, Federal Negarit Gazeta of the Federal Democratic Republic of Ethiopia, 8th Year, No 42, (6th July, 2012).

[59] *Id*.

[60] AGREEMENT BETWEEN THE GOVERNMENT OF THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA AND THE GOVERNMENT OF THE REPUBLIC OF TURKEY FOR THE AVOIDANCE OF DOUBLE TAXATION WITH RESPECT TO TAXES ON INCOME Ratification Proclamation No.480/2005, Federal Negarit Gazeta of the Federal Democratic Republic of Ethiopia,12th Year, No. 10, Addis Ababa (23rd December, 2005).

[61] *Id*, Arts 24, 25, and 26.

[62] *Id*, Art 2(1).

[63] Tax sparing refers to the acceptance by the Resident State of a notional tax credit, as provided by the Source State, against the tax charged on the investor's income in the Resident State. The social and economic development needs

Abiy Minwuyelet, legal expert and tax treaty negotiator at the Ministry of Finance and Economic Development, one of the important objectives of entering in to double taxation treaties is to bring about a tax sparing agreement.[64]According to AtoWassihun Abate,there is no reason for Ethiopia to enter into a double taxation treaty if the other contracting state does not agree for a tax sparing clause.[65] It defeats the purpose of granting tax holidaysand different incentives to foreign investors in Ethiopia if their residence country is going to tax them removing the benefits they are entitled to by the tax holiday given by Ethiopia. Investors will not be encouraged to come to Ethiopia to take advantage of the tax holidays if their country of residence makes them pay the taxes that Ethiopia has foregone. This will result in the country's objective towards attracting foreign investment being undermined. Ethiopia has included a tax sparing clause in all the double tax treaties to which it is a signatory. Almost all the tax treaties ratified by Ethiopia contain tax sparing clauses.

For example, article 23(2) of the Ethiopia – Egypt double tax treaty provides for exemption of any benefit given by domestic law of either of the contracting states for not more than five years.[66]Article 23(3) of the Ethiopia – China tax treaty also provides tax sparing agreement for unlimited period of time.[67] Ethiopia's double taxation treaties with Algeria, Czech Republic, India, Saudi Arabia and other countries generally include tax sparing agreements.[68]

Based on the preambles and the detailed provisions of Ethiopia's double taxation treaties, the explicit and implicit objectives of the treaties can be summarized as follows: [69]

1. Facilitation of international trade and investment by the removal of procedural and substantive tax barriers, for example,by avoiding international double taxation which ultimately is intended to bring about a favorable environment to attract foreign investment
2. The prevention of fiscal evasion is also another equally important objective of Ethiopia's double taxation treaties as can be evidenced from the titles, the preambles and detailed provisions of the treaties.
3. Securing a tax sparing agreement: as Ethiopia is a net capital importer and is giving various types of tax incentives to attract foreign investment, tax sparing agreement plays an important role in achieving this objective. In absence of a tax sparing agreement, the country's policy of granting various tax incentives to attract foreign investment will fail. The incentives will not be useful to foreign investors if their home countries are taxing them crediting the incentives.

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of a developing (Source) State may induce such States to offer incentives for foreign investment. Such incentives may include reduced rates of tax or no charge to tax at all. If, however, the foreign investor is subject to tax in his own State at full rates on worldwide income then such tax benefits by the source State may negate any such incentive to investment in the developing State. To the extent of its recognition for investment in the Source State the Double Tax Agreement may provide that notional taxes, that is taxes that would otherwise be payable except for the investment incentive, will be allowed as a full credit against taxes imposed in the Resident State.

[64] Interview with Ato Abiy Minwuyelet, *Supra* note 59.

[65] Interview with Ato Wassihun Abate, S*upra* note 44.

[66] Art 23(2) of the Ethiopia – Egypt Double Tax Treaty, FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA MINISTRY OF FOREIGN AFFAIRS, *Supra* note 53.

[67] Art 23(3) of the Ethiopia – China tax treaty, *Supra* note 58.

[68] *See* Art 23 of all the double tax treaties signed by Ethiopia and the mentioned contracting states.

[69] *See* the preamble and detail provisions of the treaties where Ethiopia is a party.

4. Allocation of expenditure and income between business activities conducted in the countries concerned, whether through means of branches, permanent establishments or otherwise,
5. Formation of relations based on non-discrimination, mutual assistance and the exchange of information between Ethiopia and other contracting states;
   Provision of non-discrimination provisions on the basis that non-residents are to be treated on the same basis as residents of a particular country are actually treated,
6. Simplification and harmonization of rules governing international taxation, i.e., through the formulation of internationally competitive tax and harmonization of domestic tax laws with those treaty tax laws to which Ethiopia is a party, and
7. Establishing procedures for dispute resolution in case disputes arise between Ethiopia and contracting states or foreign investors.

3. LEGAL FRAMEWORK OF DOUBLE TAX TREATIES IN ETHIOPIA

In Ethiopia, any law, customary practice, or a decision of government organ or state or public official which contravenes the constitution shall be of no effect.[70] The government shall follow the constitutional framework in dealing with double tax treaties. The FDRE Constitution empowers the federal government to formulate and implement foreign policy, which, among other things, includes negotiating and ratifying international agreements.[71]As the power of negotiating and implementing international agreements is an exclusive power of the central federal government of Ethiopia, regional States do not have the power to negotiate international agreements. It is, thus, the federal government of Ethiopia that is empowered to negotiate double taxation treaties are part of international agreements. However, the question not addressed by the FDRE Constitution is which organ of the federal government is empowered to negotiate tax treaties. The answer for this is expected to be provided in other laws and the Income Tax Proclamation is the relevant law in this regard. The Proclamation entrusts the Ministry of Finance and Economic Development with the power to negotiate such agreements: It provides that the Ministry may enter into agreement with other Government for the avoidance of double taxation on activities or transactions liable to tax in the territories of both parties.[72]

The amended Income Tax Proclamation also states that the minister may enter in to a tax treaty with a foreign government or governments.[73] Therefore, the Ministry of Finance and Economic Development (now called Ministry of Finance and Economic Cooperation, MoFEC) of the Federal Democratic Republic of Ethiopia representing the executive branch of government is the competent organ to negotiate double taxation treaties.[74]However, this does not mean that the Ministry is the only organ involved in the process of negotiating the agreements. All double tax treaties agreed by the executive organ through the Ministry will take effect only after they pass through the ratification process by the legislature. The House of Peoples Representatives (HPR) is the competent organ empowered to ratify international agreements under FDRE

[70] Art 9(1), Constitution of the Federal Democratic Republic of Ethiopia, Federal Negarit Gazeta, Proclamation No. 1/1995, 1[st]Year, No.1, Addis Ababa (21st August, 1995) (hereinafter FDRE Constitution).
[71] Art 51(8) of the FDRE Constitution.
[72] Art 42(a) of the Income Tax Proclamation of Ethiopia.
[73] FDRE Income Tax Proclamation, Proclamation No. 979/2016 (hereinafter called 'Income Tax Proclamation).
[74] *Id*, Art 42(a).

Constitution.[75] The Constitution provides that '[the HPR] shall ratify international agreements concluded by the executive.'[76]

Once the ratification process is finalized double taxation agreements shall be part of Ethiopian law as per Art 55(12) of the FDRE Constitution:'all international agreements ratified by Ethiopia are an integral part of the law of the land.'[77] Therefore, it can be concluded that once tax treaties are ratified by Ethiopia, they are at the same legal hierarchy with those of domestic laws found at the proclamation level.Treaties are ratified by a Proclamation of the HPR. Hence, the tax treaties are hierarchically below the Constitution for it is the supreme law of the land prevailing above any law including international agreements.[78]

A Constitutional requirement that needs to be taken into account in relation to double taxation treaties is in Article 43 of the FDREConstitution that requires all international agreements and relations to be geared towards ensuring Ethiopia's right to sustainable development: 'all international agreements and relations concluded, established or conducted by the State shall protect and ensure Ethiopia's right to sustainable development.'[79] The Constitution makes it a condition for the government to weigh the impact of the international agreements and relations it enters into oneconomic, social, and environmental sustainability - the parameters used in measuring sustainable development as defined by the Brundtland Commission.[80]

The principle that the Constitution providesis that all international agreements and relations, tax treaties included, should be geared towards ensuring sustainable development agenda of the country. The extent to which the Federal government and the HPR have based their decisions on these considerations needs to be examined in each and every taxation agreement. The responsibility of the legislature in this respect is crucial as the Ministry and the Executive may have economic priorities that they may favour to the detriment of the other sustainability aspects- social equity and environmental sustainability.

There are a few instances where it is questionable whether some of the treaties Ethiopia has signed are designed in a way that ensures sustainable development.Some tax treaties ratified by Ethiopia have little or no economic significance. For example, Ethiopia's treaty with North Korea and Romania are of no economic significance beyond their ceremonial value. There is practically no trade relation with these countries at the moment.[81]

Secondly, tax treaties, especially those made with countries like Russia, Turkey and other countries are based on the OECD model which favors the interests of these developed countries more than the interests of Ethiopia. As such, this may have an adverse effect on the economic

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[75] Art 55(12) of the FDRE Constitution.

[76] *Id*.

[77] Art 9(4) of the FDRE Constitution.

[78] Art 9(1) of FDRE Constitution.

[79] Art 43(3) of the FDRE Constitution.

[80] The Brundtland Commission defines sustainable development as 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs.' DANIEL BARSTOW MAGRAW& LISA D. HAWKE, SUSTAINABLE DEVELOPMENTin DANIEL BODANSKY ET AL. (eds.), THE OXFORD HANDBOOK OF INTERNATIONAL ENVIRONMENTAL LAW 614, 620-21, (2007), at 618.

[81] The purpose of these treaties is not clear. Interview with Ato Wassihun Abate, *Supra* note 44.

benefit that could have been collected through taxes without these treaties. The treaties restrict Ethiopia's power to tax non-residents on their income sourced from Ethiopia.

A third point that needs to be considered is the fact that Ethiopia is a net capital importer and not net capital exporter. This implies that there is no capital inflow and capital out flow neutrality between Ethiopia and its tax treaty partners.[82]Then, if Ethiopia is a net capital importer, tax treaties may not be economically sustainable for the country as it will be spending a huge budget to make up for the revenue lost because of the treaties. Obviously, these treaties have the objectives creating a favorable investment climate to attract foreign investment to Ethiopia. However, the question of the loss of revenue is an appropriate concern at least in the short run. This argument finds support from the short lifetime of most treaties – five years or less. Therefore, due consideration should be given to ensure that treaties are entered into in a way that applies the constitutional principle stated under article 43 and the supremacy of the Constitution.

Regarding the supremacy of the Constitution in relation to double taxation treaties, there is one issue of constitutional significance. There are instances where international agreements made by the Ministry of Finance and Economic Cooperation may take effect even without fulfilling the constitutional requirement of ratification for integration into domestic law. This can be read from the provisions of the Income Tax Proclamation that refers to'income specifically exempted from income tax by the law in force in Ethiopia, *by international treaty or by an agreement made or approved by the Minister'*.[83](Emphasis added). This implies that the constitutional prerequisite, i.e., ratification of a treaty to be integral part of the law of the land as provided under article 9(4) of the constitution may be foregone where the Minister approves exemptions as per the above provision of the Proclamation.[84] It is a case of disparity between the Constitution requiring ratification of all treaties by the legislature under articles 9(4) and article 55(11) and the Proclamation providing for the power of the executive to avoid the involvement of the legislature in some cases.

CONCLUDING REMARKS

Double taxation agreements aim to provide certainty to taxpayers of either the host State or the home country in relation to the potential tax liability that may be imposed on their international transactions. The central principle of the interpretation of Double Taxation Treaties is that which allows a reconciliation between the domestic laws of the contracting states and the obligations created by a double taxation agreement concluded by the countries.

Ethiopia has concluded several tax treaties with a number of countries. It has been argued here that there are no major problems relating to the policy and legal framework by which such treaties are signed and implemented. There is a policy and legal framework that should be followed in the negotiation and ratification of double taxation treaties and the FDRE Constitution provides the overriding principles on which the policy and legal framework is based. It is using

[82] Capital inflow and outflow neutrality is a situation which most of the times exists between and among equal economies where there is balanced capital inbound and outbound.
[83] Art 30(1) (c) of the Income Tax Proclamation of Ethiopia.
[84] *See* Art 30(1)(c) of the Income Tax Proclamation of Ethiopia vis-a-vis Art 9(4) of the FDRE Constitution.

this policy and legal framework that the country is entering into several tax treaties with different countries from the developed, developing, and even from the least developed countries. As economic cooperation with other countries is the way forward, we will be witnessing an increasing number of similar treaties in the future and the issues raised in this article need to be investigated further in the context of future treaties that Ethiopia will be signing.

However, much needs to be done, especially in making the policy and legal framework more organized and efficient. Lack of an efficiently organized system of tax policy is a challenge that the country has to address in order to benefit from the treaties.

Once tax treaties are concluded and ratified, there must be an institution that implements these treaties. In Ethiopia, it is the Ethiopian Revenue and Customs Authority (ERCA) that is empowered to implement tax laws in general including tax treaties. In practice, ERCA is not in a position to understand and implement these treaties. It does not have sufficient number of experts to deal with the treaties.[85] ERCA is occupied with domestic tax issues and it is in effect not giving adequate attention to the international issues. This may lead to the country losing revenue that it may be entitled to by the treaties or the investors ending up in paying taxes exempted by the treaties. The process of the determination of the issues will have to be efficient, so that investors and the tax authority do not waste time due to the lack of clarity in the implementation of the tax treaties.

[85] Communication with ERCA employees on 25 Decemeber 2016. The conversations have revealed that much needs to be done by the government and other concerned organs to strengthen ERCA with expert manpower specializing in tax treaties.