Income Tax (Amendment) Proclamation No. 1395/2025

On 17 July 2025, the House of Peoples' Representatives passed the Income Tax (Amendment) Proclamation No. 1395/2025, which introduces significant amendments to the Federal Income Tax Proclamation No. 979/2016. The amendment introduces substantial changes aimed at modernizing Ethiopia's tax system, simplifying administrative procedures, improving compliance and revenue collection, and expanding the tax base to cover emerging and digital business sectors. This summary outlines the key changes, their practical implications, and the associated compliance timelines:

1. Reduction in Minimum Presence Threshold for Permanent Establishment

A significant amendment affecting non-resident entities is the reduction of the minimum presence threshold for establishing a permanent establishment (PE) in Ethiopia. The threshold has been lowered from 183 days to 91 days, thereby expanding the criteria under which foreign entities may be deemed Ethiopian taxpayers.

In addition, the amendment introduces a definition of "technical services" in the context of service PEs, providing further clarity on the types of activities that could give rise to a taxable presence in Ethiopia.

2. Corporate Income Tax & Alternative Minimum Tax (AMT)

The corporate income tax rate for entities remains unchanged at 30%. However, where the total assessable business income results in a tax liability of less than 2.5% of turnover, the taxpayer will be subject to an Alternative Minimum Tax (AMT).

Under the AMT regime, taxpayers are required to pay a minimum of 2.5% of turnover. For banks, insurance companies, and commission-based businesses, the 2.5% is applied to net banking income, gross premium income, or commission income, respectively. This ensures a minimum tax contribution even when the regular income tax liability is low.

The AMT does not apply to entities undergoing liquidation, debt restructuring, or certain Category B taxpayers whose taxes are computed on annual gross sales. Additionally, AMT credits may be carried forward for up to five years to offset future tax liabilities.

Importantly, the AMT applies to taxpayers enjoying investment incentives, and in such cases, the 2.5% minimum tax is calculated after applying the tax incentive to the income tax payable.

3. Advance Tax Payments

The Proclamation introduces a significant change to the rules governing advance profit tax payments. Previously, advance payments were optional and made on a semi-annual basis. Under the amended provision, advance tax payments are now mandatory and must be declared on a quarterly basis.

Each quarterly payment is equal to 25% of the total income tax paid in the previous tax year. At the end of the fiscal year, the taxpayer is required to settle any difference between the total tax liability and the advance payments made. If the actual tax payable exceeds the advance payments, the balance must be paid. Conversely, if the advance tax paid exceeds the actual liability, the taxpayer is entitled to request a refund of the overpaid amount.

4. Taxation of Indirect Transfers of Ethiopian Assets

A major amendment under the Proclamation is the introduction of taxation on indirect transfers of Ethiopian assets conducted through offshore entities. The provision broadens the scope of chargeable income for non-resident entities.

Specifically, the gain from the realization of shares or membership interests will be subject to Ethiopian tax if, at any time during the 365 consecutive days preceding the realization, more than 20% of the value of those shares or interests is derived, directly or indirectly through one or more interposed entities, from immovable property or any other property located in Ethiopia.

This measure aims to capture gains derived from Ethiopian assets, even when such transfers occur offshore and through intermediary holding structures.

5. Application of Income Tax Incentives and Tax Exemptions

The Proclamation reaffirms the availability of income tax incentives for investors but introduces a stricter framework for their application. It clearly stipulates that only exemptions granted under the Income Tax Proclamation, its implementing regulations, and the Investment Incentive Regulation are considered valid.

All tax exemptions granted under any other laws or legal instruments are expressly repealed, ensuring a uniform and centralized approach to tax incentives.

This amendment is intended to enhance transparency, consistency, and control over the granting of tax exemptions

6. Special Support on Dividends Used to Settle Outstanding Share Subscriptions

To address the practical challenges faced by companies and shareholders in determining the tax treatment of dividends applied toward the settlement of outstanding share subscriptions, the Proclamation provides for the issuance of a new directive.

This upcoming directive will outline the amount and type of support available to shareholders who utilize their dividends to pay for subscribed but unpaid capital. The measure is intended to offer clarity and relief in such cases, ensuring appropriate tax treatment and reducing compliance uncertainties.

7. Digital Economy & Digital Services Tax

In alignment with global tax developments, the Proclamation explicitly brings digital income within the scope of Ethiopian taxation. Income from digital content creation is now taxable. Where such activities are conducted professionally, the income is taxed under the business income tax regime. If not conducted professionally, the income will be classified as "other income" and subject to a final withholding tax of 15%.

Additionally, the Proclamation introduces a new Digital Services Tax applicable to both resident and non-resident digital service providers. This tax will be levied at a rate not exceeding 5%, with the specific rate and compliance requirements to be defined in an upcoming Income Tax Regulation.

The Proclamation also provides a clear definition of digital content creation, while noting that the definition and scope of digital services will be further detailed in the forthcoming regulation.

8. Withholding Taxes & Non-Resident Taxation

The Proclamation introduces several key changes to withholding tax rates, many of which directly affect non-resident taxpayers. These changes reflect a broader effort to align Ethiopia's tax regime with international standards and increase revenue from cross-border transactions.

<table>
<tr><th>Tax Type</th><th>Previous applicable rate</th><th colspan="2">New applicable rate</th></tr>
<tr><td>Dividend</td><td>10</td><td colspan="2">15</td></tr>
<tr><td>Interest</td><td>5</td><td colspan="2">10</td></tr>
<tr><td rowspan="2">Royalties</td><td rowspan="2">5</td><td>5</td><td>In case of art and culture</td></tr>
<tr><td>10</td><td>For other royalties</td></tr>
<tr><td>Repatriated/ undistributed profit</td><td>10</td><td colspan="2">15</td></tr>
<tr><td>Capital gains on immovable</td><td>15</td><td colspan="2" rowspan="2">15</td></tr>
<tr><td>Capital gains on shares & bonds</td><td>30</td></tr>
<tr><td>Games of chance</td><td>15</td><td colspan="2">20</td></tr>
<tr><td>Non-resident entertainers</td><td>10</td><td colspan="2">15</td></tr>
<tr><td>Management and technical fee</td><td>15</td><td colspan="2">15</td></tr>
<tr><td>Insurance premium</td><td>5</td><td colspan="2">15</td></tr>
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9. Deductibility of Interest on Loans

Interest paid on loans taken specifically for the purchase of shares in another company will be allowed as a deductible expense only if the borrowing company receives dividends from the company whose shares were acquired.

10. Deductibility of Expenses Paid in Cash

The Proclamation prohibits cash transactions exceeding **ETB 50,000** (approximately USD 379) unless conducted through an account payee cheque, bank draft, bank-to-bank transfer, or an authorized payment system approved by the National Bank of Ethiopia.

This cash transaction limit applies to:

- The aggregate amount received from a single person in one day;
- Any single transaction exceeding the limit; or
- Transactions related to one event or accession from a person.

Accordingly, the Proclamation stipulates that any expense paid in cash exceeding ETB 50,000 will be considered non-deductible for tax purposes.

This measure is intended to encourage taxpayers to conduct financial transactions through traceable banking channels, thereby improving the Ministry of Revenues' ability to monitor and verify financial activities.

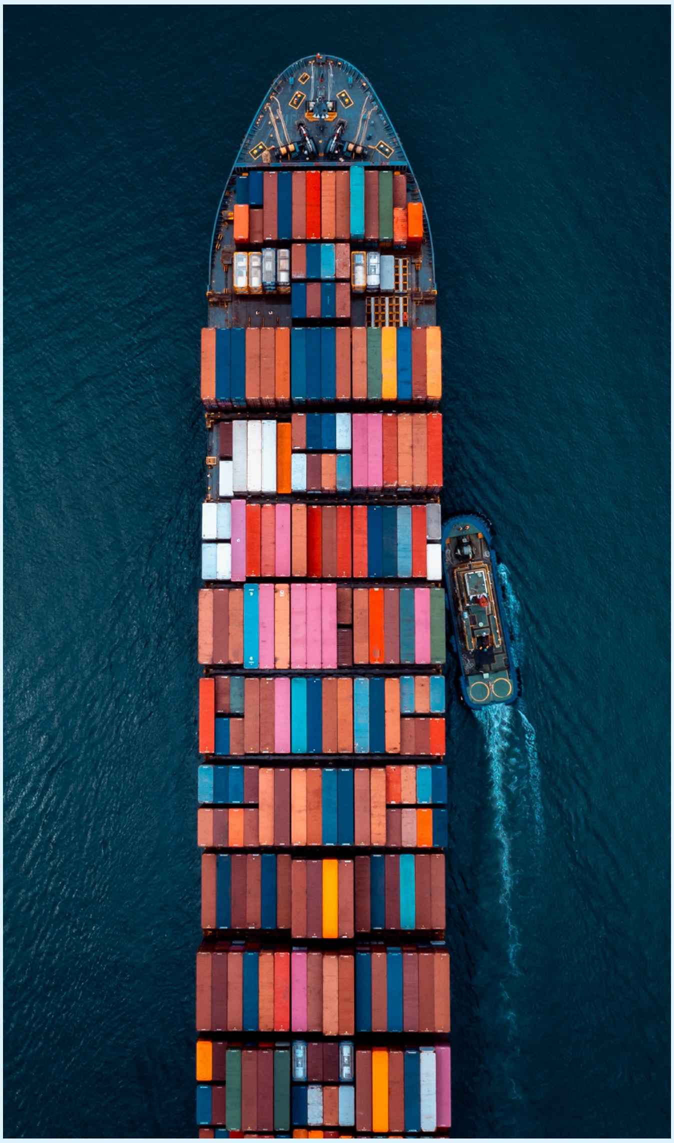
To enforce this provision, the Proclamation introduces administrative penalties for taxpayers who engage in cash transactions exceeding the prescribed legal limit.

11. Deductibility of Charitable Donations and Withholding Tax Adjustments

The amendment expands the deductibility of charitable donations to include contributions made to development activities prioritized by the government, as determined by a directive issued by the Ministry of Finance.

While the general deduction limit remains at 10% of taxable income, the amendment grants the Ministry of Finance the authority to increase this threshold specifically for donations directed toward priority development sectors.

Separately, the withholding tax rate on domestic goods and services has been increased to 3%. Corresponding thresholds have also been raised to ETB 20,000 (approximately USD 148) for the supply of goods, and ETB 10,000 (approximately USD 74) for the supply of services, applicable per supply contract.



12. Taxpayer Categories

The amendment redefined taxpayer categories by eliminating Category C and adjusting the revenue thresholds for Category A and B.

The threshold for Category A taxpayers is raised from ETB 1 million (USD 7,407.40) to ETB 2 million (USD 14,814.81).

a. Category A taxpayers are businesses and individuals with annual turnover exceeding ETB 2 million (USD 14,814.81). Taxpayers in this category are required to maintain full books of account. required to maintain full books of account.

b. Category B taxpayers, excluding businesses, are individuals with turnover of ETB 2 million (USD 14,814.81) or less. However, professional service providers such as legal, accounting, and engineering firms are required to maintain accounts regardless of turnover.

13. Employment, Rental, and Business Income Tax

One of the most socially impactful revisions is the increase in the monthly income tax exemption threshold from ETB 600 (approx. USD 4.5) to ETB 2,000 (approx. USD 14.8). Additionally, the income brackets have been adjusted, raising the monthly income level at which the highest tax rate applies from ETB 10,900 (USD 80.74) to ETB 14,000 (USD 103.70).

Similarly, the annual income brackets for rental and business income earned by individuals have been increased from ETB 7,200 (USD 53.33) to ETB 24,000 (USD 177.77). The tax rates remain progressive, reaching up to 35%, reflecting the revised employment income tax bracket structure.

Furthermore, the Proclamation excludes limited liability partnerships and legally registered collective investment funds from paying corporate income tax. However, these entities are required to withhold tax on income distributions made to their members.

14. Reporting Obligations

The Proclamation introduces a new reporting obligation for government entities, requiring them to submit information on foreign employees working in Ethiopia, including non-diplomatic staff of foreign embassies and international organizations.

This measure is designed to ensure proper tax compliance on employment income earned by such individuals, strengthening enforcement and broadening the tax base.

15. Category B Taxpayers

Category B taxpayers are required to pay tax based on their annual gross sales. This, however, does not apply to certain listed professional services and VAT registered entities who are required to keep books and accounts for tax purposes.

Importantly, the amendment repeals the Turnover Tax Proclamation No. 308/2002, removing the previous turnover tax regime and replacing it with a gross sales-based tax structure.

The applicable tax rates are progressive, ranging from:

- 2% on annual gross sales up to ETB 100,000 (approx. USD 740.74) to;
- 9% on annual gross sales between ETB 1.5 million (USD 11,111.11) and ETB 2 million (USD 14,814.81)

This change is intended to simplify tax compliance for small and medium-sized businesses while ensuring revenue collection remains efficient and equitable.

16. Effective Dates of Enforcement

The Proclamation will be enforced according to the following schedule:

- Alternative Minimum Tax (AMT): Effective from 8 July 2025 nd applicable to income tax payable for the preceding fiscal year.
- Schedule D and Withholding Tax on Domestic Transactions: Effective from 7 August 2025
- All Other Amendments: Effective from 8 July 2025

These phased implementation dates are intended to give taxpayers and relevant authorities sufficient time to adjust to the new compliance requirements.

Conclusion

These reforms represent a significant shift in Ethiopia's tax regime, introducing far-reaching changes such as the taxation of the digital economy, provisions on indirect transfers of shares, the implementation of an Alternative Minimum Tax (AMT), the reduction of the presence threshold for triggering a permanent establishment (PE), and the imposition of enhanced compliance obligations.

Corporate taxpayers, particularly multinationals and cross-border service providers should carefully assess their exposure, review and update compliance frameworks, and closely monitor the issuance of supporting regulations and directives to ensure timely and effective implementation of these changes.

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