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Taxation of the Digital Economy: Pros and Cons of Introducing a Digital Service Tax in Ethiopia

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TAXATION OF THE DIGITAL ECONOMY: PROS AND CONS OF INTRODUCING A DIGITAL SERVICE TAX IN ETHIOPIA

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TAXATION OF THE DIGITAL ECONOMY: PROS AND CONS OF INTRODUCING A DIGITAL SERVICE TAX IN ETHIOPIA

Thesis

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Thesis approval page

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Declaration I, the undersigned, declare that the thesis comprises my own work. In compliance with widely accepted practices, I have duly acknowledged and referenced all materials used in this work. I understand that non-adherence to the principles of academic honesty and integrity, misrepresentation/fabrication of any idea/data/fact/source will constitute sufficient ground for disciplinary action by the University and can also evoke criminal sanction from the State and civil action from the sources which have not been properly cited or acknowledged.

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Acronyms and abbreviations

ATAF: African Tax Administration Forum

BEPS: Base Erosion and Profit Shifting

The CSNTPK: Cabinet Secretary for National Treasury and Planning in Kenya

CITA: Companies Income Tax Act in Nigeria

DST: Digital Service Tax

E-COMMERCE: Electronic Commerce

EU: European Union

EC: European Commission

GoK: Government of Kenya

GloBE: Global Anti-base Erosion

GTV: Gross Transaction Value

OECD: Organization for Economic Cooperation and Development

MNE: Multinational Enterprise

SEP: Significant Economic Presence

SDP: Significant Digital Presence

U.S.: United States

USTR: United States Trade Representative

UNCTAD: United Nation Conference on Trade and Development

VAT: Value Added Tax

Abstract

The digitalisation of the economy is rapidly growing across the world, and discussions about how to tax it are taking place at an international level within the OECD inclusive framework. While a multilateral solution is still on the table, unilateral solution to address the issue is gaining ground. The European Union has proposed its own solution, and many OECD member countries have also introduced their own solution to address the tax effects of digitalisation. In Africa, the African Tax Administration Forum has proposed its own solution, and individual countries have also introduced digital service tax as a solution in their tax systems. In Ethiopia, the government has announced the Digital Ethiopia strategy. The movement towards digitalisation of the economy in Ethiopia is expressed by the imposition of electronic payment for fuel transactions. Recently, the launch of TELLEBIRR and the introduction of the NEDAJ app further reveal the government's intention to digitalise the economy. The ambition of the government to digitalise the economy is not coupled with showing interest in taxing the digital economy. The compatibility of the current tax systems to tax the digital economy needs to be addressed. Many countries are finding solutions to tax the digital economy at the domestic level. This paper aims to analyse the need to introduce a digital service tax in Ethiopia. By analysing the tax legislation and other laws, the paper attempts to address questions such as: Is the current tax system in Ethiopia capable of taxing foreign digital companies without permanent establishment in Ethiopia? Is there a need to introduce a digital service tax in Ethiopia? If so, how should the tax base be identified? How can the income be traced and what rate should the income is taxed? By analysing the laws and literature, the paper concludes that the current tax system is not capable to tax foreign digital companies without permanent establishment in Ethiopia. Even though the existing legal regimes create enabling conditions for the digitalisation of the economy, the issue of taxing the digital economy in Ethiopia is not well addressed. The writer believes that the introduction of a digital service tax will solve the problem. The issue of taxing the gross revenue or the net profit is also discussed. The author believes that taxing the provision of digital services based on transaction value is a better policy than imposing a minimum income criterion.

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

It is imperative to consider whether the current tax regulations are sufficient to tax foreign digital enterprises that do not have a permanent establishment in Ethiopia, given the emergence of the digitalization of the economy. People's lives and the way businesses are conducted are being drastically transformed by the internet and other worldwide communications platforms.[1] Africa is not an exception to the burgeoning global digital economy. Amazon, Facebook, Google, and other digital multinational enterprises (MNEs) are some of the key participants in the African digital economy.[2] Global discourse is still on-going around the digitalization of the economy and how it affects taxes. Global digital tax regulations are now being negotiated by the OECD. The OECD proposal is built around two main pillars. The first pillar deals with the regulations pertaining to the company location-taxation nexus, evaluates the existing profit distribution, and suggests granting new taxation rights. It is mainly based on sales, rather than on physical presence as is the case in the currently binding rules. To counter profit-shifting and lessen tax competitiveness, pillar two seeks to set a global minimum corporate tax rate.[3] The Committee of Experts on International Cooperation in Tax Matters examines whether value creation is a suitable foundation for assigning taxing rights in the interest of developing countries, taking note of the difficulties the digital economy poses to the current nexus rules under tax treaties.[4] Ethiopia's integration into the global economy means that taxation will inevitably be impacted by economic

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1 Andrew Lymar , *taxation in an electronic world: the international debate and a role for tax research*, online, A tax discussion paper series nu 3, <www.icaew.org.uk> [last accessed on July 15,2023]

2 Mpofu, Favourate Y, *Taxation of the Digital Economy and Direct Digital Service Taxes: Opportunities, Challenges, and Implications for African Countries*. Economies ,2022.

3 Miroslava Karaboytcheva, Taxation of the digital economy: Latest developments, December 2020

4 Committee of Experts on International Cooperation in Tax Matters Twenty-second Session 19-28 April 2021 Item 3(i) of the provisional agenda Tax consequences of the digitalized economy – issues of relevance for developing countries

digitization. Ethiopia has been moving toward digitalizing its economy or setting the path for one. Examples of these legislative actions include proclamation No. 718/2011, which established a national payment system and defined terms related to digitalization under article 2(8-11), Proclamation No. 1205/2020, which acknowledged electronic transactions and aimed to provide Ethiopia access to the digital era, as well as Proclamations 1072/2018 and 1205/2020 on digital identity and electronic signatures. Additionally, the government's grasp of the digitalization of the economy and its willingness to participate in business are indicated by the massive government-owned company's creation of the TELLEBIRR service. The goal of the nation to digitalize its economy is also expressed in the Digital Ethiopia strategy. There is little interest in tracking down and taxing economic revenue in tandem with the shift to digitalization of the economy. In light of this, the conventional source and residence rule for taxing overseas digital enterprises is no longer applicable. At the national level, nations are putting their tax rules to the test. The tax system in our nation has to be put to the test in order to determine if the legislation is compatible with taxing international digital businesses that do not have a permanent base in Ethiopia. In order to determine whether international digital businesses without a permanent base in Ethiopia are liable to taxes, this study will examine the necessity of implementing a digital service tax in Ethiopia. This study examines the literature and talks about global practices in this area to identify answers for the issues raised. To determine the finest lessons, the experiences of industrialized nations like France and Canada and African nations like Kenya and Nigeria are considered, together with those of the European Union and the African Tax Administration Forum from international organizations. There are four chapters in the paper. The introduction is covered in the first chapter. In the second chapter, the legislative framework in Ethiopia and global experience with the digital economy are covered. This paper's third chapter primarily analyses the present tax structure in light of the economy's digitization. The paper's conclusion and suggestions are covered in the last chapter.

1.2 Statement of the problem

It is a difficult effort for the tax authorities to track down and tax digital enterprises that do not have a physical location. The development of cyberspace tax systems requires an interdisciplinary approach, which is a required complement to an international or policy viewpoint. It will take a mix of expertise from economists, attorneys, and accountants as well as the technical know-how and comprehension of computer specialists to provide workable solutions.[5] Whether Ethiopia is ready to introduce digital service tax or not is yet unclear. The question of whether Ethiopia's current tax system is adequate to tax the digital economy is also debatable. There appear to be several issues with taxes in the digital economy. The author would also want to pose the following queries: Are digital services supplied by international corporations that do not have a permanent base in Ethiopia subject to taxes? Which of the current tax laws the income tax proclamation or the valued added tax proclamation applies to digital services, the writer wonders? Does the introduction of a tax on digital services make sense? Is the tax system we now have adequate to handle the digital economy? Does the tax base for digital service exist? The goal of this research is to verify this matter and choose the best course of action, thus all of these inquiries are anticipated to be addressed in order to evaluate the compliance of Ethiopian tax legislation.

1.3 Research objective

This study aims to evaluate the legal hurdles and benefits of integrating digital service tax into the FDRE tax system, as well as the suitability of Ethiopian tax laws for taxing international digital enterprises that do not have a permanent base in Ethiopia.

The specific objectives are:

- Examine the problems of imposing a tax on digital services in Ethiopia.
- Describe the Ethiopian tax system in the context of the digital economy and the use of digital service tax.

5 *Supra note 1.*

- Describe the process used to determine the tax jurisdiction for the digital service tax.
- Draw the best lessons from other countries regarding digital service tax.
- Explain why Ethiopia should introduce a digital service tax.
- Recommend solutions to existing problems and challenges, if any.

1.4 Research questions

1.4.1 The central research question

The study aims to address the following core research question in order to achieve the previously specified research objective.

What are the legal hurdles and benefits of integrating digital service tax into the FDRE tax system? Are Ethiopian tax laws suitable for taxing international digital enterprises that do not have a permanent base in Ethiopia?

1.4.2 Specific research questions.

The study aims to address the central research question described above by posing the following particular questions and attempting to discover a solution.

- What are the problems associated with imposing a tax on digital services in Ethiopia?
- What are the description of the Ethiopian tax system in the context of the digital economy and the use of digital service tax?
- What is the process used to determine the tax jurisdiction for the digital service tax?
- What are the best lessons that can be drawn from other countries regarding digital service tax?
- Why should Ethiopia introduce a digital service tax?
- What are the recommended solutions to existing problems and challenges, if any?

1.5 Research methodology

This research is an empirical research and the researcher applies a qualitative research method in conducting the research. Examining the actual data regarding the digitalization of the economy, the current tax system, and the methods used by the relevant authorities to levy and collect income taxes from digital services is necessary, as the main goal of this research is to determine whether the Ethiopian tax system is compatible with the implementation of the digital service tax to tax foreign digital companies that do not have a permanent establishment in Ethiopia. To this end empirical research is applied. The factual realty was gathered through an interview and examining public document. The researcher also examined policies, laws and literature. The comparative method is also used to contrast and identify optimal practices.

1.5.1 Population and sampling

The researcher interviewed the concerned organ about the need to introduce digital service tax in Ethiopia. The interviewee is chosen by means of purposive sampling. The researcher has conducted interviews with the tax authorities, lawyers, public prosecutor, and judges working at the federal level. The amount of sample will depend on data saturation.

1.5.2 Data collection and analysis method

The primary methods of gathering data for this study include personal observation, document inspection, and interviews. Foreign literatures are investigated most importantly in order to compare the practices of other countries. The descriptive approach of data analysis is used in the research.

1.6 Scope of the research

The study's scope is restricted to specific themes and geographical areas in order to keep it manageable within the time and resources allotted. It evaluates Ethiopian federal tax laws thematically and determines if any changes to the rules are necessary to tax international digital enterprises that do not have a permanent base in Ethiopia. At the federal level, the research's geographic reach is restricted. Finding the issue and offering a remedy for the tax problems pertaining to the digital economy as a whole is challenging, if not impossible, without restricting the research's scope. Because of this, the study's objectives are restricted to determining whether Ethiopia's tax system can tax international digital businesses that do not have a permanent presence in Ethiopia and evaluating the potential legal difficulties associated with implementing a tax on digital services. With this knowledge, laws pertaining to electronic transactions, electronic signatures, and the national payment system, among others, are analyzed, as well as the federal income tax law, regulation, VAT proclamation and regulation, and directives issued by the Internal Revenue authority.

1.7 Limitation of the study

This research's primary focus is on the taxation of international companies who provide digital services in Ethiopia without having a permanent place of business. The research does not include earnings from the digital economy generated by Ethiopian nationals, like those of YouTubers and tiktokers, to mention a couple. It focuses on the financial advantage that multinational corporations like Google, Facebook, Netflix, and others stand to make from the usage of digital services by Ethiopians. Geographically the research is limited at the federal level and mainly at the ministry of revenue head quarter for this fact the researcher might miss any regional good practice if any.

1.8 Literature review

It is well acknowledged that the present tax structure is inadequate for the contemporary digital economy. Despite the fact that some nations have taken unilateral action to solve this problem, these opposing viewpoints have made it difficult to reach an agreement and to re-examine some of the fundamental international tax concepts.[6] As a solution, several nations are putting their national legal systems to the test under international oversight to make sure they comply with the new situation. With an eye toward global solutions, Ethiopian academics are looking for ways to tax the digital economy. It's interesting that none of these studies have looked at whether Ethiopia may adopt a digital service tax to help with this issue. Below are some related research papers and articles that have been reviewed. The paper titled "Income Taxation of the Digital Economy: BEPS and Ethiopian Tax Administration in Focus," authored by Mekonen G/Mariam at Addis Ababa University, raises several questions. These include: what are the relevant OECD recommendations for income taxation of the digital economy and

6 OECD Going Digital Policy Note "*Tax and Digitalisation*", online, <www.oecd.org> [last accessed June 15,2023]

tax administration, and how can these recommendations assist Ethiopia in designing its tax policy and modernizing its tax system? Additionally, why has Ethiopia not joined the BEPS initiative, should it ratify the MLI, and what efforts have been made towards taxing the digital economy in Ethiopia? Lastly, what are the legal and practical challenges involved in income taxation of the digital economy in Ethiopia? The main focus of the research is to find a global solution for the digitization of the economy. This is primarily done by examining whether joining the Multilateral Convention to Implement Tax Related Measures would be beneficial or not. The researcher suggests that Ethiopia should join the BEPS project and ratify the MLI.[7] We all have a basic understanding of the digital economy and how taxable it is. This study focuses on digital businesses without a permanent presence in Ethiopia rather than the digital sector as a whole, and the implementation of a digital service tax is the proposed remedy. Unlike the aforementioned research, I will not be examining the benefits of ratifying the MLI and joining the BEPS initiative in this particular study. By analysing the digital service tax, this study seeks to provide a domestic solution for current problems in the digital economy. Although this paper may not be directly relevant to my research, it is used as a reference. Yonas Mekonin also conducted a research study in 2018 that delved into the intricacies of taxation in the digital economy. The research, titled 'Challenges of Taxing E-commerce in Ethiopia,' specifically focuses on the unique challenges of taxing e-commerce in the country. The study was carried out at the School of Law at Bahir Dar University and aimed to identify the main challenges that the Ethiopian government faces in taxing e-commerce. It examined the legal and regulatory frameworks surrounding e-commerce taxation and explored potential solutions to the challenges identified. The research study sheds light on the complexities of taxing the digital economy and provides valuable insights for policymakers and tax authorities. The main objective of the mentioned research is to identify and analyse the challenges of taxing electronic commerce in Ethiopia. The paper aims to recommend measures to be taken by the concerned bodies to make taxation of e-commerce a reality in

[7] Mekonnen G/Mariam Abamecha, *Income Taxation of the Digital Economy: BEPS and Ethiopian Tax Administration in Focus:*, LLM thesis, Addis Ababa University, law school, 2020, [unpublished available at law library],p 52

Ethiopia. It's worth noting that the paper does not discuss the need to introduce a digital service tax in Ethiopia.[8] According to the study, the issue of digital service tax was not discussed and the researcher did not address introducing it in Ethiopia. The recommendations provided are quite general, but there are a few worth mentioning, such as the suggestion to introduce digital presence as an amendment to the physical presence requirement. However, the researcher did not address the issue of what type of tax should be implemented to tax the digital economy. Furthermore, the researcher only discussed e-commerce, which is just one aspect of the digital economy. The topic of user participation in creating value is a subject of on-going debate. However, my thesis aims to delve deeper into the legal implications and advantages of the introduction of digital service tax that seeks to tax foreign digital companies without a permanent establishment in Ethiopia. As such, the scope and focus of my research is distinct from the research studies previously discussed. Through an in-depth analysis of the legal challenges and opportunities of digital service tax, I aim to provide valuable insights into this emerging area of digital taxation. Although e-commerce is just a part of the broader digital economy, it cannot be denied that they are closely related. Hence, the research that has been cited is noteworthy for its extensive and comprehensive references that cover both these areas in-depth. The research paper titled "The Need to Review the Taxation of Digital Business Income under Ethiopian Tax Law: An Emphasis on Income Derived from Social Media and Blog Businesses," It is important to discuss this connected work, which Endalkachew Abera Mekuriya finished in August 2020 for his LL.M. thesis at Haramaya University in Ethiopia. The paper's concentration on blog and social media earnings is evident from the headline. The author of the research did not address international digital firms without a permanent presence in Ethiopia, with the exception of talking about taxes on digital businesses.

According to my study, multinational digital enterprises that are not based in Ethiopia permanently are the focus. Consequently, there is no correlation whatsoever between the scope and dimensions of the aforementioned research and this particular study.

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[8] *Id*. p. 80-90

There is a lot of information available online about how to tax the digital economy. One helpful resource is an article by Kelbesa Megersa called "Digital Service Taxes and Their Application". This article provides insight on how countries can introduce digital service taxes. You can find it online at trusted sources like SSRN.[9] Also, there is a review written by Favour Y. Mpofu titled "Taxation of the Digital Economy and Direct Digital Service Tax: Opportunities, Challenges, and Implications for African Countries". Internet sources such as Tax Foundation and Bloomberg can be helpful in exploring the practices of countries that have introduced digital service tax.[10] I found the tax update by KPMG and IBFD tax research site useful. However, there is no research conducted on digital service tax in Ethiopia. My paper aims to fill this gap.

1.9 Significance of the study

The purpose of this research is to analyze the need to introduce digital service tax and implementation of it in Ethiopia. As this is a relatively new topic, the research aims to provide valuable insights for tax authorities and policymakers, with the ultimate goal of making recommendations to ensure successful implementation.

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9 Megersa,K., *Digital Service Taxes and Their Application.* K4D Helpdesk Report 914. Online, < https://www.gov.uk> [last accessed June 20,2023]

10 Mpofu, Favourate Y, *Taxation of the Digital Economy and Direct Digital Service Taxes: Opportunities, Challenges, and Implications for African Countries*, Economies, online, 2022. < https://www.researchgate.net> [last accessed July 10,2023]

CHAPTER TWO

UNDERSTANDING DIGITAL ECONOMY AND DIGITAL SERVICE TAX

2.1. Digital economy in general

The advancement of the digital economy[11] is intricately linked with the following factors: the manner and quality of value creation, product development, effectiveness of distribution channels, and the design of personal services and customization. These aspects are critical for the growth and success of the digital economy.[12] As discussed in the following section of this paper, the nature of value creation is the main connecting factor for the issue of taxation in the digital economy. The digital economy will cause a fundamental change in the way economic values are created.[13] It is becoming increasingly difficult to identify digital companies for tax purposes as the digital economy grows.[14] The digitalization of the economy can be defined as the transformation of various aspects of our daily lives, as well as the way our society and economy are organized and function[15]. This term is commonly used to describe the effects of digital technology on the economy. The speed and breadth of the changes brought about by digital transformation are remarkable and present a significant number of

11 Digital refers to binary-digit-data encoding technology. A binary code represents text, computer processor instructions, or other data using a two-symbol system of zeros and ones. Something is said to be digital if it uses such data encoding technology which enables the transfer of data worldwide in practically real time at zero marginal cost. -It was also described as a socio-political and economic system that is characterized by an access to information utilizing a variety of tools, the ability to process information, and a high communication capacity. This concept is often used to describe the global impact of Information Technology and Communications, not only within the Internet, but also in the economic field.

12 Vincent DidiekWietAryanto, *Model for Digital Economy in Indonesia*, Catholic University, Indonesia Agnes AdvensiaChrismastuti, Soegijapranata Catholic University, Indonesia,international Journal of Innovation in the Digital Economy, 2(2), 39-55, April-June 2011, p. 40

13 Zimmermann, Hans-Dieter PY ,*Understanding the Digital Economy: Challenges for New Business Models*, online, SSRN Electronic Journal ER <www.ssrn.com> [last accessed June 20]

14 Loredana Carpentieri et al, *Overhauling corporate taxation in the digital economy* ,online,<http://www.ceps.eu> 2019[last accessed June 9,2023]

15 OECD *Tax and Digitalisation*", OECD Going Digital Policy Note, (2019), OECD, Paris, online,www.oecd.org. [last accessed June 8,2023]

public policy challenges[16]. Digitalization primarily refers to the technological aspects of economic operations, and is closely related to concepts like data mining and artificial intelligence.

Digitalized services include online advertising, supply of user data, online search engine, online intermediation platform service, social media platforms, digital content service, online gaming, cloud computing service, and standardized online teaching[17].

The digital economy is characterized by the conversion of tangible goods to digital products, global connectivity through mobile devices, and the gathering, analysis, and commercialization of data collected from customers. The combination of networked computing technologies and new business models has created entirely new markets, industries, businesses, and work practices. The new or digital economy is based on intangibles, information, innovation, and creativity, and it expands economic potential by exploiting ideas, rather than material thing.[18] The fundamental components of the digital economy are centred around the digitization and extensive utilization of information and communication technologies (ICT), the codification of knowledge, the conversion of information into tradable goods, and the adoption of novel methods for organizing work and production.[19]

The OECD's going digital policy explains the digital business model in three key ways. Firstly, it enables businesses to conduct various stages of their production processes across different countries while accessing a larger customer base worldwide. This allows highly digitalised enterprises to achieve operational local scale without local mass, which is referred to as "scale without mass." Secondly, digitalised enterprises rely heavily on intangible assets such as intellectual property, including software and algorithms supporting their platforms and websites. These assets are either owned by the business or leased from a third

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16 *Ibid.*

17 Brian J. Arnold, *International tax primer*, 4rd ed. Kluwer Law International B.V. United Kingdom, 2019, page 205

18 Harbhajan Kehal and Varinder Pal Singh, *Digital Economy: Impacts, Influences and Challenges*,2004,online,<https://api.semanticscholar.org/CorpusID:153196322>, P. 3[last accessed June 23,2023]

19 *Ibid.*

party. Finally, data, user participation, network effects, and the provision of user-generated content are crucial elements of the business models of highly digitalised businesses.[20]

The benefits of data analysis increase as the amount of collected information linked to a specific user or customer grows. User participation plays an important role in social networks, where businesses would not exist without data, network effects, and user-generated content. However, the degree of user participation does not necessarily correlate with the degree of digitalization. For example, cloud computing is a highly digitalized business that involves limited user participation. In this text, we will briefly discuss the tax challenges arising from the digitalisation of the economy, as well as the benefits it brings.

Digitalisation has brought both advantages and challenges to our modern world. The benefits of digitalisation are vast, including faster access to information and increased opportunities for societal participation. Furthermore, digitalisation has improved the efficiency of production processes, accelerated the flow of information between customers and suppliers, and reduced communication costs.[21] The digital economy enables businesses to access customers and locate personnel and IT anywhere, anytime.[22] Different types of payment services and new forms of online advertising have been developed. The digitalisation of the economy has some drawbacks, particularly in terms of its taxation. Brian Arnold highlights three significant challenges that the digital economy poses to the current international tax system. First of all, firms can operate both locally and internationally in the digital economy because it has no borders. They don't need to have any physical presence, assets, or employees in a country in order to conduct business there. Second, there are a lot of intricate problems with income sources in the digital economy. Thirdly, even though data is becoming an invaluable resource for companies operating in the digital economy, tax systems find it difficult to collect the revenue produced by this data.[23] These problems

20 *Supra note* 15.

21 Francesco Boccia and Robert Leonardi, *The Challenge of the Digital Economy: Markets, Taxation and Appropriate Economic Models*', (Palgrave Macmillan 2016) p. 3

22 *Supra note* 4.

23 *Ibid.*

indicate that the current tax system is not suitable for the emerging digitalisation. Countries are currently searching for solutions to address the challenges posed by the digitalisation of the economy with respect to taxation. One potential solution being explored at the international or regional level is the introduction of a digital service tax. As this is a new concept, there is a need to clarify its definition and examine how it is being implemented by different countries. The remainder of this chapter focuses on defining the term "digital service tax" and discussing international and regional experiences. Particular attention will be given to examining African countries' experiences with implementing the digital service tax and identifying any good practices that can be applied.

2.2. Understanding Digital Service Tax and International Experience

2.2.1 Defining Digital Service Tax

The definition of digital taxes has been a source of confusion and controversy. Different researchers have offered varying definitions for taxes, and the structure of digital taxes varies depending on national contexts. [24] Some writers define digital service tax as a direct tax that is applied to non-residents who have no physical presence in the taxing country but have customers and users.[25] Others prefer to describe what the digital service tax covers rather than defining the term itself. Digital service taxes encompass policies that target businesses that provide products or services through digital means, using a special tax rate or tax base. These policies include extending existing rules to ensure a neutral tax policy towards all businesses, such as when a country extends its Value-added Tax to include digital services. Additionally, they comprise special corporate tax rules designed to identify when a digital company has a permanent establishment, even without a physical presence.[26] In order to determine if a digital company has a permanent establishment in a country, certain special corporate tax regulations are in place even if there is no physical presence. Additionally, digital services taxes

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24 *Supra note* 15.
25 *Supra note* 15.
26 Bunn,et al., *Digital Taxation around the World*, 2020 , online, <https://www.taxfoundation.org> [last accessed 12 March 2023).

are levied on the gross revenue generated from specific digital goods or services, or based on the number of digital users within a country.[27] From the literature, we can conclude that by digital service tax, we mean that type of tax intends to tax the digital economy. The specific name or type of tax may be different from country to country. Below countries' experience with digital service tax and the international context is discussed.

2.2.2 International Experience on the Application of Digital Service Tax

2.2.2.1 Digital service tax in the international context

Globally, digitalization and some of the ensuing business models provide challenges for international taxation, as acknowledged by the Organisation for Economic Co-operation and Development (OECD) in its 2015 Action 1 report[28], which was published as part of the OECD/G20 Base Erosion and Profit Shifting (BEPS) project. Therefore, starting in March 2018, the G20 Finance Ministers were given an interim report by the OECD on the taxes of the digital economy. The interim report looks at how the international tax system needs to change to keep up with the digitalization of the economy and outlines the factors that need to be considered by nations looking to implement temporary solutions to deal with the tax issues brought on by this change. [29]

On June 12, 2020, the US demanded a halt to the international talks on OECD Pillar 1, reaffirmed its position that this pillar should be based on "safe harbour," objected to unilateral DSTs because they primarily affected a small number of companies with headquarters in the US, and threatened to take retaliatory action if other nations implemented such taxes.[30]

In fact, the US has "proposed implementing the new taxing right on a "safe harbour" basis, which would enable an MNE group to elect on a global basis to be subject to Pillar One," according to the OECD's Blueprints on Pillars 1 and 2,

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27 *Ibid.*

28 OECD (2015), *'Addressing the Tax Challenges of the Digital Economy: Action 1 – 2015 Final Report'*, OECD Publishing, Paris, online, <www.oecd.org>[last accessed March 12,2023]

29 European union Proposal for a COUNCIL DIRECTIVE on the common system of a digital services tax on revenues resulting from the provision of certain digital services {SWD(2018) 81} - {SWD(2018) 82},Brussels, 21.3.2018 COM(2018) 148 final 2018/0073 (CNS), p.1

30 Georg Kofler, *The Future of Digital Services Taxes*, ec TAX REVIEW 2021–2 2021 Kluwer Law International BV, The Netherlands, p.51

which were published in October 2020. Pillar 1 leaves a number of policy options on a phased approach on the table.

It is unclear how the US will approach the OECD talks in the near future under the Biden-Harris administration. [31] The US government's steadfast opposition to the implementation of a digital service tax has not altered as of the time this paper's author submitted his research for the university.

2.2.2.2. The UN Experience

The 2021 edition of the United Nations Model Tax Conventions was published by the UN in April 2022. The adoption of the new Article 12B on Income from Automated Digital Services and its Commentary in April 2021 is one of the revision's primary elements. By way of a background, the U.N. Tax Committee released on August 5, 2020 a draft proposal for a new article 12B of the U.N. Model Convention tax treaty to address the taxation of automated digital services.[32] A tiny amount of formulary apportionment is intended to be incorporated into the global system through Article 12B. The proposal grants source nations the authority to impose an apportionment formula on net income or a withholding tax on gross revenue on cross-border payments for automated digital services. Cloud computing services, digital content services, social media services, online advertising services, online intermediation platform services, cloud computing services, sale or other alienation of user data, and standardized online teaching services are among the automated digital services that fall under this scope. [33]

After that, the idea was debated in the subcommittee. Members of the U.N. tax committee put forth a proposal on September 1, 2020, noting the distribution of taxing rights to states where software usage rights are purchased, to support their claim that software payments ought to be covered under the definition of royalties. Commenting on the draft proposal is still open through October 2, 2020. During its virtual session from October 20 to October 29, the U.N. Committee of Experts on International Cooperation in Tax Matters reviewed the proposal and its

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31 *Ibid.*

32 *Supra note* 4, p.5.

33 *Id* paragraph 5.

comments. A progress report on the subcommittee's work on a new article 12B for the U.N. model tax convention was released on March 11, 2021. The language of a new article 12B and commentary for the UN model tax treaty, which would give additional taxation powers to nations where an automated digital services provider's consumers are situated, was approved by the UN Committee of Experts on International Cooperation in Tax Matters on April 20, 2021. A contracting state may tax the gross automated digital services income received by a beneficial owner who resides in another contracting state and does not have any local PE under Article 12B. Article 12B, according to the commentary, suggests a "modest rate" of 3% or 4% to address concerns about double or excessive taxes, but it does not specify any quantitative or qualitative nexus requirements and instead leaves particular tax rates up to bilateral negotiation.

2.2.2.3. The EU Experience

After all, the EU has supported the OECD's efforts on Pillars 1 and 2, but in May 2020 it also hinted that "if no global agreement is reached," a "digital tax" might be one possible response. However, the original announcement of this "digital tax" stated that it would "build on OECD work on corporate taxation of a significant digital presence".[34]. Adopted by the Member States, Council Directive (EU) 2022/2523 on guaranteeing a global minimum level of taxation for multinational enterprise groups and large-scale domestic organizations in the Union came into effect on December 23, 2022. Member states are required by the Directive to begin implementing the Income Inclusion Rule (IIR) for fiscal years commencing on or after December 31, 2023, and to transpose the regulations into domestic legislation by that same date. For fiscal years starting on or after December 31, 2024, the under taxed Profits Rule (UTPR) will be in effect.[35] The European Commission is required to report to the Council on Pillar 1 progress and, if necessary, submit an alternative legislative proposal by the end of 2023 to address digital economy taxation in the event that Pillar 1 is not implemented.

34 *Ibid*. p. 50

35 The European Council Directive (EU) 2022/2523of 14 December 2022 *on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union*, *online*, < europa.eu>[last accessed on march 19,2023]

This pertains to Pillar 1 and the withdrawal of the DSTs.[36]The EU has been debating the difficulties of taxing the digital economy for a number of years. To tackle these issues, the European Commission (EC) has concentrated on the BEPS 2.0 project. In order to enshrine the Pillar 2 regulations in EU legislation, the EC already released a proposed EU Directive on December 22, 2021.[37] EU Digital Levy: The European Commission had previously issued two requests for comments on a proposed pathway for the implementation of an EU digital levy. The first step would be to gather input and pertinent data from interested parties regarding the proposed initiative. This would represent the EC's grasp of the matter and the initial evaluation of the anticipated effects on the economy, society, and environment.[38] The EC has acknowledged that the anticipated legislative proposal would take into account any agreement achieved by the OECD and would specify additional measures such as: However, the specifics of the tax policy choices have not yet been laid out. The EU is going to impose a "top-up" on corporate income tax on all businesses that engage in specific digital activities. A levy on profits from specific online activities carried out within the EU. Levies on digital business-to-business trade carried out within the European Union

2. Comprehensive public consultation[39] - In order to address the concerns raised by the digital economy, the EU launched a more focused public consultation questionnaire on January 18, 2021. The questionnaire asked interested parties to share their opinions on a range of topics, including the scope of the digital levy, the best options for determining where the proceeds from digital activities should be taxed, and the challenges facing taxation in the digital economy today. The Council passed regulations on March 22, 2021, extending to digital platform sales and bolstering administrative cooperation in the tax domain. The rules apply to both non-EU organizations and platform operators operating in the EU. Should

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36 *Id* at article 57

37 *Minimum corporate taxation*, online,‹ https://taxation-customs.ec.europa.eu/Minimum corporate taxation (europa.eu) >[last accessed march 20,2023]

38 *Inception impact assessment*, 2021, European Union, online, <IMMC.Ares%282021%29312667.ENG.xhtml.PART-2021-15689V1.docx(europa.eu)> [last accessed on march 20.2023]

39 *A fair and competitive digital economy: digital levy*, online, < https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12836-A-fair-competitive-digital-economy-digital-levy_en. > [last accessed March 20.2023]

the latter facilitate the participation of EU suppliers and vendors in real estate rentals or reportable commercial activity If the latter makes it possible to rent real estate located in the EU or for EU suppliers or sellers to conduct reportable commercial operations.[40]The Directive will apply from January 1, 2023 throughout the EU member states and the first reporting of data will be required by January 31, 2024.[41]

The EU is proposing to influence global tax discussions by admitting that existing corporate tax rules are out dated and based on the principle of taxing profits where value is created, primarily for traditional businesses, and focusing on physical presence rather than user participation.[42] The EU proposal proposes replacing permanent establishment requirements with significant economic presence for taxing digital business models, aiming to provide a comprehensive solution within existing Member States' corporate tax systems. We must delve deeper into the suggested articles in order to fully comprehend the EU's plan.

Terms pertaining to the topic of the digital service tax are defined in the proposal's article 3. Since the remainder of the proposal would have an impact on the digital services, it is important to pay attention to the definition provided for digital services. The definition of the digital service on the proposed proposal is as follows: (a) the provision of digitized products generally, including software and upgrades to or changes to software; (b) services providing or supporting software; (c) any service that is delivered over the internet or an electronic network and whose nature renders their supply essentially automated and involving minimal human intervention and impossible to ensure in the absence of information technology. d) The transfer for consideration of the right to put goods or services up for sale on an internet site operating as an online market on which potential buyers place their bids through an automated procedure, and on which the parties are notified of a sale through electronic mail generated from a computer. (e) Internet Service Packages (ISP) of information in which the telecommunications component forms an ancillary and subordinate part; that is, packages going

40 *Ibid.*
41 *Ibid.*
42 *Ibid.*

beyond mere internet access and including other elements like content pages giving access to news, weather, or travel reports, playgrounds, website hosting, access to online debates, or any other similar elements; (f) the services listed in Annex II.[43]

In order to qualify the permanent establishment requirement for corporate tax purposes, the proposal's article 4(1) states that a permanent establishment will be deemed to exist if there is a significant digital presence that is used to conduct business, either entirely or in part. In line with article 4(3) of the proposal, a business that is conducted through it and that consists entirely or partially of the provision of digital services through a digital interface, as well as the fulfilment of one or more of the following requirements regarding the supply of those services by the business conducting it,. As per article 4(3) of the proposal a significant digital presence shall be considered to exist in a Member State in a tax period if the business carried on through it consists wholly or partly of the supply of digital services through a digital interface and the following criteria must be met: (a) the percentage of total revenues earned during that tax period that comes from providing those digital services to users residing in that Member State must exceed EUR 7,000,000; (b) the number of users of one or more of those digital services who are residing in that Member State must exceed 100,000; and (c) the number of business contracts for the supply of any such digital service that are concluded during that tax period by users residing in that Member State must exceed Three Thousand.[44] It is believed that other nations may implement unilateral measures as a result of the EU's drive toward enacting the planned digital service tax. Let's recast the discussion on unilateral DSTs: It appears that the EU DST proposal served as a catalyst for a number of comparable unilateral actions, even if opinions on the necessity or merit of equalization taxes like DSTs are obviously divided. Numerous Member States, including Austria, Belgium, the Czech Republic, France, Italy, Hungary, Poland, Slovenia, and Spain, as well as third-party states, including Brazil, Canada, India, Turkey, and the UK, have either implemented or declared their intention to implement unilateral digital

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43 *Ibid* article 3.
44 *Ibid* article 4(3).

services taxes with varying scopes and thresholds.[45] Only the experiences of Kenya, Canada, and France will be covered in this essay following the succeeding topic.

2.2.2.4 The African Tax Administration Forum (ATAF) experience

In its first technical note on digitalization and taxation, the African Tax Administration Forum (ATAF) noted in 2019 that the OECD/G20 BEPS project's results were insufficient because digital MNEs' artificial profit shifting is too complicated to manage well and the project's results are not comprehensive enough to address the issues.[46] Following that, ATAF released a second technical note that addresses the concerns brought forth by the OECD. In an effort to find a consensus-based solution that addresses the concerns of African nations, the OECD and ATAF had talks in early July 2019, which were summarized in a third technical paper published by ATAF. Three topics were covered in the discussion: new global anti-base erosion laws, new profit allocation rules, and new nexus rules. Because of the technical complexity of such alterations and the requirement for consequential revisions, ATAF believes that tax treaty changes should be made through a new standalone provision rather than through revisions to the current PE provisions.[47] Then, ATAF released a fourth technical note outlining the adjustments to be made to the international tax laws. In order to make sure that smaller economies are not left out of the new nexus regulations, ATAF advises adopting country-specific thresholds that are adapted to the relative size of the economy. A fixed minimum return guideline is one of ATAF's top priorities for African nations when it comes to new profit allocation regulations.[48] A document on the "Suggested Approach to Drafting Digital Services Tax Legislation" is set to be published in 2020, according to a release from the African Tax Administration Forum (ATAF). The document offers a model for draft legislation that would be introduced with a DST. This proposed legislation's methodology imposes a DST

45 *Supra note* 30, p.51

46 Solomon Rukundo ,*Addressing the Challenges of Taxation of the Digital Economy: Lessons for African Countries*, , ICTD Working Paper 105, Institute of Development Studies 2020, p.9

47 ATAF TECHNICAL NOTE, inclusive framework proposal to address the tax challenges from the digitalisation of the economy, online, < www.ataftax.org >[last accessed on March 23,2023]

48 *ATAF Technical note, inclusive framework issues statement on the two-pillar approach to address the tax challenges arising from the digitalisation of the economy*, online,<www.ataftax.org>[last accessed on March 23,2023]

on "digital service revenues" that are either domestically produced or attributed to a nation. The "direct approach" is the main method used in ATAF's recommended technique to determine the amount of money that can be ascribed to a certain nation for digital services. In other words, it aims to tax money received by digital services directly from citizens of a nation. However, depending on the kind of digital service offered, different countries would have different bases for attributing revenue.[49] This contains a proposed DST rate ranging from 1% to 3% and a proposed revenue scope that covers the following:

Digital services revenue derived from users located in [Implementing Country] arising from the provision of online marketplace or intermediation platform services, other than the following; - Digital services revenue attributable to [Implementing Country] arising from online advertising services; - Digital services revenue attributable to [Implementing Country] arising from data services;

Revenue from digital services generated from users, wherever they may be, for the purpose of facilitating the rental or use of real estate situated in [Implementing Country];

Revenue from digital services generated from users, wherever they may be, for the purpose of facilitating the vehicle hire services that start in [Implementing Country];

- Revenue from digital services provided by users in [Implementing Country] that comes from cloud computing, online gaming, and digital content services; and

- Revenue from digital services derived from any other digital services that are traceable to [Implementing Country].[50] Provisions for calculating revenue from digital services, minimum thresholds based on national and international revenue, the obligation to file returns, the designation of local representatives, and other items are also included in the draft legislation template.

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49 *Digital services tax: country practice and technical challenges*. World Bank. 2021, Washington,. P.20

50 *Taxation of the digitalized economy Developments summary*, Updated: March 9, 2023, online,< https://www.kpmg.com>[last accessed march 18,2023]

It makes sense that there is currently disagreement on a global answer in the debate over the digitalization of the economy and how it affects taxes. Some selected experiences of industrialized countries and African countries are reviewed below to gain an understanding of how countries attempt to address challenges related to taxation and the digitalization of the economy.[51]

Because Canada, France, and Kenya apply different digital service taxes, it is easier to compare and contrast their experiences in order to find the best practices. For this reason, they were selected for discussion below in order to investigate the experiences of these three nations.

2.2.2.5. Canada

A new 3% DST on online marketplace, social media, online advertising, and user data of some large enterprises will go into force on January 1, 2022, according to Canada's Federal Budget, which was released on April 19, 2021. In principle, companies who satisfy both of the following thresholds would be subject to the new DST:

• Global group revenues in the preceding calendar year of at least €750 million from all sources

• In-scope revenue exceeding CA$20 million in a given calendar year that is associated with Canadian users (the new DST would only apply to in-scope revenue above that amount). The in-scope revenues would need to be equitably distributed across the activities when revenue came from both in-scope and other business activities. Two broad methods are suggested in Budget 2021 for figuring out an entity's in-scope revenue pertaining to Canadian users:

• That income amount would be within scope if Canadian users could be identified using transactional information.

• In the event that tracing is not feasible, the in-scope amount will be distributed using a formula that changes based on the type of revenue.[52]

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51 *Supra note* 28, p.2.

52 Bruce Ball, *Canada's digital services tax: Detailed proposals raise concerns*, June 24, 2021, online< Digital services tax: Details and concerns | CPA Canada >[last accessed march 18,2023]

Although the user's real-time location may be used for certain sorts of income, Budget 2021 recommends looking to the users' usual location to source revenue related to digital service users in Canada. Using information it already knows, such as the user's IP address, billing address, delivery address, and telephone area code, the digital service provider can locate a user. It would be required of digital service providers to locate their users using a uniform method.[53] If an entity incurred the DST in order to earn taxable Canadian income, it would be deducted from its taxable income under standard Canadian income tax standards. There would be no Canadian income tax credit available for DST liabilities.[54]

Additionally, the budget states that the new DST would be applied according to the calendar year rather than the fiscal year. The budget does not include draft legislation; it merely includes the salient features of the new DST proposal. Stakeholder feedback is being requested by the government by June 18, 2021. Additionally, it is confirmed that the DST will only remain in place temporarily before being removed in the event that an international agreement is reached.[55] The government's 2021 fall economic report, which was presented by Canada's Finance Minister on December 14, 2021, included draft legislation to impose a 3% DST on profits made by "large businesses" from specific digital services that depend on donations of data and content from Canadian consumers. If the multilateral approach of the OECD/G20 Inclusive Framework has not been implemented by January 1, 2024, then the tax will be levied. In such case, for profits produced as of January 1, 2022, the DST would become owing as of 2024. On August 9, 2022, the Department of Finance in Canada reaffirmed that, should the global solution deal fall through, it will impose a DST on corporations having a significant online presence.[56] During the proposal stage, the Canada Finance Department's idea was met with criticism. A number of the critics have ties to the period when the digital service tax was put into effect. Some contended that, in the event that a temporary DST is implemented, the deadline of January 1, 2022, could not provide businesses with adequate time to comprehend and get ready for

53 *Ibid.*
54 *Ibid.*
55 *Ibid.*
56 *Supra note* 26, page 19.

the DST, particularly given the unpublished draft legislation and numerous unanswered problems. Companies require time to comprehend the regulations' breadth, evaluate their effects, and decide how to get the data required computing the tax.[57] The Canadian digital service tax proposal has drawn harsh criticism from the US Trade Representative (USTR). The US trade officials have commented on the proposed act and urged Canada to drop any intentions for a unilateral action and instead strengthen its commitment to the expeditious implementation of Pillar One of the OECD/G20 accord, as well as the preparation of a global convention.

USTR also raised grave concerns regarding policies that target American companies for taxation while essentially keeping out national companies operating in comparable industries.

USTR forewarns Canada about the impending adoption of DST by citing actions that must be implemented in accordance with US domestic laws and trade agreements.[58]

2.2.2.6 France

Prior to implementing the digital service tax in 2019, France extended its excise tax in 2016 to audio-visual content that was given to final consumers for free but was paid for by viewers viewing online adverts.[59]. The money made by video-sharing websites like YouTube and others with comparable business models would be collected in this way. The tax operates similarly to the measures enacted in 2003 and 2004 regarding video games (such as VHS and DVD) and paid online video-on-demand content, with the exception that the tax base is made up of the money paid to display sponsorships or advertisements related to specific online audio-visual content.[60] Following the application of the "French digital presence" ratios to the appropriate international digital services receipts, the French digital service tax imposed a 3% tax rate on a portion of the taxable services income related to France: The availability of a digital interface that facilitates

57 *Supra note* 30, p.51.
58 *Ibid.*
59 *Supra note* 49, p.16.
60 *Ibid*

communication and interaction between users ("intermediary services"). The provision of services to advertisers with the goal of displaying customized advertising messages on a digital interface based on user data generated during interface consultation and data acquired about users ("user data advertising service").[61]

As was previously said, the United States is a fierce opponent of Canada's digital service tax, and the French digital service tax is subject to similar criticism. A study stated that US corporations were the focus of the French digital service tax. According to Neelam Shukla, the Digital Service Tax (DST), which was imposed by France, will hurt US businesses and reduce the country's tax base.[62] The study went on to say that because the DST is a gross revenue tax, it is not only a flawed tax law but also a danger to the global tax system. According to the study, the DST defies fundamental principles of the global tax system, which indicate that nations have the authority to tax their citizens and that taxes ought to be levied on income rather than revenues.[63] Although France's DST has already taken effect, the US has threatened to impose penalties in retaliation. January 22, 2020: It was reported that the United States and France had reached an official agreement for the French government to immediately suspend digital taxation levies that had been imposed to target major US IT companies by the end of 2020, and for the United States to immediately suspend its retaliatory tariffs against France. The United States and France intend to continue working toward a new solution while collaborating in on-going OECD discussions on new international regulations concerning.[64] But France declared on October 18, 2020, that it will reinstate the DST, which had been stopped, in December of the same year. This resulted from the OECD's expected consensus being postponed until mid-2021.[65]

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61 *Supra note* 52 p.8

62 Neelam Shukla, *Introduction Of Digital Service Tax by France Targeting US Digital Companies Policy Response by United States* , MA thesis, Johns Hopkins University, 2020, online < http://jhir.library.jhu.edu/handle/1774.2/63119 >[last accessed march 30,2023]

63 *Ibid*

64 Tetsuya Watanabe, *Rationales and Challenges for a Digital Service Tax: Focusing on Location-Specific Rent*, Policy Research Institute, Ministry of Finance, Japan, Public Policy Review, Vol.17, No.1, January 2021,p.4, online, < ppr17_01_06.pdf (mof.go.jp) >[last accessed march 30,2023]

65 *Ibid.*

2.2.2.7 Kenya

Kenya is pursuing a digital services tax unilaterally, that is, before the OECD and G20 reach a consensus on a globally recognized framework for digital economy taxation. In 2019, Kenya took a first look at taxing income earned in the digital sector when the Finance Act 2019 (also known as "FA 2019") modified the Income Tax Act to explicitly state that money earned in digital marketplaces is subject to income tax.[66] By means of the Finance Act 2020, the Government of Kenya (GoK) instituted the Digital Service Tax (DST), which will take effect on January 1, 2021. The Cabinet Secretary for National Treasury and Planning (also known as "the CS") released the Draft Income Tax (Digital Service Tax) Regulations, 2020 in August 2020 with the intention of bringing more clarity and detail to the people impacted and the range of services covered. The public was invited to provide feedback on the draft regulations.[67] The Income Tax (Digital Service Tax) Regulations, 2020 (the "Regulations") have been published by the CS via Legal Notice No 207 in response to public submissions of opinions. The purpose of the Regulations is to give specifics and clarification about the administration of DST.[68]. Many different digital services that are often used by both individuals and businesses would be covered by the DST rule. The proposed scope of the initiative includes the following: digital content streaming and downloadable services; data transmission obtained from users through digital marketplace activities that is made profitable; digital marketplaces, websites, or other online applications that connect buyers and sellers; subscription-based media, such as news, magazines, and journals; electronic data management, which includes website hosting, online data storage, file sharing, and cloud storage services; automated support desk and search engine services, including personalized search engine services; online tickets for live events, theatres, restaurants, and other venues; online distance learning through pre-recorded medium or eLearning, including online learning.[69] To be clear, everyone who fits

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66 *Supra note* 9, p.13

67 *Digital Service Tax*, Tax Alert December 2020, online, www.deloitte.com [last accessed March 20,2023]

68 *Ibid*

69 *Supra note* 49, p. 14.

into one of the following groups will be subject to the Kenyan DST, whether they are residents or not:

• Providers of digital marketplaces: An individual who offers a platform that facilitates electronic direct communication between buyers and sellers of products and services.

• Digital service providers: An individual who offers services via a digital marketplace. Regulation lists digital services. [70]

If they offer or enable the provision of services to a user who is considered to be located in Kenya, digital marketplace providers and digital service providers will be subject to DST in Kenya. If one of these conditions is satisfied, the user is deemed to be in Kenya: The user uses a terminal, a computer, tablet, or smartphone that is situated in Kenya to access the digital interface; Any Kenyan financial institution or business may offer a credit or debit facility for the purpose of paying for digital services; Digital services are obtained by the use of a Kenyan internet protocol address or a Kenyan country code on an international mobile phone; alternatively, the user may utilize a billing, residential, or business address.[71]

Once the conditions are met to be liable to the digital service tax, the amount of income or the threshold that qualifies as taxable income must be addressed. The minimum threshold required for DST application was not specified by the Kenyan digital service tax. The regulation on its article 6 states that the gross transaction value of the digital service, which is (a) the payment received in exchange for the services in the case of providing digital services, or (b) in the case of a digital marketplace, the commission or fee paid to the provider of the marketplace for the use of the platform, is subject to digital service tax.[72] Given that countries like Canada and France discussed above established a minimum criterion, it is evident from the regulation's provision that no minimum level is supplied. One identified flaw in the Kenyan DST policy is the lack of a minimum

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70 Legal notice number 20, Income Tax (Digital Service Tax) Regulations, 2020, Kenya Subsidiary Legislation, online,< Microsoft Word - L.N. 205-206 COMBINED INCOME TAX EDVAT (AMENDMENT) REGULATIONS.docx (kra.go.ke) >[last accessed April 1,2023]

71 *Id* 109 article 5(2)

72 *Ibid*

level. There have been suggestions that the GoK ought to have thought about establishing a minimum threshold for the application of DST and excluding certain companies with narrow profit margins. DST will probably have unfavourable effects if it is applied on all digital services, regardless of threshold, particularly to those who are subject to minimum tax and the Turnover Tax Regime and whose main source of income is from providing digital services.[73]

The Kenyan DST is commended for its ease of registration and application clarity. The final regulations make it clearer who is subject to the DST in Kenya and offer non-residents the option to register, which will make compliance easier.[74] Article 7 sub articles 1 and 2 of the regulations deal with the registration issue. If a non-resident individual offers a digital service to a user in Kenya and does not have a permanent establishment in Kenya, they can register using the streamlined tax registration system outlined in regulation. Anybody providing digital services in Kenya, whether they are a resident or a non-resident with a permanent establishment there, must register for digital service tax registration with the Commissioner using the necessary form.[75]

Article 7(1) of the rule makes it clear that registration is not required for non-residents who do not have a permanent place of business in Kenya. Non-residents who do not have a permanent address in Kenya are given the option under the rule to opt out of registration.

Although section 15A of the Tax Procedures Act, 2015 does not require non-residents without permanent establishment in Kenya to register, it does require them to select a tax representative.[76] It is also acknowledged that registration is a prerequisite for both residents and non-residents who have a permanent place of business in Kenya. Once the income and taxable person have been determined, DST will be applied at a rate equal to 1.5% of the gross transaction value (GTV). The Regulations define GTV as follows: the amount paid to a digital service provider for the services provided; and the commission or fee charged to a

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73 *Supra note* 49.

74 *Ibid.*

75 *Supra note* 70, article 7.

76 *Ibid* article 8.

provider of digital marketplaces for platform usage. excluding the value-added tax (VAT) that is tacked on to the service.[77] The effectiveness and shortcomings of Kenya's new digital service tax have not yet been examined. Some anticipate difficulties stemming from its novelty. Since DST is a new tax system in Kenya and many other countries, some difficulties are predicted to arise during its implementation and enforcement. However, these difficulties should eventually be resolved with on-going improvement and adherence to best practices.[78]

Conclusion Regarding Digital Service Tax Practices

Even though it is anticipated that international multilateral agreements would handle the taxation of the digital economy, nation-state unilateral actions are becoming more common. Roughly half of all OECD member states in Europe have enacted, planned, or announced a tax on digital services.[79]Austria, France, Hungary, Italy, Poland, Portugal, Spain, Turkey, and the United Kingdom have implemented a digital services tax. Belgium, the Czech Republic, Denmark, and Slovakia have published proposals to enact a digital services tax, and Latvia, Norway, and Slovenia have either officially announced or shown intentions to implement a digital tax.[80] Only the experiences of three nations and three international organizations are compared in this study in order to extract the most valuable lessons.

2.3 Over view of the Digital economy in Ethiopia

Ethiopia's digital economy is still in its infancy, with only a few private companies providing digital services and a few government-sponsored digitalization programs. To mention a few, the Ministry of Innovation and Technology (MInT) is working to update and modernize "WoredaNet," the Ministry of Transportation (MoT) is digitizing the national fleet management system, the Ethiopian Investment Commission (EIC) is offering online licensing services and digitizing records, the Ministry of Peace (MoP) is experimenting

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77 *Ibid.*

78 *Ibid.*

79 Digital service tax in Europe, online,<Digital Services Taxes in Europe, 2022 | Tax Foundation >[last accessed on 1/5/2023]

80 *Ibid.*

with Digital ID, and the National Bank of Ethiopia (NBE) offers e-payment systems.[81] Ethiopia is working on digitizing its economy by 2025 through a digital transformation plan.[82] The enabling framework for the digitalization of the economy is described in the digital Ethiopia strategy. It is vital to provide an overview of the digital economy's enabling framework since the goal of this study is to examine the benefits and problems of implementing the digital service tax in Ethiopia. The digital economy's enabling framework in Ethiopia will be covered here.

2.3.1. The enabling system of the digitalisation of the economy in Ethiopia

According to the digital Ethiopia strategy, the enabling system is the "middleware" or intermediary layer that connects applications and infrastructure that is necessary to transform connection into useful goods and services. This layer of technology is supported by vital systems including asset registries, payments platforms, digital ID, and cyber-security. These systems work together to provide quick verification and transaction processing.[83]The aforementioned enabling systems are discussed in their order below.

2.3.2 The Digital ID

The digital ID proclamation was approved by the house and given the number 1284/2022. According to reports, the Ministry of Revenues (MoR) and The National ID Program have already signed an agreement to link tax identification numbers (TIN) with national IDs. The National ID Program seeks to provide digital IDs to over 70 million Ethiopian citizens and residents by the end of 2025.[84] While in parliament, during debate The Standing Committee on Law and Justice's Chairman, Ms. Esgenet Mengestu, declared that it will foster favourable

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81 Digital Ethiopia strategy,2025, *A Digital Strategy for Ethiopia Inclusive prosperity, Federal Democratic Republic of Ethiopia*, p.2, online < www.pmo.gov.et> [last accessed march 20,2023] According to the digital Ethiopia strategy the term "digital economy" refers to economic activity that makes use of the increased interconnection of networks and the interoperability of digital platforms, according to the digital Ethiopia strategy. And go on to describe how it was created by combining two significant advancements in networks: (i) the Internet and (ii) IP-enabled communications systems, which include public service networks, mobile networks, and electronic payment systems

82 *Ethiopian digital economy*, online,www.trade.gov [last accessed march 20,2023]

83 *Supra note* 49 p.18

84 *Ethiopia: Parliament Ratifies Digital Identity Proclamation*, online, www.2merkato.com[last accessed March 13,2023]

circumstances for the establishment of a system of accountability and transparency in the services rendered through the ID as well as for a more efficient system of service delivery.[85]The strength of the digital service tax is its ease of registration, as demonstrated by Kenya's experience. Without digital identity, it is difficult for citizens or non-residents to register online. For this reason, the adoption of the digital service tax in Ethiopia will be made easier by the digital ID and the other supporting systems. The agreement to link the digital ID with the tax identification number (TIN) from the outset suggests that the digital ID is more than just an ID; rather, it is a fundamental tool for the digitalization of the economy and will eventually be used as a stepping stone for Ethiopia's digital service tax.

2.3.3 The Electronic signature

In the preamble to Proclamation number 1072/2018, it is stated that favourable legislative frameworks must be established in order to encourage electronic government services and trade in the nation.[86] Recognizing electronic message exchange as the standard behaviour of the digital economy is necessary in order to create a legal framework that will support electronic commerce. The parties to a contract do not need to be present in person in the digital age. The government's regulatory body requires identification verification in one area, but the contract's parties need confidence about who they are working with in another. Due to this, the Electronic Signature Proclamation made a strong statement, stating that it is now essential to give electronic signatures legal recognition in order to foster trust in electronic communication, enable the verification of message authenticity, confirm participant identity, and assure non-repudiation.[87] It is now clear that electronic commerce would benefit from a supportive environment because electronic messages and electronic signatures are legally recognized under

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85 *The Council approved the Ethiopian Digital Identity Proclamation by majority vote - Addis Insight*, online, www.addisinsight.net[last accessed March 18,2023]

86 Electronic Signature Proclamation, 2018, *Federal Negarit Gazzeta*, Proc. NO. 1072, 24th Year, No.25, [here in after Pro. No.1072/2018]

87 Proc. No.1072/2018, The proclamation's definitional section defines a digital signature as an electronic signature that satisfies the following criteria and makes use of an asymmetric cryptosystem: It must meet the following requirements: a) it is exclusively linked to the signatory; b) it can be used to identify the signatory; c) it is generated using a private key under the signatory's exclusive control; and d) it is connected to the related electronic message in a way that makes any changes to the signature or electronic message noticeable.

Ethiopian law. In order to verify the revenue obtained through digital economy or electronic transactions, the tax authorities will also assist in tracking down the relevant parties. Because of this, the electronic signature proclamation will provide a framework that will facilitate the digitalization of the economy.

2.3.4 The electronic transaction

Proclamation 1205/2020, which aims to usher Ethiopia into the digital era, permits electronic transactions. According to the proclamation's preamble, it is imperative to treat users of computer-based and paper-based information equally in order to create a more secure legal environment that favours and facilitates the use of electronic transactions by individuals, businesses, and government agencies.[88] According to Article 2(19) of the proclamation, an electronic transaction is any business conducted using computer-mediated networks, including mobile phones and other devices. This definition includes, but is not limited to, electronic government services and electronic commerce. The proclamation's article 9(4) cross-references the applicability of the proclamation on electronic signatures. The author of this article thinks that both proclamations' similarities are to be anticipated since they both aim to establish an atmosphere that is favourable for the economy to become digital, as indicated by the digital Ethiopia 2025 strategy. These similarities will serve as a network of roads that lead to a single destination. The proclamation establishes legal grounds for accepting payments made electronically.[89]Public entities were required by the proclamation's article 35(3) to begin offering electronic services within a year of the proclamation's effective date. According to the proclamation's text, governmental entities are anticipated to begin electronic service one year after June 30, 2020. The Ministry of Revenue initiates an electronic service of some kind. Even if it does initiate electronic service and take the critical step for the implementation of digital service tax by requiring online registration. The absence of technology for that purpose and the non-applicability of the Ministry of Revenue's proposed e-service are the reasons, as per the interview with MR.

88 Electronic transactions Proclamation, 2020, *Federal Negarit Gazzeta*, Proc. No. 1205, 26th Year No. 57 preamble [here in after Proc. No. 1205/2020]

89 Proc. No. 1205/2020, article 16

Binyam Zerihun Haile, for not launching the online registration of digital service taxpayers.[90]

The proclamation's article 45 gives the council of ministers the authority to create regulations pertaining to the proclamation's execution. The rule is still in the draft stage as of the writing of this paper. "Electronic commerce operators, including individuals who are engaged in the informal business sector and do business through the Internet or other information network, shall have the obligation to get a Tax Identification Number," reads the most recent draft of rule v (21.05.2021). The regulation's drafter wants to tie the requirement to pay taxes to electronic transactions. The tax payment was not guaranteed by just holding a tax identification number. A framework for taxing revenue from the digital economy must be devised. According to the tax officials from the ministry of revenue who conducted the interview, the commission that intermediaries earn from their service users serves as the tax basis for electronic commerce. Instead of the transaction itself, the intermediaries will be registered as PLCs.[91]

2.4. Blessings of introducing Digital Service Tax in Ethiopia

The digital economy is a rapidly expanding sector with many benefits if properly controlled. There will be benefits to taxing the digital economy through the implementation of the digital service tax. The benefits of Ethiopia's introduction of a digital service tax will be covered in this section of the study.

2.4.1 The increase in tax revenue

Research suggests that there may be more opportunities for increased revenue creation in emerging nations. African countries have the chance to increase revenue mobilization and expand their tax bases by implementing direct digital taxes.[92] Developed nations project how much money they would generate by enacting a tax on internet services. A digital advertising tax, suggested by the Austrian government, would impose a 5% tax on internet ad revenue. Companies

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90 Interview with Mr Biniyam Zerihun Haile, tax auditor at the ministry of revenue, on the issue of tax enforcement, date of interview April 18,2023

91 Interview with Mr Biniyam Zerihun on the issue of taxing the net profit or the gross revenue

92 *Supra note* 10, p.13

earning more than €750 million ($835 million US) in sales globally as well as €25 million ($28 million US) in revenue in Austria would be subject to the tax.[93] In addition to other measures affecting digital businesses, the new tax is expected to earn €25 million ($28 million US) in 2020 from digital advertising alone. It is anticipated that the tax will bring in €34 million ($38 million US) in 2023.[94] Also, the French government projects that by 2020, the tax will generate €500 million (or $555 million in US dollars).[95] Similarly, Australia said that the implementation of OECD guidelines on online sales of digital services and goods generated AUD 348 million (USD 242 million) in additional DST revenues in 2017.[96] If the digital economy is appropriately managed, the tax income generated by the digital service tax will rise. Every respondent to this paper concurred that the current tax system is unfit to tax the digital economy; thus, a new tax base must be established.

2.4.2 Building public trust

Trust in tax administration may be improved by taxing large digital multinational corporations that are not physically present in the nations. When it comes to generating income, the government could be seen as just.[97] International businesses without a permanent presence in Ethiopia will not be subject to taxes in the absence of the implementation of a digital service tax. The implementation of the digital service tax will provide equitable treatment for both local and international enterprises. International tax laws were given an unfair advantage in the competitive environment due to the non-taxation of digital enterprises operating abroad, while domestic companies were required to pay corporate tax, VAT, and other taxes. The use of DSTs may boost public confidence, boost taxpayer mood about taxes, and eventually improve tax compliance.[98] It is necessary to determine how taxes should be distributed between digital and non-digital firms.

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93 *Digital Services Tax Revenue Estimates Digital Tax Analysis,* online, <www.taxfoundation.org>[last accessed March 24,2023]

94 *Ibid.*

95 *Ibid.*

96 *Ibid.*

97 *Ibid.*

98 *Ibid.*

CHAPTER THREE

EXISTING TAX REGIME VIS-À-VIS DIGITAL ECONOMY: A CALL FOR THE INTRODUCTION OF DIGITAL SERVICE TAX IN ETHIOPIA

3.1 Existing tax regime vis-à-vis digital economy in Ethiopia

The digitalization of the economy has led more companies to adopt virtual operations, disrupting traditional means of consumption and income taxation.[99] In the digitalised economy as repeatedly mentioned the physical presence of the company is not necessary to participate in the market jurisdiction of other country. To effectively analyse the need to introduce digital service tax in Ethiopia it's important to check the current tax system. The rest of the paper, as the heart of the research, will discuss the issue.

3.1.1 Existing nexus and tax base vis-à-vis digital economy

Either a human or a business entity's income is usually subject to taxation based on a linking factor (Nexus) that establishes whether the entity will be subject to tax in a given jurisdiction. According to article 6(2) of the income tax proclamation, business revenue received by an Ethiopian resident is considered income from Ethiopian sources, unless it can be linked to a business the resident conducts through a permanent presence outside of Ethiopia.[100]

With the exception of the situation where foreign income related to a permanent establishment is excluded, this article grants Ethiopian residents complete authority over their universal income. Article 7(1) further establishes this by saying that Ethiopian citizens are included by this Proclamation regardless of their worldwide wealth. Due to this, inhabitants of Ethiopia are under Ethiopian tax jurisdiction.

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99 *Watch: Taxing the digital economy*, online,www.taxfoundation.org[last accessed march 25,2023]

100 Federal Income Tax Proclamation, 2016, Federal Negarit Gazzeta, Proc. No. 979, 22nd Year, No. 104 [Here in after, Proc. No. 979/2016]

Article 6(3) of the proclamation identifies non-resident business revenue as Ethiopian source income if it can be linked to a permanent establishment in Ethiopia, similar sales of goods or merchandise, or similar business ventures in Ethiopia. Accordingly, foreign corporations or non-residents operating through a permanent establishment in Ethiopia are liable for income taxes in Ethiopia. A permanent establishment, according to the proclamation's article 6, is an established place of business where a person conducts all or part of their business.

It is evident from the aforementioned clause that the foundation of a permanent establishment is the requirement for a fixed location.

The proclamation makes it clear that in order for international businesses to be within the income tax's jurisdiction, they must have a fixed base or physical presence. The ability to conduct business in another country without a physical presence is what makes the digital economy unique, as was covered in the chapter before this one. This is the reason the author of this article contends that, in accordance with the current nexus requirement, foreign digital enterprises that do not have a permanent presence in Ethiopia are not subject to Ethiopian income tax. A reverse taxation mechanism is mandated under the VAT proclamation for non-resident individuals to pay VAT. For services rendered in Ethiopia to individuals registered for VAT in Ethiopia or to any resident legal entity, non-residents are liable to reverse taxation under article 23.[101] Rendering of services is defined as everything done that isn't a supply of goods or money under article 4(2) of the proclamation. This includes the granting, assignment, discontinuance, or surrender of any rights or making a resource or benefit available.[102] In relation to online services the phrase was not defined in the proclamation. Article 4(7) of the value added proclamation states that goods and services delivered by non-Ethiopian nationals via online platforms or permanent establishments in Ethiopia are covered by this proclamation.[103].

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101 Value Added Tax Proclamation, 2002, *Federal Negarit Gazzeta*, Proc. No. 285, 8th Year, No.33, article 23. [Here ins after, Proc. No.285/2002]

102 Proc. No.285/2002 article 4

103 Proc. No.285/2002, Art. 4(7)

A further indication of the statements' developing nature is the mention of offering services online. Online service provision isn't meant to cover digital services in general, though, because of the nature of the digital economy. One way that services are given is through online platforms or through in-person delivery. The study's author believes that the purpose of the VAT proclamation was not to include digital services as subject to VAT because the matter was not completely understood in 2002. In 2015, there was a discourse over the effect of the digital economy on taxes, especially after the OECD expressed worries regarding profit shifting and base erosion action plans, or BEPS. In its Article 24, the proposed VAT proclamation plans to address the matter under the subject of electronic transactions conducted remotely. The proposal states that terms and conditions must be included, the service provider must supply the service to the user, and it must ask for payment for the service. The planned VAT proclamation would not fully address the tax consequences of the digital economy because the digital services offered by the digital service provider are not always paid for. To sum up, in compliance with the current income tax and value added tax proclamations, non-resident firms must have a permanent establishment in order to be subject to Ethiopian tax jurisdiction. It has been repeatedly said that a permanent building is not necessary for conducting business in the digital economy; hence, in addition to the requirement for a permanent facility, other requirements, such as a strong economic presence and virtual presence, must be implemented.

The income tax proclamation defines income as any form of financial gain, whether in cash or kind, from any source, paid for, credited to, or received; it also includes one's one-time profits. A precise description of digital revenue is not given in the proclamation. It will become clear by reading the proclamation in its entirety that the definition's usage of the phrase "from whatever source" does not apply to digital revenue. It looks easy to conclude by referring the definitional part that income from digital economy is included in our income tax. The perspective of Mr. Zinaw, who served as a consultant to the Ministry of Revenue for over five years and is currently a licensed attorney, is quite different. He believes that both the income tax and the value added tax proclamation taxed all income; rather, the problem is that the multinational corporations did not receive any funding, and the value creation that was theoretical will remain theoretical. He came to the conclusion that taxes will be applied if there is revenue and that it originates in Ethiopia. The author disagreed with Mr. Zinaw's suggestion since it is challenging to subject foreign digital enterprises that do not have a permanent establishment in Ethiopia due to their lack of physical presence. It is debatable whether article 63 of the proclamation encompasses revenue from the digital economy for businesses that are digital residents.[104] According to the cited article, article 63 Income tax is due at the rate of 15% on the gross amount of income for any individual who receives any income that is not taxable under Schedule A, B, C, or the other Articles of this Schedule. Article 8 of the proclamation is worth discussing in order to better comprehend its provisions. The Proclamation stipulates that income will be taxed in line with the following schedules: a) Schedule "A," which lists income from employment; b) Schedule "B," which lists income from building rentals; c) Schedule "C," which lists income from businesses; d) Schedule "D," which lists other income; and e) Schedule "E," which lists exempt income. [105]

As can be seen from the above of the article, schedule "D" is different from schedules "A," "B," and "C," which represent revenue from jobs, money from renting out buildings, and income from businesses. Clearly, employment, building rental income, and business revenue for non-residents do not include income from digital businesses. Because of this, there are those in Ethiopia who contend that citizens who derive their income from the digital economy must pay income taxes under schedule "D." Judge Negash Kidane's viewpoint is likewise shared by Mr. Zinaw. The tax bases used for the digital economy are not applicable to non-residents. Net profit serves as the basis for business income taxation. In the digital economy, figuring out a company's net profit is tough.[106] Traditional business revenue and digital revenue have different characteristics. In the digital economy, there are several ways to make money. One such way is through the advertising-based model, in which a business sells goods, services, or content in exchange for

104 Interview with judge Negash kidane judge at the federal high court of Ethiopia on the issue of digital service and the tax system, date of interview April 12,2023

105 Proc. No. 979/2016 article 8

106 Interview with Negash Kidane, Judge at The Federal High Court of Ethiopia, Commercial and investment Bench, On the issue of digital service and tax system.

an advertising platform and a fee from advertisers (think Facebook and Google). (b) The subscription model, in which a website that provides users with services or material charges a subscription fee to access all or part of its content (e.g., consumer reports online, the New York Times, and so forth). (c) Sales model, in which a business makes money by offering customers products, services, or information (e.g., Amazon.com and Gap.com). (d) The licensing of content and technology, whereby an organization grants access to specialized online content (such as publications and journals), algorithms, software, cloud-based operating systems, and so forth; or specialized technology, like artificial intelligence systems. (e) The sale of user data and customized market research models, which are utilized by data brokers, data analytics companies, internet service providers (ISPs), and businesses in need of telemetric and data obtained from non-personal sources.[107] Understanding the role of the customer in this new revenue model for the digital economy is necessary to determine the tax base and apply taxes. Alibaba, Amazon, eBay, Facebook, Google, and other well-known platforms are practically mini-kingdoms on their own, with a global reputation each. Based on a market where various separate groups of people interact through a middleman or platform, this business model considers how decisions made by one group of people might have a positive or negative externality on the outcome for another group of people.[108] Price increases to the other side are possible if the actions of one side result in a positive externality for the other side (such as an increase in user clicks on links sponsored by advertisers).[109] According to research on the digital economy, value generation depends on user interaction. Consumers are an essential source of data creation. User participation in the generation of value in the digital economy is not included in the current income tax pronouncement. Ethiopia's current tax structure is incompatible with the digital economy since it does not employ user engagement as a measure of value creation.

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107 Li, Jinyan, *Protecting the Tax Base in a Digital Economy* (April 18, 2018). United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries, Osgoode Legal Studies Research Paper No. 78,p.494 ,online ,< https://wwwssrn.com>[last accessed April 29,2023]

108 *Ibid.*

109 *Ibid.*

3.1.2. Existing assessment, accrual and collection of taxes vis-à-vis digital economy

In the event that the current tax declaration procedure specified in article 83 of the income tax proclamation is not used, the projected tax assessment specified in article 26 of the tax administration proclamation will take effect. The current tax system leaves open the question of paying income obtained from Ethiopian market jurisdiction for digital enterprises lacking a taxable presence and permanent base. It's unclear which method of assessment individual taxes through tax declarations or anticipated taxation applies to digital businesses that aren't physically present in Ethiopia. Ethiopia's current tax structure establishes jurisdiction to tax based on residency and source, making it impossible to tax the digital economy, which operates without a physical presence in Ethiopia. Because of this, the tax assessment and accrual system did not foresee the arrival of digital businesses in Ethiopia without a fixed location. Because of the definition of taxpayers under article 2(22) as a person liable to pay tax under the proclamation, the record keeping obligation provided to taxpayers under article 17 of the income tax proclamation appears to have limited application to resident companies and foreign companies with permanent establishment in Ethiopia. In summary, the current tax structure is not conducive to the modern digital economy.

If the tax liability is voluntary and paid by the taxpayer, their agent, or a third party required by law to withhold taxes, the issue of tax collection does not appear. The option of direct tax payment would not be the best choice given the absence of foreign digital enterprises' physical presence in market jurisdiction. If taxes are not voluntarily filed, there are few opportunities for tax recovery when money is transferred overseas, and the tax system's efficacy is constrained.[110] A taxpayer's tax liability is a debt owed to the government that must be paid to the appropriate authority in accordance with tax laws. Since taxes are an obligation owing to the government, there must be a means of enforcement if the money isn't paid voluntarily.[111] The authority may notify the taxpayer in writing when they

110 Lucas mas et al, *tax theory applied to the digital economy: A proposal for a digital data tax and a global internet tax agency*,2021, Washington DC, world bank. P.80

111 Proc. 983/2016 article 30(1)

are behind on their taxes, stating that they intend to apply to the registering authority to register a security interest in any assets they may own in order to collect the unpaid taxes and any associated costs from the recovery process.[112] The authorities may issue a seizure order upon notice if the tax debtor refuses to pay the required sum. According to article 41(9) of the proclamation, the main objective of a property seizure order is to sell the asset at auction and get the payment of overdue taxes. The question that has to be answered is how property can be seized effectively in the event that the debtor is a foreign digital corporation without a permanent presence in Ethiopia.[113] It is not tax audits that taxpayers fear; rather, it is effective tax enforcement that could lead to freedom loss (imprisonment) and asset loss (property seizure, cash freeze, judicial foreclosure). Wherever assets are located and taxpayers are physically present and have their tax domicile, such penalties are effectively imposed.[114]The existing tax regime in Ethiopia did not predict the engagement of commercial activity in Ethiopian market without permanent establishment this will hamper the tax collection of foreign digital companies without permanent establishment in Ethiopia.

3.1.3 Existing tax enforcement mechanism vis-à-vis digital economy

The federal tax administration proclamation imposed the obligation to implement and enforce tax laws on the authority.[115]

The tax administration proclamation is applicable to any other legislation that imposes a tax, according to the definitional section's wording. The proclamation made according to Article 9 mandated that taxpayers register.[116] The proclamation made in accordance with article 9 sub article 2 exempts non-residents from the registration requirements. The exclusions for non-residents apply only to individuals who are specifically listed in articles 51 and 53 of the income tax proclamation. Dividends, interest, royalties, management fees, technical fees, and

112 Proc. 983/2016 article 39(3)
113 Proc. 983/2016 article 41(2)
114 *Supra note* 110.
115 Tax Administration Proclamation, 2016, *Federal Negarit Gazzeta*, Proc. No. 983, 22nd Year, No.103, art. 5. [Here in after, Proc. No.983/2016]
116 Proc. No.983/2016 article 9(1)

insurance premiums that are originated in Ethiopia are covered under Article 51 of the income tax proclamation, which is titled Income of Non-Residents. Since all of the stated incomes are sourced from Ethiopia, the tax administration proclamation did not require non-residents to register if their only source of income was one of the listed passive sources.

Article 53 deals with taxing non-resident performers who are exempt from registration requirements. According to the tax administration proclamation previously mentioned, non-residents are exempt from registering requirements. As deduced from articles 89 and 90 of the proclamation for the implementation, the income tax proclamation opts for tax withholding by Ethiopian residents or non-residents with permanent establishment. It is clear that the non-residents with permanent establishment in Ethiopia are not relieved from the requirements of registration. The problem here is that it is challenging to implement the registration requirement for taxpayers without a permanent establishment in the digital economy. The proclamation included a penalty clause under article 101 for resident taxpayers and non-residents who maintain a permanent establishment in Ethiopia. The proclamation's choice to compel non-residents to pay taxes is the need to notify the person who has a service contract with them.[117] The author of this paper believes that the language of the previously mentioned provision for digital services could be expanded; however, as has been said many times, Ethiopia's current tax system is not set up to tax the income from the digital economy because the nation's tax base and connecting factor have not taken the nature of the digital economy into consideration. As discussed in chapter two for the digital service tax purpose simplified method of registration is implemented. The experience of Kenya will be the evidence for this fact. The current federal tax administration proclamation introduced the application of electronic tax system under article 82. The application of electronic tax system is an enabling tool for the digital service tax.[118]

117 Proc. No.983/2016
118 Proc. No.983/2016

This paper's author noted that the Ministry of Revenue established a website with the domain name www.mor.gov.et. The online portal had a variety of information, with the services heading being one of them. The writer tried to browse the website and found that the following services are mentioned under the service heading: income tax calculator, custom tax calculator, car verification, e-tax, and e-service.[119] The e-tax payment system, which has been tested for almost a year by 11 enterprises as a pilot program, is anticipated to go fully operational soon, according to the ministry. The state-owned financial firm Commercial Bank of Ethiopia, which controls more than half of Ethiopia's banking industry, has tested the e-tax payment system.[120] By simplifying the online registration and payment process for non-resident digital service providers for Ethiopian consumers, the ministry of revenue's electronic service provision serves as a prelude to the eventual implementation of a digital service tax.

3.2- Is there a need to introduce digital service tax in Ethiopia?

3.2.1 The current nexus rule of taxation and Digital Service tax

Certain countries contend that their income tax regimes are antiquated. The taxing of profits concept, which dates back more than a century, was based on the then-current state of the economy and involves granting taxation rights and allocating authority to apply taxes. That model used to function, but it doesn't currently.[121] Due to factors including globalization, market liberalization, and the development of the internet, companies both traditional and tech are becoming more and more capable of serving markets virtually, either completely absent from the market or with a minimal presence limited to routine tasks. In Ethiopia, the residency and source concept now serves as the nexus rule for taxes. Revenues originating in Ethiopia are anticipated to be subject to taxation within Ethiopian borders. Under the residency requirements, non-residents are only liable for income generated from Ethiopia and profits attributed to permanent establishments, while Ethiopian nationals are responsible for their income earned anywhere in the world. A

119 The website is available on the following domain, www.mor.gov.et [last accessed March30,2023]

120 *Ibid*. at the news feed, Ethiopia Introduces Electronic Tax Payment System.

121 Maarteen De Wilde, *tax base reallocation and I'll tax if you don't* , 2019, online, www.ssrn.com [last accessed march 30,2023]

connection between intangible company operations and overseas markets is not anticipated or included in the idea of permanent establishment.[122] Globally, it is thought that the digital economy and the current permanent establishment requirement are incompatible. The OECD's task committee on the digital economy has been deliberating about five ideas in particular: changing the PE exemption; establishing a major online presence PE, several types of virtual presence PE, digital transaction withholding tax, and consumption tax alternatives.[123] Countries are changing their tax rules in response to their inability to come to international agreements, as this paper's second chapter discusses. Redefining the meaning of permanent establishment is one of the daring amendments. Significant digital presence, substantial economic presence, and persistent virtual establishment are noteworthy ways to redefine the idea of permanent establishment. As a response to an issue raised by the current permanent establishment requirements, the strong digital presence criterion was introduced. The amount of internet data flow into the territory would be determined by two indicators, which would also be used as allocation keys to divide global digital data tax revenues among market jurisdictions. These indicators are (a) the number of digital transactions made with users who are physically present in the territory and (b) the quantity of visits made by users who are physically present in the nation to online websites.[124]The first indicator seeks to quantify the economic activity associated with the paid provision of digital services and content, including online gambling, virtual banking, virtual insurance, online e-commerce marketplaces, licensing of digital content, and subscriptions to digital content.[125] This article examined in chapter two French, Canada and Kenyan approaches in this regard, drawing best practices from African nations based on the aforementioned factors. The foreign company's notable economic presence in Israel If an international corporation has a substantial economic presence in Israel, even if it only operates virtually and doesn't have a physical presence there, it will be considered to be conducting

122 Subhajit Basu, *international direct taxation and e-commerce: a catalyst for reform,* 2017, NUJS law review, volume 19,p.33

123 *Ibid*.

124 *Supra note* 110.

125 *Ibid.*

business there. A foreign company's considerable economic presence in Israel can be demonstrated by a number of markers, some of which are listed below: With regard to its Israeli users, the foreign business offers its client online services like marketing, advertising, agency, support, and so on. The foreign business conducts a significant amount of online business with Israeli citizens.

The international business offers online services tailored for Israeli users or clients, such as online credit card clearing in Israel, the usage of Hebrew in language and style, and the use of Israeli currency for customer payments. Many Israeli consumers use the services offered by the foreign business online there is a significant percentage of Israeli users on the website.[126]

The only requirement in Kenya is the ability to deliver digital services via digital market platforms. Kenya does not have a defined definition of a significant economic presence or threshold requirements. We can infer from the two experiences that the common requirement for the implementation of the digital service tax is the delivery of digital services via digital market platforms. According to Mr. Zinaw, in order to tax digital economic activity in Ethiopia, it is required to redefine the current permanent establishment. To this end, new legislation that explicitly defines one's online presence is required, and a new legal framework must be established. In his capacity as a legal advisor for the Ministry of Revenue, he continued, they attempted to interpret the law as it was written in order to address some side issues, which he did not discuss due to secrecy. He therefore pushed for the creation of new legislation that had comprehensive provisions for each of the concepts.[127] During the interview, both Judge Zewde and Judge Belete agreed that the PE test is out-dated, even though they could not find any issues with the incompatibility of the current permanent establishment standards to tax the digital economy.[128] According to the interviewee for this paper, Ethiopia's permanent establishment criteria should be redefined. Mr. Biniyam contends that the commercial activity of the digital

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126 The Israeli Tax Authority (ITA) , Circular No. 4/2016, "Non-Resident Company Activity in Israel, online, https://www.fbclawyers.com[last accessed March 27,2023]

127 Interview with Mr zinaw on the issue of digital service and the tax system. April 20, 2023.

128 Interview with Judge Zewde and Judge Belete on the issue of permanent establishment, April 20, 2023.

corporation in relation to Ethiopian Users should be taken into consideration when evaluating the option of virtual presence or significant economic presence, rather than the terminology itself. The author also believes that the nexus criteria which take into account the relationship between the digital Corporation and Ethiopian users should be incorporated by the Ethiopian government into its tax structure.

3.2.2 The current tax base and the Digital Service Tax

Countries are currently unilaterally extending the digital service tax in order to include user participation in value generation. The experience of other nations with user engagement suggests that a country that imposed a digital service tax must have some sort of relationship with its users. Consumers frequently have an impact on business models' monetization techniques. According to the literature, popular user-centred monetization techniques include: - Selling users' demographic information (race, gender, economic standing, education level, family status, income level, and employment)-The sale of behavioural data on users, including values, personalities, attitudes, opinions, lifestyles, and hobbies.

The commercialization of user activity data, such as browsing and purchase histories and recent actions, selling material made by users (blogs, reviews, opinions, databases, sharing of media files), taking ownership of intangibles created by users (fan-made video game content, group translations, server emulators), the digital business's sale (exit) following user contributions that increase its worth in exchange for users' free access to digital platforms and content.[129]

Users who benefit from such free access aren't actually getting it for free because they unknowingly provide personal information and digital content that digital companies utilize and monetize.[130]

For instance, non-resident businesses without a permanent establishment in Ethiopia that target Ethiopian users from Canada or elsewhere may be charged the digital service tax. Countries are defining their users according to their own standards since the digital service tax is a novel tax concept. Regarding

129 *Supra note* 122.
130 *Ibid.*

digitalization, Ethiopian users were neither defined nor described under the country's current tax legislation. Not to mention the tax regulations the proclamation on electronic transactions did not specify what Ethiopian users meant in terms of the digital economy, despite its preamble envisioning both the inclusion of citizens in the economy and Ethiopia's entry into the digital era. It is helpful to talk about Kenya's digital service tax regulation in this regard in order to compare the experiences of neighbouring nations. Under the Kenyan digital service tax regulation, a user is considered to be in Kenya if: (a) they receive the digital service from a terminal (computer, tablet, or mobile phone) located in Kenya; (b) they pay for the digital service with a debit or credit card issued by a Kenyan financial institution or business; (c) they obtain the digital service through an internet protocol address registered in Kenya or an international mobile phone country code assigned to Kenya; or (d) they have a business, residential, or billing address in Kenya.[131]

The provision of digital services to domestic customers is the fiscal basis for digital service tax, as per the Kenyan experience. The offering of digital services to Ethiopian users was not included in the present business income tax. Mr. Zinaw contended that it will be challenging to comprehend and implement taxation due to the theoretical justification of the function of user engagement. However, Mr. Abeje feels that other organizations, such as Ethio-Telecom, should work with the issue of taxing the digital economy because the latter's server holds user data, which will aid in understanding Ethiopian users' roles and in making policy decisions.

According to MR. Biniyam, multinational companies that target Ethiopian consumers for digital service provision or data usage for corporate decision-making should be identified. The participation of economist, ICT expert and telecom service providers are needed to this effect.[132] According to the author, among other things that will be included in the digital service tax are advertising directed at Ethiopian users, the provision of digital services for Ethiopian users, search engines customized for Ethiopian users, such as Google Amharic and other

131 *Supra note* 70.

132 Interview with MR Biniyam, on the issue of tax base in the digital economy, April 20, 2023.

customized local languages, and payment by Ethiopian birr for the provision of digital services.

3.2.3. The current tax rate and the digital service tax

The current tax system basically the direct tax and the indirect tax have different kinds of tax rate. The income tax proclamation for schedule 'A' income from employment uses the progressive tax rate which starts from 0% to 35%,[133]for schedule 'B' income from rental of building the proclamation applied double standards while for the body flat rates of 30% is applied for individuals progressive tax rate ranges from 0% to 35% is provided,[134]for schedule 'C' business income two categories of tax rate are provided 30% rate for body and progressive rate ranges from 0% to 35% for individuals, under schedule 'D' different category of income are listed with different corresponding tax rate. The value added tax proclamation incorporated two types of flat rate for taxable activity which is 15% and 0%.[135] The announcement on value added tax included two different flat rates for taxable activities: 15% and 0%. We can infer that the rates of digital service tax vary throughout nations based on national experiences and OECD recommendations. The tax rate is low since the majority of digital service taxes are based on gross turnover and do not have a deduction or exemption plan. Given the low tax rates associated with digital service taxes in other countries discussed in Chapter two the Ethiopian digital service tax ought to take this approach into account. By eliminating the deductions, lowering the tax rate will make it easier to avoid going through a rigorous process to analyse taxable income. As the experiences of countries indicate the gross transactional income from the digital service is taxed at the minimum rate. To conclude the current tax rate in Ethiopia is not compatible with the digital service tax rate introduced by countries. The writer of this paper is of the opinion that considering minimal tax rate while introducing digital service tax is a necessary factor for good digital service tax design.

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133 Proc. No. 979/2016 article 11
134 Proc. No. 979/2016 article 14
135 Proc. No.285/2002, article 7

3.2.4 Registration and enforcement measures under the current tax system and digital service tax

Non-residents of Ethiopia must register for their permanent establishment under the country's existing tax system. For non-residents receiving passive income from Ethiopian sources, including as dividends, interest, and royalties, there is no longer a registration obligation. The proclamation did not exempt non-residents who did not have a permanent place of residence in Ethiopia from registration requirements, nor did it waive those requirements. There is a dearth of information regarding foreign digital enterprises' activities in Ethiopia because they are now not required to register if they do not have permanent establishments there. Identification of taxpayer details and use of that data for correspondence with the relevant authorities and taxpayers are the two main goals of registration. When taxpayers neglect to pay taxes, their residence and other information will be utilized for enforcement. It is necessary to specify the registration procedure for international digital enterprises because of this. Simplified registration procedures, as discovered from other nations' experiences, will make registration requirements easier. In this case, the question is how the tax authorities will enforce the registration requirement after it has enabled foreign digital enterprises to apply online for a simplified registration procedure and taxpayers have not registered. During the interview, Mr. Binyam expressed his belief that taxes will play a part in regulating life patterns. For this reason, he suggested that the government require digital enterprises to register; failure to do so could result in the digital company's services being banned. As per Mr. Biniyam, following the identification of digital companies with the assistance of Ethio-Telecom and other institutions such as the Ministry of Innovation and Technology, which confers authority upon Ethiopian users, the companies are notified to register, revealing that non-registration will result in service ban. Judges Belete and Negash responded to Mr. Biniyam's opinion by pointing out that in emergency situations, such as during a war, or for security-related reasons, the government has occasionally shut down internet connection in certain regions of the nation. They reasoned that this would mean the government might impose the registration requirements on those digital businesses operating in Ethiopia, potentially suspending their services if they declined to register. In Ethiopia, 16.7% of the population uses the internet, according to figures from January 2023. In January 2023, there were 20.86 million internet users in Ethiopia.[136] In January 2023, Ethiopia had 6.40 million active social media users. Early in 2023, there were 6.00 million Facebook users in Ethiopia, according to data that was made available through Meta's advertising services.[137] According to Meta, the yearly revenue per user for Facebook and Messenger in 2022 was 39.63 USD. Put another way, during the course of the year, it made 39.63 USD per user.[138] Based on the provided information, we can calculate that Facebook may earn $237,780,000 (two hundred thirty seven million seven hundred eighty thousand) USD from 6 million users in Ethiopia. It is not easy for Meta to lose such potential revenue, and this will give the tax authorities more negotiating leverage to force Facebook to register and tax its portion of the money it makes from Ethiopian users or the market. Mr. Biniyam said it was feasible to require foreign digital enterprises to register. This is what we call the role of users in value creation, and it will be used as a benchmark to subject digital companies in Ethiopian jurisdiction. Even though the social media service appears to be free, the truth is that there is no such thing as a free lunch. Those social media platforms gained access to user data after making their service freely available, and by selling this data to advertisers, they can earn revenue.

3.3 Legal Challenges of introducing Digital Service Tax in Ethiopia

3.3.1 Legal Challenges of introducing Digital Service Tax in Ethiopia

It appears from the literature that the majority of the difficulties in implementing the digital service tax are due to its novelty. Applying the digital service tax is anticipated to present obstacles for tax administration, as most writers have linked the capacity issues with tax administration, particularly in Africa. Digital business

136 Digital reports, online, <www.datareportal.com>[last accessed on 19/07/2023]
137 *Ibid.*
138 Online,<www.investopedia.com> [last accessed on 19/07/2023]

models can be classified as either tax disruptive or non-tax disruptive based on how suitable they are for taxes. Non-tax disruptive digital business models leverage digital technology as a tool to improve traditional business activities and use the internet as a communication channel to adapt existing business models to the digital economy.

The aim of this paper is to investigate foreign digital enterprises that have not established a permanent presence in Ethiopia; as such, the tax-related legal issues that domestic digital companies confront have been purposely excluded from the debate. The majority of the issues raised by the interviewee and investigated in the literature are covered in the section that follows.

3.3.2. Fear of discouraging the growth of the digital economy

Ethiopia's economy is still in its infancy when it comes to digitalization, thus there is concern that taxing the profits from this sector may stunt its development. Any tax imposed on the provision of specific services is likely to increase capital costs and decrease the motivation to spend, which will have a negative effect on growth. Additionally, limiting the application of a gross tax to solely digital industries runs the danger of discouraging innovation investment for businesses that are directly or indirectly impacted by the tax, which might penalize emerging businesses like start-ups that experience losses or decreased profitability.[139]And some writers argue that Digital services tax might result in reduced usage of digital services.[140] Innovation is sparked by digitalization, and if it is suppressed, the growth of the digital economy suffers as well.[141]It is the character of taxes that will endure, according to judge Belete Alemu, even though every tax has an effect on the economy. In the judge's opinion, taxes should be implemented so that the government may receive a fair part of the benefits of the digital economy.[142] This is a view that Mr. Biniyam also shares. He maintained that when a new tax base is introduced, it is necessary to cause some confusion. To that end, he added, raising awareness of the workings of the digital economy prior to the tax base's

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139 *Supra note* 9, p.7.

140 *Supra note* 10, p.15.

141 *Id,* p. 19.

142 Interview with judge Belete Alemu presiding judge of high court on tax bench, date of interview April 15,2023 on the issue of introducing digital service tax

legalization is preferable to introducing the tax and learning from experience.[143] As was covered in chapter two, the majority of African nations do not have a minimum threshold; instead, the tax base is determined by turnover or gross revenue. Zimbabwe and Nigeria, in an unusual move, offered a minimal barrier. Providing minimum threshold is strongly criticised by judge zewde Gashaw, he argues that, the principle of ability to pay, needs to be followed especially in developing countries like us. He added that Every One should have to pay tax from income he/she gained from whatever source either digital or non-digital. He also doubted that even we follow as Zimbabwe and Nigeria did to provide a minimum threshold the government will get nothing to tax because no local business will meet such threshold like 500000 USD annual income.[144]The idea of providing minimum threshold is also criticised by Mr Abeje Abera Dana.[145] The EU member claims that no fundamental principle was broken by setting a minimum criterion. In order to safeguard small businesses and startups, Judge Belete suggests offering tax incentives such as tax holidays. Mr. Binyam is also in favour of providing small businesses with incentives to encourage start-ups engaged in digital economy endeavours.[146]

According to the Ministry of Revenue's tax expert, there must be a minimum threshold that is exempt, similar to what is offered for income taxes.[147] In conclusion, imposing a tax on digital services in Ethiopia will have an effect on the country's economy. The government need not, however, turn off potential income from the digital economy because of its uncertainty about its effects.

3.3.3 Difficulty to Regulate Digital Service Tax

The revenue authorities of developing countries, especially those in Africa, encounter administrative obstacles in their endeavours to generate tax revenue.[148]

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[143] Interview with Mr Binyam on the issue digital service and the tax system

[144] Interview with judge Zewde Gashaw, judge at federal high court tax bench, date of interview April 12,2023 on the issue of introducing digital service tax

[145] Interview with Mr Abeje Abera Dana, tax compliance, research and strategy design office at the ministry of revenue, date of interview April 22,2023 on the issue of introducing digital service tax

[146] Interview with Mr Binyam on the issue of Digital Service and the tax system. Date of interview April 12, 2023.

[147] Interview with Mr Binyam one the issue of digital service and the tax system. Date on interview, April 12, 2023.

[148] *Supra note* 10 p. 16

Weak institutional, technological, and legal frameworks and capabilities are some of these difficulties.[149] There is concern that the digital service tax, which is new for Africa and developing nations, could lead to significant enforcement and administrative costs that are out of proportion to the tax revenue collected under the DST, particularly if the measure is only meant to be temporary. The taxation jurisdiction may also run into difficulties when auditing and verifying the legitimacy of the payments made by non-residents and the submitted returns.[150] The problem of value generation is not as challenging for tax authorities in traditional taxes. For the tax authorities, controlling value creation in the digital age is a challenging undertaking. In the context of the digital economy, people' contribution to value generation is poorly recognized. The current tax structure, as Mr. Zinaw Birhanu says, simply paid attention to actual income and failed to account for the role that users play in creating value. Even among the Ministry of Revenue's tax experts, the value generation issue will be challenging to comprehend.[151] The only way to identify value creation is through digital data collection. There is no legal framework that specifies how to collect digital data. The topic of value generation cannot be addressed if this data is not collected.[152] Ethiopia has the least developed digital infrastructure, so recognizing value generation will probably be difficult when implementing a digital service tax. African countries' experience shows that instead of deciding how to create value, they choose to describe digital services and the tax bases for digital service taxes. As was said in chapter two, for example, the following two categories are subject to the Kenyan Digital Service Tax:

Those that offer a platform that facilitates direct electronic communication between buyers and sellers of products and services are known as digital marketplace providers.

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149 *Ibid*.

150 Supra note 9 p. 6

151 Interview with Mr zinaw Birhanu, consultant and attorney at law and former law officer at the ministry of revenue. On the issue of digital service and the tax system, Date of interview April 16,2023

152 Lyla letif, *The Challenges In Imposing The Digital Tax In Developing African Countries*, Journal Of Legal Studies And Research Volume 5 Issue 3 – (June 2019), online, www.ResearchGate.com[last accessed April 22,2023]

• Digital service providers: Individuals who offer digital services via online marketplaces.

A legal entity that provides two or more parties with online sites for business operations, matchmaking, information release, and other services so that the parties can engage in independent trading is referred to as, a "Electronic commerce platform operator" under Article 2(14) of the Ethiopian Electronic Transaction Proclamation. The first group of taxable people in Kenya is comparable to this definition.

The electronic transaction proclamation facilitates the growth of the digital economy by providing legal recognition and defining the term "electronic commerce platform operator." From the perspective of legal drafting, the proclamation is not expected to provide information about their future with regard to taxes. The operator of an electronic commerce platform must either be a resident individual or body or have a permanent establishment in Ethiopia in order to be subject to taxation under Ethiopian law. Therefore, if international digital businesses offer electronic platform operator services to Ethiopian consumers without having a permanent establishment there, they are no longer subject to income tax. According to the income tax proclamation's Article 6(3)(a), non-residents' business income is considered Ethiopian source income to the extent that it may be linked to their non-residential business operations through a permanent establishment in Ethiopia. Income derived from Ethiopia that was not required to be attributed to a permanent institution is specified in article 6(4), items (a) through (g); Income sourced in Ethiopia that is taxed from non-residents without a permanent establishment includes dividends paid to the individual by a resident body, rental income, gains from disposals, insurance premiums, income from performances or sporting events held in Ethiopia, winnings from games of chance held in Ethiopia, interest, royalties, management fees, and technical fees. Articles 51–57 of the income tax proclamation should be read in conjunction with the previously indicated article. The provisions listed above outline several forms of income that are obviously distinct from the revenue generated by the digital marketplace provider. The income tax proclamation's article 63, which offers a flat 15% tax rate to individuals whose income is not subject to schedule A, B, or

C, is all that remains. Judge Belete Alemu and Judge Negash Kidane have interpreted that this law covers digital enterprises that have a permanent establishment in Ethiopia. The problem here is that Ethiopian user data may be sold by digital businesses without a physical presence in Ethiopia through the use of data mining techniques. In theory, automated analysis of Ethiopian users' digital data will aid international businesses in making market decisions. Advertising aimed to Ethiopian consumers is automatically analysed. These internet businesses take advantage of the Ethiopian market by advertising. In an alternative, such digital businesses may provide Ethiopian citizens access to their digital material for sale. The income tax does not consider sales of digital material to citizens of Ethiopia to be income sourced in Ethiopia. It is inappropriate to tax the supplier of digital marketplace services under the present source rule and permanent establishment rule; as a result, a digital service tax must be implemented. It is not as difficult for domestic electronic commerce platform operators to determine taxable presence. In order to design a digital service tax, the author of this article believes that it is preferable to identify the operator of an electronic commerce platform as a taxable person rather than defining value generation. There must be a system in place to tax foreign digital businesses that operate electronic commerce platforms for Ethiopian consumers in relation to their income. It is thus essential to introduce a digital service tax to resolve the issue.

Digital service providers are the second group in Kenya that is liable to digital service tax, and they are worth talking about here. The categories of services that are considered to be digital services are outlined in Kenya's digital service tax regulation. The electronic transaction proclamation in Ethiopia did not include a description of digital services. All that is defined and described in the proclamation is e-commerce, which is a component of the digital economy. The following summarized lists of services are classified as digital services for the purposes of the digital service tax based on the experiences of the nations covered in chapter two:

-website, online hosting, or equipment and remote applications

-Software, including updates; -texts, pictures, or data (screen savers, desktop themes, photos, and visual images are a few examples).

-Access to the database, which contains electronic and media that requires a subscription.

-Online education programs (e-learning) -movies, music, and video games, including interactive gaming

-Events and broadcasts related to politics, culture, the arts, sports, science, and other fields, including broadcast television.

-streaming or downloading services of digital contents, including but not limited to movies, videos, applications, and e-books to any person

- Transmission of data collected about users which has been generated from such users activities on a digital interface including website or mobile applications,

- Provision of goods or services directly or indirectly through a digital platform

- Provision of intermediation services through a digital platform, website or other online applications that link suppliers and customers

- using countries domain name or registers a website address in the country

-Has a purposeful and sustained interaction with persons in the country by customising its digital page or platform to target persons in the country, including reflecting the prices of its products or services in countries currency or providing options for payment in countries currency

- sale of, licensing of, or any other form of monetising data collected about countries users which has been generated from the users' activities on a digital marketplace;

-Provision of a digital marketplace;

- Subscription-based media including news, magazines and journals;

- Electronic data management including online data warehousing, file-sharing and cloud storage services;

- Electronic booking or electronic ticketing services including the online sale of tickets;

-Provision of search engine and automated help desk services including supply of customised search engine services

Here, the issue is whether Ethiopia treats the aforementioned digital services as taxable or exempt from taxation. Income exempt from tax under schedule "E" of the proclamation is known as "exempt income" as defined under article 2(10) Digital services are not included in the list of exempt income under Article 65. Digital services are not taxed in Ethiopia just because they are not included in the lists of exempt revenue. From the perspectives of income tax we have to check from the schedules of incomes. Schedule 'A' is income from employment, schedule 'B' income from rental of building, schedule 'C' income from business and schedule 'D' other income. It is clear that digital service is not categorized under income from employment and rental of building. Business income as defined under article 2(4) has the meaning in article 21 of the income tax proclamation. According to Article 21, "business income" is defined as the total amount of money that the taxpayer receives from running their business during the year, including gains from selling trading stock and gross fees for providing services (apart from income from employment). According to article 21(1)(a) and (b), the two main sources of business income are gains from the sale of a business asset and revenue from conducting a business. The definition of a business will follow, which is provided in article 2(2) as any industrial, commercial, professional, or vocational activity carried out for profit, regardless of duration, as well as any other activity recognized as trade under the commercial code. In contrast to its predecessor, the new commercial code, which was established as proclamation number 1243/2021, adds many more facets of business activity to its list of individuals who are considered merchants under article 5. One of the recently included business practices associated with the subject matter we are examining is the activity of traders, as specified in article 5(19) (25). Article 5(19) of the Commercial Code states that anybody who publishes works professionally and profitably using any medium, including paper printing, photography, audio and video recordings, radio, television, and the internet, is considered to be in the publishing business.[153] Since publishing works online is recognized as trade activity, this provision will be interpreted to include anyone who, for profit and in a professional capacity, provides streaming or downloading services of digital contents, including but not limited to movies, videos, applications, and e-books, to any individual. According to article 5(25) of the New Commercial Code, a trader is defined as an individual who uses computer and software technologies to professionally and profitably organize, provide, or store information, supply it to the public via the internet, and provide space and a computer so that customers can access the information. This will be understood to cover cloud storage services, file-sharing, online data warehousing, and electronic data management. The recognition of online data warehousing as a commerce activity in the new commercial code is a fantastic development. When the new commercial code and the income tax proclamation are read together, it will become clear that online data warehousing and streaming of digital content that is done for profit and in a professional manner is taxable as business income under schedule "C" of the income tax proclamation. The problem is that the income tax proclamation is prepared to tax only income originating in Ethiopia, which means that the international digital corporation without a permanent location in Ethiopia would escape taxation. Because of the digital economy, it is no longer essential to establish a permanent presence in order to do business. As a result, nations are considering digital service taxes as a way to tax international digital enterprises. At the moment, international digital businesses that provide digital services without having a permanent base in Ethiopia are not subject to taxes because of this.

The difficulty of creating value in the digital economy will be lessened by enumerating the digital services that are liable to the digital service tax. Africa's use of unilateral measures to tax the digital economy is expanding, despite the lack of study around the application of digital service taxes throughout the continent. Because of this, the author thinks Ethiopian lawmakers should take the aforementioned digital services into account when creating the digital service tax.

[153] Commercial code of Ethiopia proclamation No. 1243/2021, extraordinary issue

3.3.4. Difficulty of Addressing the Dilemma of Taxing the gross revenue or net profit

A further difficulty in implementing a digital service tax is figuring out what to tax and whether to tax net profit or gross income. Nearly all of the nations whose DST regimes are discussed, along with the ATAF and UN proposal for a model tax convention, apply their digital taxes to a measure of gross revenue, such as the amount collected from users in exchange for a service or the gross revenue from the sale of data or advertising.[154] Only Nigeria and Indonesia seem to be exempt from taxing a measure of revenue; in these cases, the regulations apply to a measure of net profit. "The extent that the company has significant economic presence in Nigeria and profit can be attributable to such activity" is what Nigeria's regulations relate to.[155] Selecting the net profit option is expensive from the standpoint of policy choice. Because determining the net profit, particularly in non-resident multinational firm situations, necessitates calculating taxes in conjunction with other nations, which requires the presence of a bilateral agreement. According to Mr. Abeje Abera, taxing the digital company's net earnings makes things harder for the authorities to do.[156] As he thinks the wisest course of action is to tax the transaction.[157] Furthermore, it will probably be difficult to apply regulations based on a formulaic allocation of all or part of global revenues under laws that are unilaterally approved by a nation.[158] Ethiopia does not yet have a digital service tax; hence the policy option is unclear. According to the literature, the easiest approach to create a digital service tax is to tax gross revenue. Due to the paucity of literature and policy on digital service taxes, the research participants were unable to recommend or select a course of action that would be most appropriate for Ethiopia. The author of this paper believes that when creating digital services, lawmakers should choose to tax gross revenue rather than net profit because it will likely be more difficult to attribute

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154 *Supra note* 10, p.32.

155 *Ibid.*

156 Interview with Mr Abeje Abera on the issue of taxing the revenue or the transaction, April 20, 2023

157 *Supra note* 10, p.32

158 *Ibid.*

profit to a nexus, deemed, or actual PE. This will lead to approach uncertainty and increased costs associated with compliance and enforcement.

3.3.5. Challenges of collecting digital service tax

Even though Ethiopia has not yet implemented a digital service tax, it is helpful to address the issue of collecting digital service tax since the goal of this paper is to examine the difficulties in doing so. Digital economy taxes are relatively new phenomena with little precedent. Although its effectiveness has not yet been studied, the nations who implemented digital service taxes did so with their own systems for collecting the tax. Several nations have attempted to impose withholding taxes on the internet economy, such as Malaysia, Pakistan, and Mexico, in which the resident taxpayer withholds a portion of outgoing payments for digital services.[159]Withholding tax is deficient because it requires the payer to be a resident of the taxing jurisdiction. Tax collectors will have a tough time dealing with non-resident taxpayers in the event of the digital service tax. Tracking money is a challenging endeavour. The Kenyan digital service tax, as covered in chapter two, requires registration or the appointment of a tax representative, who must subsequently file a return and pay the required tax. Penalties for not registering must accompany the registration requirement. To implement such an obligation in circumstances of non-resident taxpayers, additional mechanisms such as diplomatic links with the nation of residence are required. By including a collaboration provision, the French digital service tax attempted to make the difficult task of collecting digital service tax easier. Penalties for noncompliance with the regulations are outlined in Article 13 of the Kenyan digital service tax regulation. Requirements to maintain records are another way that nations have secured the collection of digital service tax. Under schedule 1, part 3 of the UK digital service tax law; the record keeping obligation was introduced into the UK digital service tax. It appears as:

In order to submit an accurate and comprehensive DST return, the responsible member shall: (a) maintain any records that may be required; and (b) safeguard such documents in compliance with this paragraph. (3) The documents have to be

159 *Id* p.38

kept on file through the end of the day in question. (5) All receipts and costs connected to the provision of digital services are among the records that must be maintained and preserved in accordance with this paragraph.[160]

The responsibility to maintain records is one that tax payers must fulfil. The problem is that non-resident taxpayers are beyond the purview of tax authorities, and it will be challenging to enforce. Some contend that if sales above or reach the taxable levels, businesses providing digital services might elect not to file tax returns in the market jurisdiction or nation where their customers are domiciled in order to dodge paying the associated tax requirements.[161] However, the foreign nation where the digital business is based might not have any incentive to help enforce compliance with the other nation's tax laws or even make sure that accurate sales data is shared.[162] Many tax authorities are unable to handle the volume of transactions that has to be examined.[163] In the instance of Ethiopia, determining if they are technologically capable of tracking their revenue from the digital economy and verifying the digital transaction is sufficient. In addition to the digital service tax, Ethiopia's traditional tax system is not operating as planned, as Mr. Binyam clarifies in an interview. According to Mr. Binyam, the government is actively updating its system, filing taxes online, and making other changes. Even if the government is working to update the system, there remains a policy problem with how the digital economy is taxed. Mr. Binyam of the Ministry of Revenue claims that further study is required and that new job categories should be established with the responsibility of overseeing taxes issues related to the digital economy. He claims that at the moment, it is challenging to levy taxes on the internet economy. However, he emphasized that the problem will likely lessen with a bilateral connection. Because they are unfamiliar with the idea, the respondents had no opinion on the digital service tax, but he thinks that creating a new revenue base is essential.[164]

160 *Id* p.40
161 *Supra note* 10, p. 18
162 *Id* , p. 7
163 *Ibid.*
164 Interview with Mr Binyam tax audit expert at ministry of revenue on the challenge of collecting digital service tax, date of interview April 22,2023

In summary, it is clearly evident that the current income tax is incompatible with the taxation of overseas digital enterprises that do not own a fixed location. Digital service tax introduction in Ethiopia is the answer to the issue. In no way would such a digital service tax constitute an assumed income tax: Conventional tax theory assumptions are incompatible with source income taxes of non-resident corporations that do not have a physical presence.[165] Because the internet economy is new, academics advise implementing a recently developed solo tax. Consequently, the new digital service tax would be able to tax the digital presence of both international and local internet users who operate in market jurisdictions without having a physical location. Such targeted users are characterized by their monetization-oriented economic activity in the form of a digital business model, whether or not they generate revenue in the end and whether or not they run the business model as people or as legal companies.[166]Mr. Abera Abeje suggests implementing an independent digital service tax, and the writer agrees, given the nature of the digital economy. Since the problem of a substantial digital presence and the contribution of users to commercialization and value generation differ from traditional business mechanisms, it is beneficial to have legislation that addresses these issues explicitly.

165 *Supra note* 10, p.90

166 *Ibid.*

CHAPTER FOUR

CONCLUSION AND RECOMMENDATION

4.1. Conclusion

The following are findings of this research:-

1. The current tax system of the federal government of Ethiopia is not compatible to tax foreign digital companies without a permanent establishment in Ethiopia for lack of definition of the digital service, lack of taking into consideration the digital presence of the company and lack of identifying the Ethiopian digital service users.
2. The government's desire to digitalize the economy is not reflected in its willingness to impose taxes on foreign digital companies without a permanent establishment in Ethiopia.
3. The electronic tax system incorporated by the federal tax administration proclamation, the enactment of electronic transaction, digital ID, electronic signature proclamations will use as a stepping stone for the introduction of digital service tax in Ethiopia.
4. In order to tax foreign digital companies without a permanent establishment in Ethiopia, the paper concludes that an independent digital service tax must be introduced due to the incompatibility of the country's present tax structure and the unique characteristics of the digital economy.

4.2. Recommendations

This study found that, should it be taxed, the digital economy will contribute to higher income. The kind of tax that is imposed and the means by which it is enforced will determine how effective the tax system is. The author of this work will send along the following suggestions:

- ✓ The current tax system to tax foreign digital companies without permanent establishment in Ethiopia needed the introduction of digital service tax.

- ✓ From the experience of EU Proposal, France, Italy, Spain, Turkey, Austria, UK, Zimbabwe, Kenya, Uruguay, ATAF and scholars from world bank like Lucas mass and Raul Felix assertion, the digital service tax which will be introduced should be new standalone legislation.
- ✓ The concept of economic digital presence needs to be included in the digital service tax legislation.
- ✓ Significant digital presence, as determined by the literature reviewed in this paper, would be based on the volume of internet data flow with the territory, as indicated by two metrics: (a) the number of digital transactions made with users who are physically located in Ethiopia, and (b) the number of visits to online websites by users who are physically located in Ethiopia. The first indicator seeks to quantify the economic activity associated with the paid provision of digital services and content, including online gaming, virtual banking, virtual insurance, and nonuser digital content sales and licenses. The economic activity resulting from the commercialization of user-related data and information provided in return for free access to digital platforms and content is the focus of the second indicator: selling user-related goodwill as part of the sale of a digital firm, selling user-related data and user-contributed digital content, and online user-targeted advertising.
- ✓ The digital services that are subject to the upcoming digital service tax must be listed under this new tax.
- ✓ Because the United States is afraid of the introduction of digital service tax, claiming that the threshold criteria set by other countries targeted US companies, and because of the lesson learned from Kenya's digital service tax, the digital service tax that will be introduced in Ethiopia should target revenue rather than company. This means that the gross transaction will be subject to taxation rather than a minimum threshold requirement.
- ✓ For non-resident digital enterprises, a streamlined registration process that incorporates online registration, online tax payment, online clearing procedure, and e-service should be implemented.

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iv. Others

- Interview with ,Belete Alemu judge at the high court of the federal democratic republic of Ethiopia on the current tax system and digital economy
- Interview with ,Zewde Gashaw judge at the high court of the federal democratic republic of Ethiopia on the current tax system and digital economy
- Interview with ,Negash Kidane judge at the high court of the federal democratic republic of Ethiopia on the current tax system and digital economy
- Interview with, Biniyam Zerihun, tax auditor at the ministry of revenue on the issues of taxation of the digital economy
- Interview with, Abeje Abera, tax compliance, research and strategy design officer at the ministry of revenue on the issues of taxation of the digital economy

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Interview questions

Interview question for judges and lawyers

1. How do you understand the tax challenges of the digitalisation of the economy?
2. Is the existing tax system compatible with the digital economy?
3. With the current nexus rule of taxation like source and permanent establishment how the digital companies taxable under Ethiopian tax system?
4. How do you understand the significant digital presence, user participation, value creation and digital service tax?
5. What are the challenges of introducing digital service tax in Ethiopia

   Interview questions for ministry of revenue experts

   1. How digital companies are currently taxed in Ethiopia?
   2. What is the tax base to tax the digital economy?
   3. What is the technological advancement in the ministry to tax the digital economy?