June - August, 2023

HST Business Insights

Management insights from the future.

Knowledge Management, Unleashing Organizational Potential

Low Yields and the Peril of a Real Estate Bubble in Ethiopia

Ethiopia's rules on transfer pricing

Key Updates on Tax

Nurturing Family Businesses

Building Ethical Foundations *for* Long-Term Success

Message from the CEO

Dear Readers,

I am delighted to welcome you to the inaugural edition of HST Business Insight Magazine, which we call HBI. It is dedicated to unraveling the intricacies of the Professional Services industry. At the helm of this dynamic sector, we find ourselves on a relentless quest for excellence, innovation, and the pursuit of success for our clients and partners.

In today's fast-paced and ever-evolving business landscape, professional services firms play an indispensable role. They are the architects of transformation, the guardians of compliance, and the catalysts for growth. The diverse array of expertise encompassed within this sector, from legal and financial services to consulting and beyond, ensures that it remains a wellspring of knowledge and innovation. I am truly honored to write about the first edition of HST Business Insight, which aims to reach the wider business community with applied knowledge solutions to critical problems that hamper business and societal growth.

Modern society is highly interconnected regardless of geographic boundaries. Innovations made by one society can easily be available to others that are open to embracing change. Business organizations are prime institutions that use innovations to produce goods and services, resolve societal challenges, and improve the quality of life.

As we navigate through these pages, I invite you to embark on a journey of exploration, inspiration, and enlightenment. Our magazine is dedicated to shedding light on the trends, challenges, and opportunities that shape our industry. We aim to empower professionals and leaders with the insights, strategies, and thought leadership needed to thrive in this dynamic environment.

In these times of change and uncertainty, the importance of adaptability cannot be overstated. The professional services sector has consistently demonstrated its resilience, ability to adapt, and capacity to drive positive change. It is in this spirit that HBI has been conceived—to provide you with the tools, knowledge, and perspectives to not only survive but to thrive.

Our team of professional services leaders and experts has worked tirelessly to bring you articles, thought-provoking features that reflect the heartbeat of the industry. We will delve into topics such as family business leadership and sustainability, knowledge management, real estate, and transfer pricing, all of which are redefining the landscape of professional services.

In closing, I want to express my gratitude to our readers, contributors, and the entire team behind HST Business Insight for their unwavering commitment to making this inaugural edition a reality. Together, we embark on a journey of discovery, learning, and collaboration.

As the CEO of a professional services firm, I understand the challenges and opportunities that lie ahead. I believe that our collective wisdom and shared experiences can pave the way for a brighter, more innovative future for our industry. I encourage you to engage with us, share your insights, and be a part of this vibrant community.

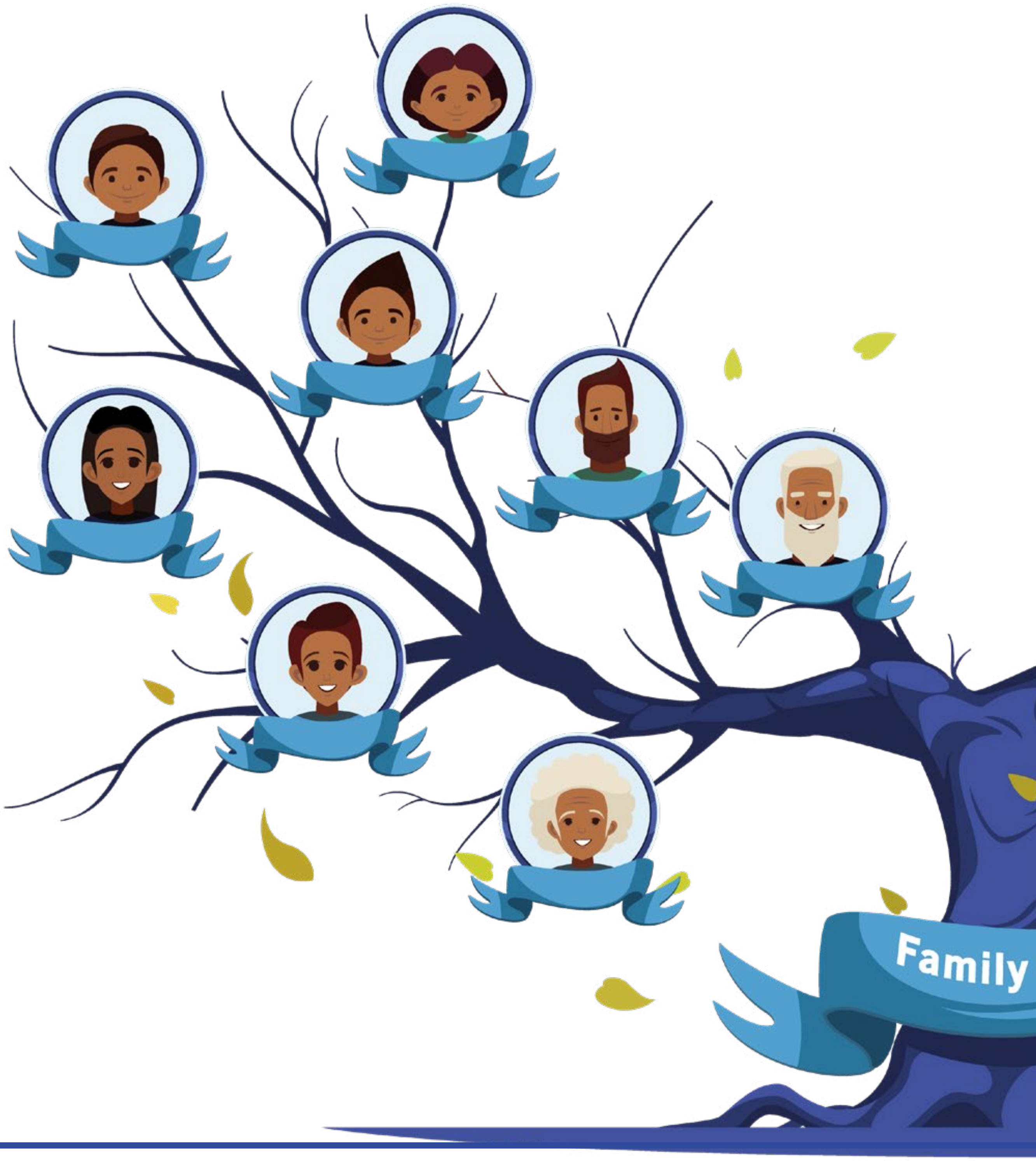
Thank you for entrusting us with your time and attention. I look forward to the exciting journey ahead and the invaluable connections we will forge along the way.

Sincerely,

by: Solomon Gizaw
Chairman and CEO of HST

Contents
Sections

The Game Plan



Nurturing Family Businesses: Building Ethical Foundations for Long-Term Success

by: Solomon Gizaw

Nurturing Family Businesses: Building Ethical Foundations *for* Long-Term Success

by: Solomon Gizaw
Chairman and CEO of HST

In today's world, the livelihood of modern societies is significantly reliant on the existence and growth of businesses. Business assumes a central role in society, shaping various aspects of economic, social, and even cultural development.

The importance of business to society can be understood from multiple perspectives: economic growth and employment, innovation and technological advancement, as well as sources of revenue for governments; skill development and training, global trade, interconnectedness, and more.

While major private corporations make substantial contributions through groundbreaking innovations and the accumulation of considerable wealth, family businesses also play a vital role in employment and economic growth across both developed and developing economies.

In contemporary society, governments strive to regulate business activities through a spectrum of laws and regulations designed to shield society from detrimental business practices. However, laws and regulations alone prove insufficient in effectively governing businesses.

> **"Laws and regulations alone prove insufficient in effectively governing businesses."**

The sheer complexity of prescribing intricate rules to oversee the operations of every business within diverse sectors of the economy makes this approach nearly impractical. Thus, genuine self-discipline in the form of ethical practices becomes imperative for the sustainable well-being of society in the long term.

While innovation and profitability undoubtedly drive the growth of various business ventures, this article places particular emphasis on the paramount importance of ethical business practices for ensuring the enduring survival of family businesses. This is rooted in the understanding that unless a family business aligns with the values of society, its eventual decline becomes inevitable.

Beyond nurturing continued growth and profitability, ethical practices within family businesses are pivotal in maintaining extended family harmony, attracting, and retaining external family talent, securing ongoing support from capital providers, and minimizing avoidable penalties related to compliance with laws.

Considering the pivotal role of ethics in business, why do some family businesses grapple with upholding these principles? Addressing this question is intricate, as conducting a comprehensive field study is nearly impracticable due to the unwillingness of individuals to disclose illegal or immoral activities to outsiders, even close friends. However, scrutinizing the operations of family businesses can yield logical and plausible hypotheses.

Beyond the realm of questionable ethical practices, numerous family businesses exhibit reluctance to share critical business model information outside the family or with close confidants within the business. Valid concerns encompass the preservation of competitive advantage, safeguarding intellectual property, maintaining family privacy, upholding family values and traditions, apprehension regarding misuse, and concerns about trust and reliability. However, more serious concerns can also involve an inherently questionable business model.

If a family business model hinges on corrupt practices and/or inappropriate and covert political support, as is prevalent in many developing economies, constructing a thriving, intergenerational family business that necessitates the backing of strategic growth partners and professional talent beyond the family becomes infeasible.

The challenge of establishing ethical practices within family businesses is further compounded by factors such as the informal nature of family enterprises, the intertwining of business and personal interests, the absence of external oversight, allegiance to family

"The presence of divergent values and priorities among different family members can lead to conflicts when attempting to establish a unified set of ethical practices aligned with everyone's perspectives."

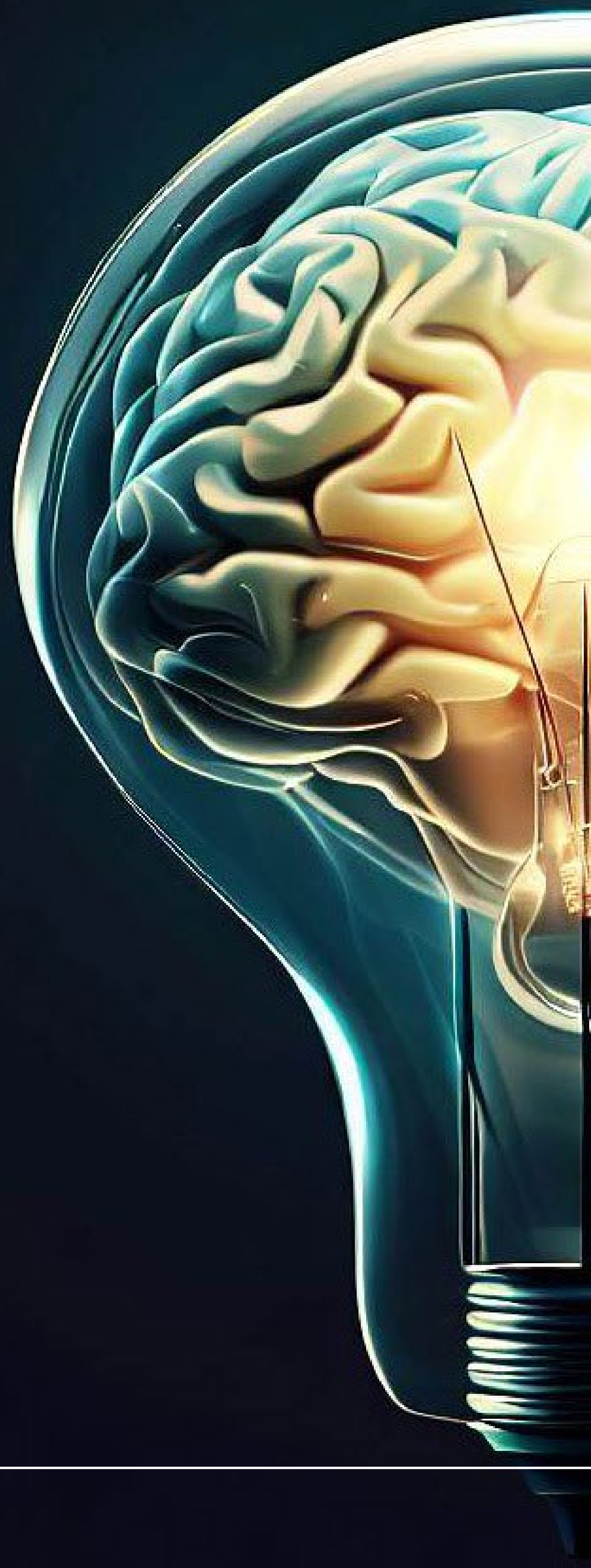
members, and the fear of conflicts within the family. Moreover, the presence of divergent values and priorities among different family members can lead to conflicts when attempting to establish a unified set of ethical practices aligned with everyone's perspectives. From a practical standpoint, family businesses often exhibit deep emotional attachments to their historical legacy, potentially introducing biases that cloud objective judgment when making ethical decisions.

Family businesses practicing corruption and favoritism might experience swift growth within their chosen industry, as long as these practices remain concealed from the broader community and stakeholders. However, over time, the significance of business governance becomes a central concern, not solely for the benefit of society and the environment, but also to ensure the continuity of family businesses across generations.

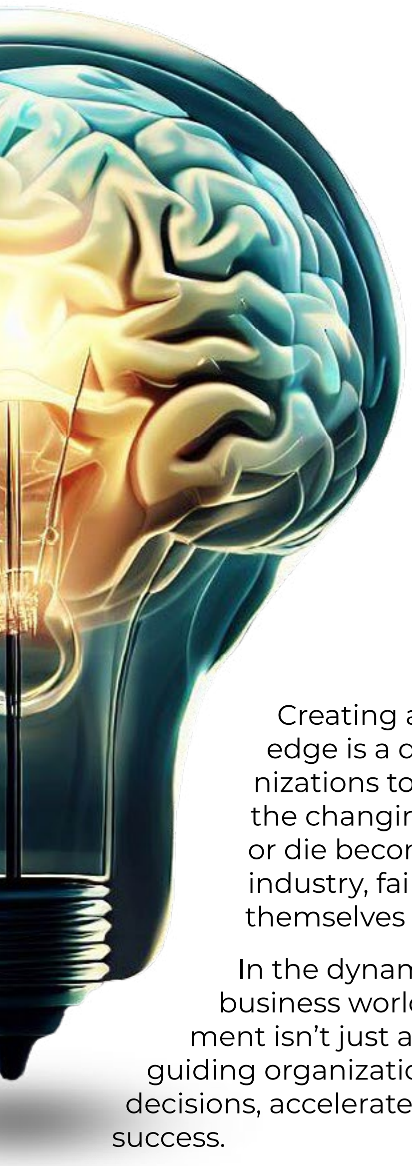
Given the backdrop of numerous business and governance scandals over the years, it has become imperative for all businesses to adopt acceptable governance practices and transparent business operations. The challenge lies in the fact that effective governance structures and best-practice management systems necessitate a strong ethical foundation throughout the family business. The encouraging news is that, with determination, a committed family business leadership supported by cooperative family members can design and implement ethical business practices programs with the guidance of trusted advisors such as HST. ■

"Valid concerns encompass the preservation of competitive advantage, safeguarding intellectual property, maintaining family privacy, upholding family values and traditions, apprehension regarding misuse, and concerns about trust and reliability."

Solomon Gizaw is a Chairman and CEO of HST and he can be reached at solomon.gizaw@hst-et.com



Knowledge Managment, Unleashing Organizational Potential



Knowledge Management, Unleashing Organizational Potential

by: Hana Degefa | Senior Researcher and
Noah Desta | Manager at HST

What makes a lasting organization? Strong leadership with sustainable pipeline of talent, learning organization continually upskilling its workforce responding to changes in the market, employees empowered to get their job done and serve their customer well, what is the linchpin that makes it all work together?

Creating and managing knowledge is a defining factor for organizations to adapt and grow with the changing landscape of markets or die becoming dinosaurs of their industry, failing to learn and shape themselves to market demands.

In the dynamic landscape of today's business world, knowledge management isn't just a tool – it's the compass guiding organizations towards smarter decisions, accelerated innovation, and lasting success.

Knowledge management is essential because it enables organizations to effectively capture, store, share, and apply their collective knowledge and expertise.

By creating structured processes for knowledge creation, distribution, and retention, knowledge management facilitates better collaboration, problem solving, and adaptability, leading to overall improved performance and competitiveness.

KM as a competitive advantage

KM is a competitive advantage for organizations to remain relevant in the market and industries they operate. It's not a 'nice to have' initiative which shows up in organization's leadership radar as a hot topic at the start of the year and disappears when operations crop up. It is a 'must have' continuous and never-ending operation that defines the efficiency and effectiveness of all other operations.

From our survey, respondents said lack of an established KM processes lowers quality of services/products and increases costs of production. When it comes to agility in responding to market disruptions, innovation/time to market, shortening the learning time of new hires, and meeting revenue targets, they indicated absence of KM negatively impacts these crucial competitive factors of their organization. They also added that it lowers customer satisfaction and slows problem resolution.

The leadership in organizations should make knowledge management one of its strategic pillars. An organization-wide team, a steering committee, should be established out of each department in the organization to oversee and smoothly facilitate the process of establishing successful KM initiative that will be part and parcel of the organization's operations just like Finance and HR. Each department should be held accountable for generating and managing its own knowledge.

There should be a separate KM team centrally managing KM activities of companies, setting standards, ushering KM operational policies, ensuring relevant knowledge is being captured by departments and that they are regularly categorized, and stored in an accessible manner.

For instance, a managing partner from a prominent local law firm explained, if the above stated measures are taken, they can leverage their existing experience and capabilities without having to start from scratch. Additionally, it safeguards the continuation of the firm's practices, irrespective of changes in leadership, mitigating the risk of losing invaluable knowledge when key employees transition to other opportunities.

"Creating and managing knowledge is a defining factor for organizations to adapt and grow with the changing landscape of markets or die becoming dinosaurs of their industry, failing to learn and shape themselves to market demands."

Technology as a fundamental enabling tool for KM

According to our interviewees and survey respondents, the primary challenge in knowledge management lies in establishing effective channels and platforms for sharing information, rather than simply capturing, and storing it.

Professional Service Firms serve as good examples, as their main product is knowledge itself. For instance, the managing partner from the above mentioned law firm explained that they maintain a comprehensive database of client communications, categorized, and stored according to the firm's practice areas.

However, difficulties arise in easily retrieving information from the computer server, particularly when it dates back over a decade. The captured information is not stored and indexed in a manner that ensures easy accessibility. Furthermore, the partner noted that they have witnessed peer firms in East African countries already utilizing technology-enabled platforms specifically tailored for knowledge management in law firms.

This highlights the advantage gained by investing in such systems, not only enhances the flow of information but also enables the development of institutional memory.

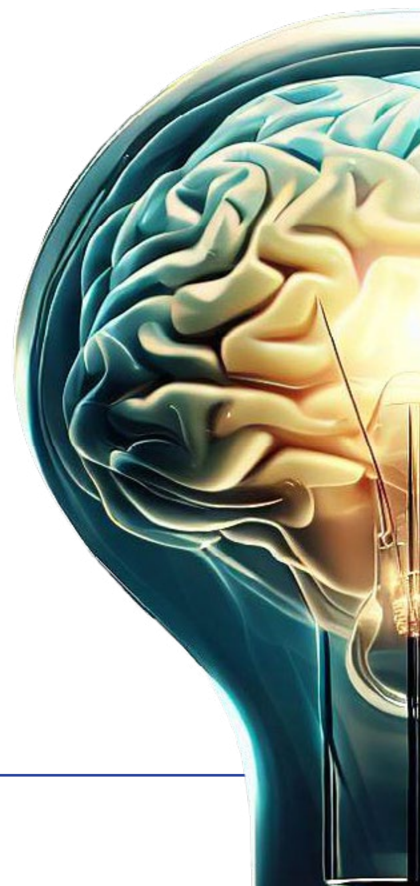
A critical mass of our survey respondents assumes a leadership role in their organizations. Almost all of them worry that they use tacit knowledge to get done the jobs that are critical to the organization, and if they left their job tomorrow, their firm would lose a lot of valuable knowledge. And that the firm would have to relearn how to do certain tasks and processes.

One organization we looked at is a state-owned enterprise [SOE] that underwent a significant turnaround led by its current CEO. The company employs 2,200 people, manages 700 branches, and handles 6 million transactions annually.

The company is making existing resources, such as manuals and SOPs, more accessible through their website and internal intranet. As a locally designated service provider for the industry they represent, they also recognize the value of learning from global organizations they work with and similar models in other countries, to aid employees' learning and professional development.

They are also working on developing a well-organized information system to optimize the use of valuable data derived from millions of customer interactions, which can be utilized for marketing and business analytics.

Additionally, addressing the staff skill gap is a priority, with a goal of achieving 100% connectivity to the system for all branch offices within the next three years. Only 40% of their branch offices have full access to the intranet infrastructure. They are mitigating this challenge by using easily accessible digital platforms and by uploading regularly updates essential information.



Culture, the driving engine for KM

Another challenge, besides organizing knowledge in an accessible manner, lies in cultivating a culture of knowledge sharing. While technology platforms can be useful, they are only effective when supported by an organizational culture that empowers and champions employees to share their knowledge. Upskilling also plays a critical role in addressing these challenges.

From our survey it is observed that, a noticeable absence of effective knowledge management will lead to duplicating information already available elsewhere within the organization, relying solely on a single individual for each task, and lacking a structured system. The practices of sharing knowledge are confined to close colleagues and friends through electronic mediums. Moreover, collaborative tendencies emerge when encountering challenges, alleviating the pressure of accountability in case of mistakes.

"While technology platforms can be useful, they are only effective when supported by an organizational culture that empowers and champions employees to share their knowledge"

The CEO of the SOE we interviewed told us that they have improved capturing relevant knowledge and learning processes by utilizing written reports, including details of project and key performance indicators (KPIs). The organization acknowledges the importance of knowledge management and the need for a cultural shift to encourage information sharing and collaboration. Each department and the entire company provide regular reports aligned with their annual plan. These reports are shared throughout the organization to facilitate learning.

The company has also implemented changes to their monthly reports, which were previously focused solely on results, to share the experiences and insights of their top performers. This encourages a culture of learning from success.

The company understands the significance of knowledge management for organizational development. They are actively working towards creating a collaborative environment and encouraging employees to share information rather than hoarding it. This cultural shift, along with improved information systems and upskilling efforts, will enhance organizational learning and decision-making processes.

One other company we interviewed for this article, as a best practice, demonstrates all the important components we laid out to successfully build a knowledge management capability. The organization is a global research institution and the research it conducts plays a crucial role for advocacy and informed decision making on a global scale. This process involves generating and analyzing data, making it accessible to the public, and storing it for future use. The organization implements ethical policies to regulate access and prevent data theft. It also follows proper processes and quality control mechanisms to maintain standards. Projects are meticulously documented, with supervisors and project leaders ensuring quality control before publication. The organization has a standalone KM team handling these tasks and it's not assigned to someone or groups of people who are already occupied with other priorities. A portal and open access approach are used to store and share published papers, while workshops and

seminars facilitate knowledge exchange.

According to our survey respondents, there are several areas where their organizations need improvement. These include simplifying major processes, standardizing workflows, documenting critical knowledge, facilitating connections with experts and colleagues, promoting conversations among peers, and implementing search tools for accessing information across platforms.

A well-implemented knowledge management system can be a game-changer, propelling your business towards improved efficiency, innovation, and decision-making. Overall, to implement KM in your organization, the following steps in sequence are recommended. Begin by identifying your organization's unique needs and challenges. Engage stakeholders from various levels and departments to ensure a holistic perspective.

Define clear objectives aligned with your business goals. Choose a user-friendly platform with an intuitive interface to encourage adoption. Develop a strategy for content curation and maintenance to keep information accurate and relevant. Provide comprehensive training and support to ensure seamless adoption. Integrate the system into existing workforce for natural usage. Implement metrics to measure the system's impact on processes and innovation. ■

Hana Degefa is a Senior Researcher and Noah Desta is a Manager at Client and Professional Services Business Unit of HST. Hana can be reached at hana.degefa@hst-et.com and Noah at noah.desta@hst-et.com

The survey questions used for this article are adopted from APQC.

Low Yields and the Peril of a Real Estate Bubble in Ethiopia

by: Zekrie Negatu
Managing Director at HST

Real estate investment holds a paramount position in the minds of Ethiopian investors, both within the country and the diaspora. Consequently, the emotional aspect of property ownership forms the backbone of many real estate firms in Ethiopia. However, amidst the flourishing real estate market, a concerning trend has emerged – one that should raise alarms, particularly for long-term investors and those attuned to financial principles.

For finance professionals, a property's intrinsic value lies in its capacity to generate future cashflows, usually through rental income. This is why experts analyzing real estate often employ property yield as a basic gauge of investment appeal.

Property yield, a straightforward but somewhat crude metric, assesses the return on a property investment. It is computed by dividing the property's annual rental earnings by its current market value.

In essence, the ratio reflects the prospective earnings relative to the property's present worth. This ratio can be either gross yield or net yield, with the former using total rental income in the numerator and the latter factoring in all property ownership costs. For example, if a 3-bedroom apartment in Addis Ababa is purchased for 14.5 million ETB and is expected to yield 35,000 ETB monthly in rent, the gross yield stands at 2.9%.

Though this example may be dismissed as anecdotal, it is not far from the overall reality of the local market because casual discussions with people who have intimate knowledge of the real estate market in Addis Ababa generally produce gross yield rates below 3%[1].

The website of the Global Property Guide which calculates rental yield rates from more than 60 countries reports the following under the "Very Poor" or "Poor" category:

Country	Gross Yield	Yield Rating
Taiwan	2.09%	Very Poor
Luxembourg	2.59%	Very Poor
Hong Kong	2.78%	Very Poor
Switzerland	2.94%	Poor

Source: Rental Yields Compared (globalpropertyguide.com)

Unfortunately, the database does not include Ethiopia, but it is reasonable to expect that it could easily join this league of low-yield countries if a similar survey is done on the subject.

In a balanced real estate market, property yields tend to align with prevailing interest rates and borrowing costs. Healthy yields that equal or exceed borrowing expenses signify fair property valuations and a sustainable investment climate. Conversely, persistently low property yields that significantly lag behind borrowing costs indicate overpriced properties and a disconnect between property prices and their income-generating potential.

Evidence from other economies demonstrates that excessive overpricing and low yields can serve as early warnings of impending real estate bubbles. When demand surges due to a fervent belief in continuous price appreciation, investors and speculators drive prices to unsustainable levels. This speculative behavior creates a stark mismatch between property market prices and their future income-generating ability. The trend continues as long as irrational exuberance dominates the market, but the situation collapses when the next buyer, often referred to as the 'next fool', fails to materialize.

The highest bids recently submitted by investors for undeveloped land in Addis Ababa (USD 7,500 and USD 12,630 per square meter) may be considered outliers, yet they hint at the overall trajectory of the local property market. The Global Property Guide cited earlier reveals that countries like France, Israel, and Taiwan have some of the most expensive developed property prices (e.g., France at USD 14,808/m2). The average selling prices reported for developed properties in some African countries are enviable by Ethiopian standards: USD 1,700 per m2 for South Africa and USD 831 per m2 for Egypt. It's essential to note that these figures pertain to developed properties, not undeveloped land as cited above for Addis Ababa.

The question of whether a real estate bubble is imminent is complex and contextual. Ethiopian investors face unique circumstances, limited investment options, and other factors that make real estate investment a more accessible option, despite its low yield. Many local investors view real estate as a hedge against inflation rather than a purely commercial endeavor, allowing for greater tolerance of low yields.

Moreover, unlike other parts of the world, local property buyers, especially in the residential sector, have limited access to mortgage loans. As a result, they rely heavily on personal and family savings for property acquisition. These funding sources are more patient during financial hardships and may not lead to widespread foreclosures by banks as seen in other countries during real estate bubbles.

While predicting real estate bubbles and their eventual bursts is challenging, one thing is clear: even with Ethiopia's unique circumstances and mitigating factors that can delay market corrections, economic principles cannot be disregarded in the long run. Property yields that fall significantly below the economy's cost of money are unsustainable and untenable in the long term. ■

Zekrie Negatu is a Managing Director of Consulting at HST and he can be reached at zekrie.negatu@hst-et.com

[1] A recent publication by the Accounting & Auditing Board of Ethiopia was brought to my attention after I submitted the draft for this article to HST's Editorial Team. Interestingly, the publication had an article from Million Kibret of BDO on the same topic with almost the same example. I hereby recognize the seniority of Million's article but also declare that, despite the timing and similarity of the topic, this is my independent work.

Ethiopia’s Rules on Transfer Pricing

by: Thomas Mulugeta | Partner at HST

In a recent discussion made between The Ministry of Revenue and stakeholders, the issue of transfer pricing was brought up to create more awareness on the rules and their applicability. This session has clearly indicated that more focus is needed on transfer pricing, arm’s length principles and taxpayers’ role in this respect.

Back in 2015, Ethiopia enacted its first rule on transfer pricing through the issue of Directive 43/2015. This marked the beginning of a regulated transfer pricing policy which for long has been a mere principle on income tax proclamations of the land with regards to Arm’s Length transactions between related parties. Transfer pricing Directive 43/2015, which provided guidance on both Article 29 of the old income tax proclamation 286/94 also serves as a guidance to article 79 of the income tax proclamation no. 979/2016. This is clearly indicated in the article 101/6 of the 2016 proclamation.

This directive follows the comparability principles of the Organisation for Economic Co-operation and Development (OECD) guidelines as stated in Article 18 of the Directive. The guidelines consider circumstances of comparability of controlled transaction (transactions with related parties) and uncontrolled transactions (those with unrelated parties) These circumstances are:

i. If there is no significant difference between them that could have any substantial impact on the financial indicator under the appropriate transfer pricing method or

ii. If any such difference exists, it can be eliminated by adjusting the financial indicator of the uncontrolled transaction to eliminate the effect of the difference on comparability.

Although Directive 43/2015 allows five different methods as 'approved transfer pricing methods', it also allows taxpayers to adopt other methods, as long as the taxpayer can establish that none of the approved methods can be applied under the circumstances and as far as the results of the adopted method are consistent with arm's length principle.

These five 'approved transfer pricing' methods are:

i. Comparable uncontrolled price method

ii. Resale price method

iii. Cost plus method

iv. Transactional net margin Method

v. Transactional profit split method

Selection of appropriate methods, as specified in Article 7 of the Directive, first and foremost should be consistent with the Arm's length principles. This is followed by four criteria to evaluate the appropriate methods for the selection. These criteria are:

- strength and weaknesses of the transfer pricing method.
- appropriateness of the approved transfer pricing method in view of the nature of the controlled transaction.
- availability of reliable data needed to apply selected transfer pricing method(s) and
- degree of comparability between controlled and uncontrolled transactions.

Internal comparable price is a common method of comparison, defined by the directive as uncontrolled transactions that are made between the taxpayer and an unrelated party, for the purpose of determining an arm's length range to compare with a controlled or related party transaction.

Documentation

Taxpayers are required to maintain adequate documentation to substantiate conditions and circumstances of controlled transactions (transactions with related parties) that are consistent with the arm's length principles. These documentations should ensure that the taxpayer discloses the nature of the operations, history and general overview of the relevant market.

They should also include the organizational structure of the business. In this situation members of a group company if any, or operations and business relationships of any related companies should be included in the documentation.

One other significant aspect of the documentation requirement is with respect to list of controlled transactions along with an analysis on the comparability factors with uncontrolled transactions. The analysis to be documented should include comparability adjustments taking into account the materiality of the difference for which the adjustment is being considered, the quality of the data subject to adjustment, the purpose of the adjustment and the reliability of the approach used to make the adjustments.

The taxpayer is also required to document an explanation on the appropriateness of the selected methods including specific financial indicators and the party on which the methods are tested where relevant.

As comparability is the key aspect of the TP and Arm's length principles, the analysis thereto and the descriptions of the comparable uncontrolled transactions should also be part of the taxpayer's files and documentation.

Other documentations to consider are detailed adjustments made after the comparability analysis, budgets and projections used, sector analysis done and any other relevant information.

Advance pricing arrangement

Article 12 of the directive provides an opportunity for taxpayers to enter into an agreement with the tax authority to determine appropriate criteria to set arm's length conditions for related party transactions. This arrangement is agreed for a fixed period of time. Such practices are also exercised in other countries as a tool to eliminate uncertainty and with a view of ensuring the confidentiality of information during the process. This also enhances the relationship with the tax authorities.

The Directive guides the taxpayer to file a formal request for the pricing arrangements if need be. This advance pricing request should be filed along with description of controlled transactions, proposed scope and duration of the arrangement, TP method selected, the comparability factors considered, and countries to be included in the arrangement.

Application of the law and recent developments

Currently, more emphasis is given to controlled or related party transactions between businesses operating in Ethiopia and their international related partners even though the Directive also covers related companies in Ethiopia without any international affiliations. This means transfer pricing is also a key issue regarding transactions between two or more domestic related businesses as clearly required by Article 79/4 of the income tax proclamation 979/2016.

However, the authority is now paying more attention to controlled transactions that are entirely between resident companies in Ethiopia. These companies are required to declare such transactions along with their annual income tax filing. Therefore, companies need to set their house in order to organize and furnish all information, analysis and documentation on transfer pricing in time. One other issue to be put into consideration in case of controlled transactions between two domestic companies is, any adjustment on the related party transactions should affect both parties.

If one looks at the transfer pricing declaration document or form, it primarily describes transactions to be filed as ‘Internationally Controlled’. The Ministry of revenue has recently acknowledged this in its deliberations to stakeholders.

The Ministry has also decided to increase filing requirement of the minimum threshold of aggregate controlled transactions of ETB 500,000 to ETB 1,000,000. The annual declaration also prohibits offsetting of income and expenses to avoid non detection of controlled transactions.

The bottom line is taxpayers with controlled transactions need to continuously be alerted to the need for filing transfer pricing declarations. And those with adequate documentations and a robust transfer pricing policy do not find it difficult to file TP requirements in time. ■

Thomas Mulugeta is a Partner at the Audit Business Unit of HST and he can be reached at thomas.mulugeta@hst-et.com

Key Updates from August 2022 to August 2023 in the Ethiopian Tax System

by: Mamo Abdi | Manager at HST

The tax laws are changing over the last several years in Ethiopia, the primary reasons for the case is presumed not only raising revenue to redistribute wealth among citizens, but also to broaden the tax base, ensure and enhance the voluntary tax compliance as well as equity in the tax system.

In an ever -changing tax environment, businesses are advised to stay updated on the recent tax developments.

Therefore, this is an update aimed to provide recent tax developments about domestic, international tax and any other changes that are directly or indirectly related to tax compliance. It addresses custom, investment and excise tax developments that happened from August 2022 to August 2023 in the Ethiopian tax landscape.

A. Regulation No. 519/2022 to Provide for Social Welfare Levy on Imported Goods

This regulation is issued by Council of Ministers and came into effect on 22 August 2022.

As stated in the preamble of the enactment, the Social Welfare Levy is aimed to fulfill the commitment of the Government to provide and finance education, training, health, and other social services. The main contents of articles contained in the regulation are:

A.1. Goods that are subject to social welfare levy

Except for the followings, all imported goods are subject to social welfare levy.

- Goods imported by persons and organizations with diplomatic privileges.
- Goods that are subject to sur tax under import Sur tax regulation No 133/2007 issued by Council of Ministers.
- Goods exempt by a Directive to be issued by the Ministry of Finance for social and economic reasons.

A.2. Rate of social welfare levy

- Except the exempted goods from social levy, tax at the rate of 3% shall be levied on all imported goods.
- The social levy imposed on imported goods is in addition to custom and taxes to be collected under the applicable laws.

A.3. Social levy computation

- The base for calculation of the social levy are aggregate cost, insurance, and freight (CIF).
- The social levy tax shall not serve as a base for any other tax imposed on imported goods.

B. Investment Incentive Regulation Number 517/2022

B.1. Location privileges

An investor who invests in an area far from the center with very low infrastructure development that are listed in the Directive issued by MoF in consultation with concerned stakeholders shall be entitled to an income tax exemption of 30% for three consecutive years after the expiry of income tax exemption period specified in the schedule.

An investor who invests at new, atypical and selected tourist destination areas in hotels, lodges and resorts with a rank of star is eligible to income tax exemption for five consecutive years.

B.2. Creation of employment opportunity abroad

An Investor who provides employment opportunity outside Ethiopia to Ethiopians who have obtained qualification certificate,

a. will be entitled to benefit for one year income tax exemption if he provides employment opportunity for 100 up to 300 Ethiopians.

b. will be entitled to benefit for two years income tax exemption if he provides employment opportunity for 300 up to 500 Ethiopians.

c. will be entitled to benefit for three years income tax exemption if he provides employment opportunity for more than 501 Ethiopians.

d. The income tax exemption to be granted under this rule will not exceed 6 years.

B.3. Incentive for expansions

Investors who seek to expand or upscale the existing investment will be entitled to an income tax exemption specific for the new income generated through the expansion.

B.4. Income tax incentives for exporters of goods and services

Investors who invest outside industrial parks and who export or provide supplies to an exporter of at least 60% of their products or services will be entitled to a one-time income tax exemption for two years in addition to the exemption of income tax provided in the schedule. This too, applies to investors who invest within industrial parks and who export or provide supplies to an exporter of at least 80% of their products or services.

B.5. Loss -carry forward as an incentive

Any investor who has incurred loss within the period of income tax exemptions will be allowed to carry forward such loss for half of the exemption period after the expiry period. The loss cannot be carried forward more than five income tax periods.

C. Excise Tax Proclamation Amendment

The new Ethiopian excise tax proclamation No 1287/2023 became ratified by the House of Peoples Representatives to be effective starting 27 April 2023.

The new changes in the proclamation include:

C.1. Inclusion of new excisable items

Telecommunication service of mobile and wireless telephone (internet, voice, and SMS) is subject to excise tax at the rate of 5%.

C.2. Existing Excisable Items with Reduced Excise Tax Rate

Excisable items	Last Rate (%)	Present Rate (%)
Edible animal or vegetable fats and oils and their cleave products containing 40g or more saturated fat per 100g, or unable to determine level of saturated fat from label and partially and wholly hydrogenated	40 &30	30
Any sugar excluding medical	20	10
Chewing gum	20	10
Edible chocolates and sweets	20	10
Ethyl alcohol	60	10
Salt	25	10
Fuel — super benzene, regular benzene, petrol, gasoline and other motor spirits, jet fuel	30	15
Textile fabrics, knitted or woven of natural silk, rayon, nylon, wool, partly or wholly made from cotton, which is grey, white, dyed or printed, in pieces of any length or width (except mosquito net and Abugida) and including blankets, bedsheets, counterpanes, towels, counterpanes, towels, table clothes and similar articles manufactured by industries.	8	5
Carpets	30	15

C.3. Vehicles' Excise tax

Excisable vehicle	Status	Tax rate range (%)
Vehicle with cylinder capacity (CC) 1500 diesel	New	10
Vehicle the same CC with service years 1 to 5	Used	70-410
Vehicle with CC 1501-2500	New	20
Vehicle the same CC with service year 1 to 5	Used	70-420
Vehicle with CC 2501-3000	New	30
Vehicle the same CC with service years 1 to 5	Used	80-430
Vehicle with more than 3000 CC	New	30
Vehicle with the CC with service years of 1-5	Used	90-500
Vehicle with electric cylinder not exceeding 1500cc	New	5
Vehicle the same CC with service years 1 to 5	Used	60-410
Vehicles whose service year is more than 5 years	Used	200

C.4. Exclusion from Excise Tax Scope

Video recording or reproducing, television broadcasting receivers, apparatus, photo, or video camera whose excise tax rate was 10% are now excluded from Excise tax scope. ■

Mamo Abdi is a Senior Manager at Tax and BSS Business Unit of HST and he can be reached at mamo.abdi@hst-et.com

Sources:

- Social Welfare Levy on Imported Goods Regulation No. 519/2022.
- Investment Incentive Regulation Number 517/2022.
- Excise Tax Proclamation No 1287/2023.

HST is an end-to-end professional service firm. With our 20 years of experience, working with one of the global big 4 firms and our deep expertise within local markets, we specialize in delivering excellent services in the fields of strategy and organization, finance compliance and advisory, as well as innovative learning solutions, human capital and technology services. HST provides you with expert assistance and support in achieving your business goals and staying ahead in today's competitive landscape.

Ethio–China Friendship Avenue
Mina Building 4th and 5th Floor
Tel: +251 115 52 76 66/67 | Fax: +251 115 52 83 84
Email: info@HST-et.com
Web: www.hst-et.com