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Tax Avoidance and the General Anti-Avoidance Rule under Ethiopian Income Tax Law: A Tax Policy Review

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Abstract

The Income Tax Proclamation No. 979/2016 introduces the General Anti-Avoidance Rule (GAAR) as a fundamental mechanism to address tax avoidance practices that undermine the objectives and principles of the tax system. Generally, this article aims to examine the implications of tax avoidance for Ethiopian tax policy and to evaluate the policy design of GAAR under the Income Tax Proclamation (ITP). Specifically, it investigates the legislative structure of GAAR, focusing on its scope of application and alignment with the fundamental principles of the Ethiopian tax system. Using a doctrinal research approach, it analyses pertinent statutory provisions and scholarly literature to elucidate the meaning, purpose, and operational framework of GAAR within the income tax regime. The article contends that, as tax avoidance practices increasingly threaten the goals and principles of the Ethiopian tax system, the GAAR holds the potential to increase government revenue by enabling the tax authority to disregard arrangements whose primary purpose is to secure a tax benefit. Nevertheless, the provision currently lacks explicit guidelines and exceptions to differentiate between abusive avoidance and legitimate tax planning. This deficiency grants the tax authority extensive discretion, thereby engendering uncertainty in interpretation and enforcement and undermining core principles of taxation such as equity, certainty, simplicity, and neutrality. The article highlights the need to amend the GAAR by introducing interpretive guidelines or subordinate legislation to clarify its application. Such measures would ensure consistent enforcement aligned with tax principles, thereby limiting discretionary power and better balancing anti-avoidance objectives with the integrity of the tax system.

Keywords

Tax Avoidance; Ethiopia; Tax Policy; Income Tax; GAAR; Principle of Taxation

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1. Introduction

Taxation is the primary means by which governments finance public goods and services.[1] These goods and services benefit all citizens but are often under-produced by the private sector due to their non-excludable and non-rivalrous nature.[2] While taxation is fundamental for financing public services, citizens often perceive it as an unavoidable evil and, as such, explore legally permissible avenues to reduce their tax obligations.[3] For instance, in the income tax system, taxpayers navigate various opportunities to adjust their tax burdens,[4] utilising strategies such as deferring income losses to a later period, shifting income to a different tax unit, or receiving income from tax-favoured sources, e.g., capital gains.[5] While these strategies are inherent in the tax structure,[6] loopholes and ambiguities in tax laws can be exploited by taxpayers to minimise their tax liabilities, sometimes without violating the law.[7]

Tax avoidance and the tax system are inherently mutually exclusive. This is because the impact of tax avoidance practice undermines the overall objectives of tax policy, i.e., revenue generation.[8] and disrupts the fundamental principles of the tax system, including equity, efficiency, neutrality, and certainty.[9] Recognising these challenges, many countries have adopted GAAR as a fundamental legislative measure to address complex tax avoidance strategies.[10] For instance, Australia, Canada, Tanzania, the United Kingdom, and South Africa, to name a few, incorporate GAAR into their tax legislation to deter and address tax avoidance.[11]

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[1] S. L.Winer and W. Hettich, 'The Political Economy of Taxation: Positive and Normative Analysis When Collective Choice Matters' in C.K. Rowley and F. Schneider (eds.), The Encyclopedia of Public Choice (Springer, Dordrecht, 2004).

[2] Neelima K. Menon, 'The Economic Philosophy of Taxation' (PhD thesis, Azim Premji University, 2018), p. 34.

[3] Mario J. Rizzo, Richard A. Epstein and David Schmidtz, 'Justifying Taxation', Social Philosophy and Policy, Vol. 39, 2022, p. 1, https://doi.org/10.1017/S0265052523000080.

[4] M.B. Taylor, 'Tax Policy and Tax Avoidance: The General Anti-Avoidance Rule from a Tax Policy Perspective' (LL.M. thesis, University of British Columbia, 2006), p. 3.

[5] Federal Income Tax Proclamation, 2016, Art. 54-62, Proc. No. 979/2016, *Fed. Neg. Gaz.*, Year 22, No. 104.

[6] Belete Addis, 'Characterization of Taxable Units and Tax Bases under the Income Tax Schedules of Schedule "A" and "B" of the Federal Income Tax Proclamation of Ethiopia: A Commentary', Bahir Dar University Journal of Law, Vol. 8, 2019, p. 35–69.

[7] Joseph E. Stiglitz, 'The General Theory of Tax Avoidance, National Tax Journal', Vol. 38, No. 3, 1985, p.325.

[8] David Fernandes & Kerrie Sadiq, 'A Principled Framework for Assessing General Anti-Avoidance Regimes', British Tax Review, No. 2, 2016, P. 172.

[9] Taylor, *supra* note 4, P. 4.

[10] Lang M, Rust A, Schuch J, Staringer C, Owens J and Pistone P (eds), *GAARs: A Key Element of Tax Systems in the Post-BEPS World* (IBFD, Amsterdam 2016), P. 515-531.

[11] Judith Freedman, 'Designing a General Anti-Abuse Rule: Striking a Balance, Asia-Pac. Tax Bull., Vol.20, 2014, p.167. https://ssrn.com/abstract=2488541.

In some countries, notably Australia and Canada, statutory GAAR has been significantly reinforced and structured through judicial interpretation and doctrinal development.[12]

Before the 2016 tax reform, efforts to address tax avoidance in Ethiopia relied predominantly on specific anti-avoidance rules (SAARs). While SAARs explicitly targeted specific avoidance practices, such as transfer pricing, the rules' nature and scope arguably rendered them increasingly inadequate for addressing the complexity of tax-planning schemes. In this regard, the adoption of GAAR under the Income Tax Proclamation No. 979/2016 undoubtedly represents a significant milestone within Ethiopia's broader fiscal reform framework. In this regard, the introduction of GAAR under Article 80 of the 2016 Proclamation represents a transformative policy shift, fundamentally transitioning legislative tax-avoidance measures from a restrictive, narrowly focused framework to an expansive one.[13]

Equally, other tax legislation, including the Excise Tax Proclamation[14] and the Value-Added Tax Proclamation,[15] also adopt GAAR to combat tax avoidance practices as the ITP. Accordingly, all the provisions authorise the tax authority to adjust transactions or schemes carried out with the sole or dominant purpose of obtaining the tax benefit. In this context, the 2016 tax reform marked a pivotal development by extending the GAAR framework beyond income taxation and establishing a comprehensive, preventive legal architecture against avoidance practices. Through this integrated approach, Ethiopia has equipped its tax administration with a robust, flexible, and adaptive instrument to combat complex tax avoidance practices.

The design and implementation of anti-avoidance rules play a critical role in preserving the integrity and stability of the tax system.[16] Notably, well-structured anti-avoidance rules, when properly enforced, contribute to a fair, transparent, and efficient tax system by establishing

[12] Krever R, 'Policy Forum: Rethinking GAAR—Back to Basics', Canadian Tax Journal, Vol. 72, No.3, 2024, P. 617.
[13] Income Tax Proclamation No. 979/2016, *supra* note 5, Art. 80.
[14] Excise Tax Proclamation, 2020, Art. 41, Pro. No. 1186/2020, *Fed. Neg. Gaz.*, Year 26, No. 25.
[15] Value Added Tax Proclamation, 2024, Art. 70, Proc. No. 1341/2024, *Fed. Neg. Gaz.*, Year 30 No. 61. For instance, while the ITP and VATP used the term *ከግብር ለመሸሽ የሚደረጉ ዕቅዶች እና የተጨማሪ እሴት ታክስ ያለመክፈል ዕቅድ* respectively, the Excise Tax Proclamation used the term *ታክስ ላለመክፈል የሚደረግ ስምምነት*. The literal meaning of the former Amharic terms connotes a tax-avoidance plan, while the latter connotes an agreement not to pay tax. However, the author opines that, given the uniformity of the content of those provisions, save for academic discourse, such mere term deference does not hamper the tax authority in applying them.
[16] R. Garg & K. Mukerjee, Removing the Fences: Looking through GAAR (PricewaterhouseCoopers, February 2012) http://www.pwc.in/assets/pdfs/publications-2012/pwc-white-paper-on-gaar.pdf .

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clear guidelines and minimising opportunities for exploitation.[17] Conversely, poorly designed rules that grant excessive discretion to tax authorities may lead to legal uncertainty, increase compliance, and ultimately undermine public trust in the tax system.[18] This calls for anti-avoidance rule design that is precise, administratively feasible, and aligned with international best practices to prevent loopholes while maintaining simplicity.[19]

In Ethiopia, although there is growing policy focus on addressing tax avoidance, scholarly and legal analyses of anti-tax-avoidance rules, particularly from a tax policy perspective, remain limited. As discussed above, existing studies have examined specific issues such as treaty shopping, avoidance in the context of a permanent establishment (PE), tax avoidance and double tax avoidance agreements, corporate income tax planning loopholes, and regulatory responses affecting multinational enterprises,[20] as well as localised administrative and enforcement challenges.[21] While these contributions provide valuable insight into tax avoidance and regulatory shortcomings, they offer little guidance on advancing a systematic and principled evaluation of tax avoidance and anti-avoidance measures (GAAR) and their broader implications for the foundational objectives of Ethiopia's tax system. Thus, by employing doctrinal legal analysis, statutory interpretation, and limited comparative examination of other GAAR regimes, this article aims to bridge this scholarly lacuna by examining these two interconnected questions.

This article addressed these outstanding issues in five sections. The first section provides the conceptual and theoretical framework of tax avoidance. The second section examines tax avoidance and its impact on Ethiopian tax policy, i.e., its foundational objectives and normative principles. The third section undertakes a critical analysis of the income tax GAAR as an anti-tax avoidance mechanism. The fourth section further discusses the design of the GAAR under Article 80 of the ITP, in line with Ethiopian tax principles, and assesses whether the prevailing

[17] David G. Duff, 'General Anti-Avoidance Rules Revisited: Reflections on Tim Edgar's "Building a Better GAAR", Canadian Tax Journal, Vol. 68, No.2, 2020, P.584.
[18] Shu-C. Chen, 'Predicting the 'Unpredictable' General Anti-Avoidance Rule (GAAR) in EU Tax Law', Inter EU Law East: Journal for the International and European Law, Economics and Market Integrations, Vol.5, No.1, 2018, P. 91.
[19] R. Garg & K. Mukerjee, *supra* note 16.
[20] Hirko Alemu, Critical Analysis of the Regulatory Framework Governing Corporate Income Tax Planning in Ethiopia (LLM Thesis, Addis Ababa University, 2020).
[21] Abate Gashaw Ayele, 'A Study on Tax Evasion and Avoidance in Ethiopia: The Case of Ethiopian Revenue and Custom Authority Bahir Dar Branch', Research Journal of Finance & Accounting, Vol.10, No. 13, 2019, p. 52–63; Tariku Lorato, Yonas Sendaba and Tasew Tadesse, 'Tax Evasion Attitude and Taxpayers' Perception of Government Legitimacy: Evidence from Southern Ethiopia, Cogent Economics & Finance', Vol. 12, No. 1, 2024.

GAAR framework sufficiently protects the fiscal integrity of the tax system or unintentionally undermines it. Finally, the article provides concluding remarks and the way forward.

2. Theoretical and Conceptual Approach

2.1.Conceptualising Tax Avoidance and its Challenge to the Tax System

Tax avoidance holds an ambiguous status within the legal and fiscal frameworks of modern tax systems.[22] Unlike tax evasion, which entails the illicit concealment or misrepresentation of taxable income in breach of legal mandates, tax avoidance encompasses arrangements that adhere to the literal wording of statutory provisions while deliberately reducing tax liability, often in defiance of legislative intent.[23] It involves the deliberate structuring of transactions or affairs to exploit gaps, inconsistencies, or unintended consequences within tax legislation.

Scholars and international organisations have conceptualised tax avoidance in diverse ways. For instance, the Organisation for Economic Co-operation and Development (OECD) delineates it as the deliberate arrangement of a taxpayer's affairs to minimise tax liability in a manner contrary to the law's underlying intent.[24] Likewise, legal scholars, including Barker and Stiglitz, assert that tax avoidance often entails the deliberate manipulation of legal forms and structures to obtain tax benefits unanticipated by the legislator.[25] This position is also buttressed by other schools that portray tax avoidance as a strategic exploitation of legislative gaps, ambiguities, and inconsistencies through contrived transactions that adhere to the letter of the law while subverting its spirit. [26] In essence, tax avoidance transcends superficial compliance with statutory text. Rather, it relies on artifices that obscure the true economic substance, ultimately securing a tax benefit without incurring the economic consequences the Legislator anticipated would be borne by taxpayers qualifying for such a reduction in their tax liability.[27]

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[22] Nigar Hashimzade & Yuliya Epifantseva (eds.), The Routledge Companion to Tax Avoidance Research (Routledge, 2018), p. 1.
[23] Dinah M. Payne & Cecily A. Raiborn, 'Aggressive Tax Avoidance: A Conundrum for Stakeholders, Governments, and Morality, Journal of Business Ethics', Vol. 147, No. 3, 2018, p. 470.
[24]OECD, *International Tax Avoidance & Evasion, Issues in International Taxation* No. 1 (OECD, Paris, 1981), p. 16–17.
[25] William B. Barker, 'The Ideology of Tax Avoidance', Loyola University Chicago Law Journal, Vol. 40, 2009, p. 232.; see also Stiglitz, *supra* note 7.
[26] Takayuki Nagato, 'A General Anti-Avoidance Rule (GAAR) and the Rule of Law in Japan', Public Policy Review, Vol. 13, 2017, p. 37.
[27] Zoe Prebble & John Prebble, 'The Morality of Tax Avoidance', Creighton Law Review Vol. 43 (2009) p. 702.

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Tax avoidance, while operating within the legal boundaries, poses a serious threat to the tax system by undermining governments' ability to achieve key policy objectives such as revenue mobilisation, fairness, and economic efficiency.[28] Moreover, the practice of tax avoidance ultimately narrows the tax base, complicates revenue forecasting, and forces tax administrators to respond with more complex and fragmented legislation. These, in turn, raise compliance burden for taxpayers and tax authorities, notably in countries with limited administrative capacity. Thus, tax avoidance threatens the coherence and sustainability of tax policies designed to support public finance and equitable economic development. [29]Beyond these operational and fiscal impacts, the practice of tax avoidance distorts the relationship between taxpayers and the government, thus eroding public trust and compliance with tax policies.

2.2.Anti-Tax Avoidance Measures

In response to the impact of tax avoidance, countries have been using various anti-avoidance measures, i.e., judicial and legislative anti-avoidance measures.[30] Before the introduction of statutory (legislative) anti-avoidance measures, which are formally codified responses, countries relied on judicial anti-avoidance doctrine, in which courts often denied tax benefits to artificial or abusive arrangements by looking beyond the legal form of transactions to their real economic substance or purpose.[31] In doing so, courts often employ various judicial doctrines, including the substance-over-form doctrine and the business-purpose doctrine.

For instance, the substance-over-form principle empowers courts to determine based on real economic activity rather than on superficial legal structure.[32] In addition, the economic substance coupled with the business purpose test allows the court to evaluate whether a transaction was undertaken primarily for *bona fide* commercial reasons or to obtain tax advantages, thereby permitting denial of tax benefits if avoidance is the dominant motive. Collectively, these judicial anti-avoidance doctrines represent a vital framework that curtails artificial contrivances that imperil the integrity of tax systems.

[28] Archi Sarawgi, 'Impact of Tax Avoidance on Economic Growth: Loopholes & Policy Solutions, Taxguru.in' https://taxguru.in/corporate-law/impact-tax-avoidance-economic-growth-legal-loopholes-policy-solutions.html
[29] Tylor, *supra* note 4
[30] Arnold B, 'A Comparison of Statutory General Anti-Avoidance Rules and Judicial General Anti-Avoidance Doctrines as a Means of Controlling Tax Avoidance: Which Is Better? (What Would John Tiley Think?)', in Avery Jones J, Harris P, Oliver D (eds.), *Comparative Perspectives on Revenue Law: Essays in Honour of John Tiley* (Cambridge University Press, 2008) p. 1-24.
[31] Reuven S. Avi-Yonah and Amir Pichhadze, 'Formulating a General Anti-Abuse Rule (GAAR) in Tax Legislation: Insights and Recommendations', in Nigar Hashimzade and Yuliya Epifantseva (eds.), *The Routledge Companion to Tax Avoidance Research*, Routledge, (2018) p. 117.
[32] Ibid.

However, given the limitations of traditional judicial doctrines and the increasing ingenuity of tax-avoidance tactics, many countries have adopted legislative anti-avoidance measures that combine SAARs and GAARs. [33] Importantly, SAAR, while providing legal certainty and being easier to implement than GAAR, is inherently reactive and may become obsolete as taxpayers adopt new avoidance techniques.[34] To address these limitations, many countries introduced GAAR as an additional avoidance measure, empowering tax authorities to disregard or re-characterise arrangements primarily designed to obtain tax benefits that are contrary to the purpose of tax legislation.[35]

From a policy perspective, while countering aggressive tax avoidance, GAARs seek to restore the balance between taxpayers' autonomy and fiscal integrity by prioritising substance over form, legislative purpose, and equitable taxation.[36] However, they also engender significant concerns about legal certainty, excessive administrative discretion, and the potential for arbitrary enforcement.[37] Notably, overreliance on GAARs, which grant broad powers to tax authorities, can deter foreign investment, escalate compliance costs, foster pervasive uncertainty, and erode taxpayers' voluntary compliance.[38] Conversely, proponents argued that when GAARs are carefully designed and transparently applied, they can enhance fairness and strengthen voluntary compliance by promoting trust in the tax system's integrity.[39]

2.3.Analytical Framework of the Article

Drawing on these theoretical and legal foundations, this article employs an analytical framework grounded in fundamental tax policy goals and principles recognised under the Ethiopian tax system. Here, tax avoidance emerges as a systematic consequence of the intersection between taxpayers' behaviour, legal structure and institutional capacities. In contrast, anti-tax avoidance measures, notably GAARs, are analysed as regulatory measures designed to restructure tax benefits in line with legislative intent and policy objectives.[40] This framework facilitates a balanced evaluation of GAARs' design under the ITP, assessing

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[33] Ning Hou, 'Research on the Dilemma of Anti-Tax Avoidance Measures in Developing Countries and Their Response', BCP Business & Management Vol. 20 (2022) p. 222.
[34] Ibid.
[35] Robert B. Whait, Gerald E. Whittenburg and Ira Horowitz, 'The World According to GAAR', Australian Tax Forum Vol. 27, No. 4 (2012).
[36] Ibid.
[37]Matheus Peixoto Behrends, 'Under Which Conditions Would the ATAD's GAAR Benefit from Automatic Decision-Making in Terms of Legal Certainty and Efficiency' (LLM Thesis, University of Amsterdam) 2022, P.7.
[38] Rachel Anne Tooma, *Legislating against Tax Avoidance*, (IBFD, 2008).
[39] David G. Duff, *General Anti-Avoidance Rules Revisited*, *supra* note 17, p. 579.
[40] Tylor, *supra* note 4.

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whether it strengthens tax policy coherence by enhancing fairness, economic neutrality, and revenue generation, or compromises these aims.

In general, building on the conceptual and theoretical foundations of tax avoidance established in this section, the subsequent section examines how tax avoidance practices undermine the fundamental principles and objectives that underpin effective tax policy. In particular, it scrutinises how tax avoidance obstructs tax systems from achieving their designated purposes, including revenue mobilisation, equity, economic efficiency, and administrative simplicity, thereby endangering the integrity and long-term viability of fiscal architectures.

3. Tax Avoidance as a Threat to Ethiopian Tax Policy

Although Ethiopia lacks a single codified tax policy document, a constellation of pivotal strategic instruments, including the Plan for Accelerated and Sustained Development to End Poverty (PASDEP),[41] the first Growth and Transformation Plan (GTP I)[42] and the second growth and transformation plan (GTP II),[43] the 10-Year Development Plan,[44] the National Medium-Term Revenue Strategy (NMTRS),[45] and various tax legislations collectively discharge this function. Notwithstanding their somewhat fragmented disposition, these documents embody the cardinal objectives and principles that orient the Ethiopian tax regime.

Tax policy provides a normative and analytical framework for designing, implementing, and evaluating a tax system.[46] At its core, it grapples with fundamental questions of why taxes are levied and how they should be structured and administered.[47] In this regard, the rationale for taxation concerns the state's role and the objectives it pursues, including revenue mobilisation, redistribution, and broader socio-economic and inter-jurisdictional goals.[48] Meanwhile, the

[41] Ministry of Finance and Economic Development (MoFED), *A Plan for Accelerated and Sustained Development to End Poverty (PASDEP) (2005/06–2009/10)*, 2006.
[42] *FDRE, Growth and Transformation Plan I (GTP I) (2010/11–2014/15)* (Ministry of Finance and Economic Development, 2010).
[43] FDRE, *Growth and Transformation Plan II (GTP II) (2015/16–2019/20)* (Ministry of Finance and Economic Development, 2016).
[44] FDRE, *Ten Years Development Plan: A Pathway to Prosperity 2021–2030* (Planning and Development Commission, 2020), P. 32–33.
[45] FDRE, *National Medium-Term Revenue Strategy (NMTRS): FY 2024/25 to FY 2027/28,* (Ministry of Finance) 2024.
[46] R. Boadway and K. Cuff, 'Tax Policy: Principles and Lessons' (Cambridge University Press, Cambridge, 2022) p.1.
[47] Taddese Lencho, 'The Ethiopian Income Tax System: Policy, Design and Practice' (PhD thesis, University of Alabama, 2014) p.35.
[48] Allison Christians, Introduction to Tax Policy Theory (Social Science Research Network, 2018), P. 2 https://doi.org/10.2139/ssrn.3186791. While the first and second goals are clear, the third, negotiated expansion, arguably a novel one, deals on the use of tax system to interacts with other jurisdictions with the aim to take comparative advantage in socio, economic and political arena.

mechanics of taxation (how taxation works) encompass the juridical and institutional architecture of the tax regime. Most importantly, it provides the criteria by which we evaluate the design, implementation, and administration of a tax system.[49] In academic discourse, *inter alia*, equity, efficiency, simplicity, and neutrality are fundamental principles that scholars use to analyse tax policy.[50]

Tax avoidance poses a considerable challenge to the integrity of the tax system, as it jeopardises the fundamental goals and tenets of sound tax policy. As shall be discussed, tax avoidance practices undermine not only the revenue-generating capacity and economic development but also the fairness, simplicity, and efficiency of the tax system.

In this context, the following subsection examines the challenge of tax avoidance on the Ethiopian tax policy goals and principles.

3.1. Ethiopian Tax Policy Goals and the Threat of Tax Avoidance

Tax avoidance and the implementation of countermeasures against it have constituted enduring challenges in the Ethiopian tax regime since the 2002 reform.[51] These challenges are evident across multiple national strategic documents, including the PASDEP, GTP I and GTP II, the 10-Year Development Plan, and the NMTRS. For instance, PASDEP marked an inaugural policy initiative to strengthen Ethiopia's domestic revenue mobilisation amid broader state-building and poverty alleviation imperatives.[52] To do so, the strategy prioritises refining tax administration, streamlining income tax, closing loopholes, improving the incentive system, strengthening tax administration, overhauling the income tax law and regulations, broadening the tax base, and rectifying revenue shortfalls.[53]

Besides, GTP I and II accorded heightened priority to domestic resource mobilisation to fund expansive public investment agendas.[54] Specifically, these plans clearly identified deficiencies in tax administration, aggressive avoidance strategies, and base erosion as barriers to enduring revenue mobilisation.[55] In response, they prescribed legislative and institutional

[49] Ibid., p. 10.
[50] Taddese Lencho, *supra* note 47, p. 35.
[51] Alemayehu Geda & Abebe Shimeles, Taxes and Tax Reform in Ethiopia, 1990–2003, WIDER Research Paper No. 2005/65 (UNU-WIDER, Helsinki, December 2005), p. 7.
[52] A Plan for Accelerated and Sustained Development to End Poverty (PASDEP), *supra* note 41, p. 62.
[53] Ibid, p. 4.
[54] GTP I, *supra* note 42, p. 38; GTP II, *supra* note 43, p. 108
[55] Ibid.

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transformations to strengthen enforcement apparatuses, raise compliance levels, and suppress malicious tax manoeuvres, including by strengthening regulatory structures and administrative competencies.[56]

Currently, the 10-Year Development Plan identifies maintaining a healthy balance between revenue generation and expenditure as the government's two major fiscal focuses for the next 10 years.[57] In particular, to fulfil the central fiscal goal of increasing domestic revenue, the plan identified several key measures, including intensifying tax collection efforts, broadening the tax base, reforming tax policies and regulations, modernising the tax system and its administration, restructuring the tax structure, and combating illegal trade activities.[58]

For instance, during the Plan years, the government, though ambitious, aims to increase domestic revenue from 317.9 billion birr to 3.5 trillion birr, thereby raising the tax-to-GDP ratio from 9.2% to 18.2%.[59]In terms of year-by-year trajectory, the tax-to-GDP ratio is projected to grow progressively. Accordingly, starting at 9.23% in 2019/20, it is projected to reach 11.6% from 2020/21 to 2024/25. It is then expected to rise further to 16 % between 2025/26 and 2029/30. The average for the entire plan year 2020–2030 is 13.8%, with the ratio expected to reach 18.2% by 2030.

Nevertheless, despite revenue generation being a fundamental goal of fiscal policy, the tax-to-GDP ratio has declined continuously since FY2014/15, falling from 12.4% to 6.8% in FY2022/23.[60] This figure remains well below the IMF's recommended minimum tax-to-GDP ratio of 15%, and the 16% target projected in the national development plan.[61] This trajectory indicates slower revenue growth relative to GDP.

Ethiopia's low tax-to-GDP ratio reflects structural and institutional issues, including weaknesses, inefficiency, corruption, inflation, and security challenges, as Tahir *et al* highlights.[62] Furthermore, low tax compliance, particularly tax avoidance and evasion, is a major contributor to Ethiopia's tax gap. Abel identifies these practices as key drivers of weak

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[56] Ibid.
[57] Ten Years Development Plan: A Pathway to Prosperity 2021–2030, *supra* note 44, p. 32–33.
[58] Ibid.
[59] Ibid.
[60] National Medium-Term Revenue Strategy, *supra* note 45, p 12.
[61] Ten Years Development Plan: A Pathway to Prosperity 2021–2030, *supra* note 44, p. 33.
[62] Tahir Desta, Mekdelawit Reta, & Bizuneh Girma, 'Determinants of Tax Revenue in Ethiopia: Autoregressive Distributed Lag Approach', Ethiopian Journal of Business and Social Sciences, Vol.6, No.2, 2024, P. 106. DOI: https://doi.org/10.59122/154F59lk

revenue collection,[63] while Taddese highlights widespread tax avoidance and generous tax incentives as major causes of the country's poor tax performance relative to other Sub-Saharan African countries.[64] These findings underscore tax avoidance as a persistent challenge to Ethiopia's revenue mobilisation.

In addition to revenue generation, enhancing economic development is another major objective of Ethiopian tax policy. On this account, various policy documents, i.e., the 10-year development plan, NMTRS, and the recent homegrown economic reform, identify domestic revenue from tax sources as a key and sustainable source of financing for poverty eradication and the country's economic development.[65]

Besides, the preamble of the Income Tax Proclamation, as a source of tax policy, makes supporting economic development through taxation its major priority.[66] To this end, incentive provisions, including tax holidays, reinvestment deductions, allowances for forward losses, and exemptions from dividend taxation for reinvested dividends, are being used to foster economic development.[67] While these incentive laws are intended to foster economic growth, investment, and saving, they inadvertently create opportunities for tax avoidance and result in ineffective tax revenue mobilisation.[68] Thus, tax avoidance, although seemingly illusory in its impact on economic growth goals, significantly undermines the tax system's objectives by reducing the revenue needed to achieve those targets.[69]

Furthermore, the prevalence of tax avoidance undermines the objectives of the tax policy aimed at modernising the country's tax system and administration.[70] Modernising the tax administration is vital for bolstering the country's capacity to fund public services, infrastructure, and overall economic progress. Modernising tax administration requires a significant investment in technology, training, and enforcement mechanisms (e.g., digital tax systems), which is unthinkable without adequate revenue. However, by undermining the

[63] Abel A. Mebratu, 'Theoretical Foundations of Voluntary Tax Compliance: Evidence from A Developing Country' Humanities and Social Sciences Communications, Vol. 11, No.1, 2024, P. 443.
[64] Taddese, *supra* note 47, p. 117.
[65] FDRE**,** *A Homegrown Economic Reform Agenda: A Pathway to Prosperity, Ethiopia Country Strategic Plan (2020–2025),* (2020).
[66] Income Tax Proclamation No. 979/2016, *supra* note 5.
[67] Taddese, *supra* note 47, p. 110-116.; Ibid., Art.22 (d), (2); Art. 59; Art. 26, & Art.35.
[68] A.T. Mengistu *et al*., 'Tax Evasion and Missing Imports: Evidence from Transaction-Level Data, ICTD Working Paper, 2019, P.7.
[69] Taddese, *supra* note 47, p. 118.
[70] Ten Years Development Plan: A Pathway to Prosperity 2021–2030, *supra* note 44, p. 31.

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government's revenue-generating capacity, increasing compliance costs, and impeding crucial reforms, tax avoidance substantially threatens the government's efforts to modernise the tax system.[71]

3.2. Tax Avoidance Challenge on Major Tax Principles

Tax policy is also intricately linked to the standards or benchmarks used to evaluate or design tax reform. Various writers have proposed criteria for evaluating tax systems. Notably, Adam Smith's maxims of taxation, i.e., equity/equality/fairness, certainty, convenience, and economy, have influenced tax policy discussions and continue to be widely recognised as foundational principles.[72] To this end, Taddese observes that the Ethiopian tax system has been deliberately designed to align with the core tenets of taxation, such as equity, efficiency, certainty, and neutrality, as reflected in the nation's fiscal policy and tax legislation.[73] However, he argued that the pervasive issue of tax avoidance substantially undermines the effective actualisation of these principles.

Considering this, the following discussion flaunts how tax avoidance compromises each of these fundamental tax principles.

3.2.1. Tax Equity

Equity in taxation, categorised as horizontal and vertical equity, entails a fair distribution of the tax burden based on taxpayers' ability to pay.[74] Horizontal equity requires that taxpayers in similar economic positions be treated alike, thus preventing arbitrary or irrelevant distinctions from influencing their tax liabilities, while vertical equity requires that those with greater ability to pay shoulder a proportionately higher share of the tax burden.[75] The Ethiopian income tax laws also appear to incorporate both horizontal and vertical equity through progressive tax rates on the major sources of income, mainly employment, rental, and business income.

Beyond fairness, tax equity also serves as a tool for redistributing resources, particularly in countries such as Ethiopia, where market mechanisms alone are insufficient or socially

[71] Joel Slemrod & Shlomo Yitzhaki, *Tax Avoidance, Evasion and Administration*, in A.J. Auerbach & M. Feldstein (eds.), Handbook of Public Economics, Vol. 3 (2002), P. 1423.
[72] Piotr Eckhardt, 'Adam Smith's View on the Functions of Taxation', *Internetowy Przegląd Prawniczy TBSP UJ*, 2016, P.86.
[73] Taddese, *supra* note 47, p. 36.
[74] Robin Boadway & Katherine Cuff, *supra* note 46, p. 3.
[75] Pasquale Pistone *et al.*, *Fundamentals of Taxation: An Introduction to Tax Policy, Tax Law and Tax Administration* (IBFD, 2019), p. 9-13.

undesirable.[76] In this context, the tax system assumes a dual function: firstly, by generating sufficient revenue to finance public goods and social services that benefit the wider population; and secondly, by implementing progressive taxation, whereby the tax burden escalates with the taxpayer's income or wealth, thereby ensuring that higher-income individuals contribute a more equitable share relative to their means.[77]

Tax equity has been a major consideration for tax reforms in Ethiopia.[78] Evidently, the preambles and substantive provisions of income tax laws amplify tax equity.[79] For instance, paragraph two of the preamble of the ITP reads "… make the tax system fair and bring income that is so far not subject to tax into the tax net" as one rationale for introducing the ITP.[80] Furthermore, some of the substantive provisions of the income tax law, i.e., provisions defining income tax jurisdiction, uniform income brackets, and tax rate structures, and the inclusion of previously untaxed income sources, such as windfall profit,[81] undistributed profit,[82] repatriated profit,[83] recharged technical fees and royalties,[84] and inclusion of Article 63, which imposes tax on a person who has derived income not otherwise taxable under the ITP. All of this represents stronger cases for recognising tax equity under the income tax law.[85]

Besides, the new Income Tax (Amendment) Proclamation No. 1395/2025 also unequivocally enshrines tax equity and fairness as foundational tenets of Ethiopia's ongoing fiscal reform agenda.[86] Notably, the Amendment delineates advancing tax equity, substantially broadening the tax base, alleviating the burden on low-income earners, meticulously rectifying systemic fairness deficiencies, and vigorously combating tax avoidance as major objectives of the reform.[87] This commitment is further demonstrated in the substantive part of the Amended Proclamation, as some of the provisions focus on the strategic expansion of the tax base, via

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[76] Taddese, *supra* note 47, p. 36.
[77] Linda Sugin, 'Theories of Distributive Justice and Limitations on Taxation: What Rawls Demands from Tax Systems', Fordham Law Review, Vol.72, 2004, P.1991.https://ir.lawnet.fordham.edu/flr/vol72/iss5/27.
[78] Michael Seifu, 'Equity Potentials for Tax Reform in Ethiopia', Ethiopian Journal of Economics, Vol.8, 1999, P. 21.
[79] Taddese, *supra* note 47, p.120.
[80] Income Tax Proclamation No. 979/2016, *supra* note 5. The preamble part of every law, including tax laws, is considered the traditional section for policy statements in the Ethiopian legal system.; Ibid., p. 134.
[81] Income Tax Proclamation No. 979/2016, *supra* note 5, Art. 60.
[82] Ibid., Art. 61.
[83] Ibid., Art. 62.
[84] Ibid, Art. 50 & 51.
[85] Taddese, *supra* note 47, p. 131-143.
[86] FDRE Ministry of Finance, 'Explanatory note on Income Tax (Amendment) Proclamation No. 1395/2025', 2025, P 1.
[87] Ibid.

introducing a new tax base, i.e., the Digital Service Tax,[88] changing the standard exemption threshold from 600 to 2000, etc.[89]

Despite the recognition of tax equity, the very structure of the income tax is arguably susceptible to tax avoidance. In particular, its scheduling design, overlapping tax schedules, difficulties in income characterisation, and the absence of clear legal definitions for certain transactions create opportunities for taxpayers to engage in tax avoidance.[90] Furthermore, the prevalence of exceptions, exemptions, and exclusions that depart from the Proclamation's comprehensive concept of income further increases the system's susceptibility to tax avoidance.[91]

In this context, tax avoidance undermines the two main components of tax equity (horizontal and vertical equity).[92] Mainly, it arguably undermines horizontal tax equity by allowing taxpayers in similar economic positions to bear dissimilar tax burdens for reasons unrelated to their income or wealth. [93] This ultimately creates a *de facto* arbitrary or irrelevant distinction in the allocation of the tax burden. Equally, it undermines vertical equity by enabling wealthier taxpayers to exploit legal loopholes, deductions, and sophisticated tax-planning strategies that are generally beyond the reach of low- and middle-income earners.[94] As a result, the tax burden falls disproportionately on those with fewer resources, eroding the fairness of the tax system and weakening the integrity of Ethiopia's income tax regime.

Furthermore, even though the exact revenue loss is difficult to quantify, tax avoidance indirectly undermines tax equity by reducing government revenue, thereby limiting public investment in essential services and infrastructure.[95] This disproportionately affects lower-income groups that rely on public services and weakens the redistributive function of Ethiopia's income tax system. In general, tax avoidance weakens the fairness and effectiveness of the tax system by eroding the tax base and disrupting the government's projected revenue. In this

[88] Income Tax (Amendment) Proclamation, 2025, Proclamation No. 1395/2025, Art.12 (Art.22 as amended).
[89] Ibid., Art. 7 (Art.11 as amended).
[90] Belete Addis, *supra* note 6, p. 35; Taddese, *supra* note 47.
[91] Taddese, *supra* note 47.
[92] Taylor, *supra* note 4, p. 13.
[93] Faster Capital, 'Tax Avoidance: Navigating the Gray: Tax Avoidance in the Realm of Horizontal Equity' https://fastercapital.com/content/Tax-Avoidance--Navigating-the-Gray--Tax-Avoidance-in-the-Realm-of-Horizontal-Equity.html accessed on 4 November 2025.
[94] Taylor, *supra* note 4, p. 14.
[95] Ute Reisinger, 'Three Essays on Tax Abuse and the Fulfillment of Economic and Social Rights' (master's thesis, 2017) p.1157. https://digitalcommons.lib.uconn.edu/gs_theses/1157

context, the Income Tax Proclamation (Amended) makes the prevention of tax avoidance a central objective, aiming to enhance revenue while reinforcing tax equity and fairness.[96]

3.2.2. Simplicity and Convenience

The principle of tax simplicity and convenience emphasises that the tax system should be clear and easy to understand for both taxpayers and administrators. Notably, it entails that tax obligations, the timing, method, and amount of tax payment, should be transparent and unambiguous.[97] Thus, by ensuring clarity in tax rules and procedures, this principle seeks to promote fairness, enhance compliance, and reduce administrative burdens.

In the Ethiopian context, the fundamental characteristic of the Ethiopian tax reforms lies in their emphasis on simplicity and convenience.[98] For instance, the central objective of the 2002 tax reform, among others, was to modernise the tax system, expand the tax base, bolster administrative capacity, simplify the tax framework, reduce structural complexity, and thereby reduce opportunities for targeted tax avoidance and evasion.[99] However, despite these efforts, the reform was criticised for fragmented rules, persistent legal complexity, and a narrow tax base, which in turn limits its overall effectiveness.[100]

Building on the pitfall of the 2002 reform, the 2016 tax reform also incorporated more clearly delineated tax classifications, a rationalised tax rate structure, and modified stipulations to attenuate interpretive ambiguities and compliance burdens, thereby advancing voluntary taxpayer adherence and revenue yields, thereby ensuring tax simplicity.[101] Additionally, the enactment of the NMTRS[102] alongside the amendment of the 2016 ITP, which adopts a scheduled tax system with withholding as the final tax for employment and other income, payments for goods and services, and imports, simplification has been foregrounded as an explicit policy objective. This is intended to reinforce fiscal resilience, elevate regulatory congruence, and close avoidance channels through precise statutory articulation and enhanced

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[96] Explanatory note on the Income Tax (Amendment) Proclamation No. 1395/2025, *supra* note 86, p.1.
[97] Kenneth H. Ryesky, 'Tax Simplification: So Necessary and So Elusive', The University of New Hampshire Law Review, Vol.2, No.2, 2024, p. 94.
[98] Delessa Daba, 'Tax Reforms and Tax Revenues Performance in Ethiopia,' 5 Journal of Economics & Sustainable Development, Vol. 5, No.13, 2014, p. 11.
[99] Getachew Demirew, 'Tax Reform in Ethiopia & Progress to Date, Ethiopian Economics Association', International Conference on Ethiopian Economy, 2005, p.3.
[100] Belete Addis *et al*., 'The 2016-Income Tax Reforms of Ethiopia: Drivers, Major Legislative Changes, and Constraints, Bahir Dar University Journal of Law', Vol. 13, 2022, p. 3.
[101] Ibid., p. 29
[102] FDRE, NMTRS, *supra* note 45, p.35-36.

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enforcement mechanisms. All of this reflects the importance of reducing tax complexity to uphold the principle of simplicity.

Conversely, when a tax system is burdened with unclear legislative terms and an extensive array of rules, exceptions, exclusions, deductions, and credits that are hidden from intended beneficiaries, it becomes a complex structure.[103] Therefore, an unclear or unpredictable taxation system diminishes taxpayer confidence, impairs economic planning, and may unintentionally promote avoidance behaviours by creating ambiguity about tax obligations, ultimately compromising the fundamental objectives of a coherent tax framework.[104] In this regard, Taddese explicitly articulates this scenario and contends that excessive complexity in tax design undermines the fundamental principle of ability-to-pay and supplants it with a dynamic of ability-to-manipulate, thereby allowing well-resourced taxpayers to exploit systemic loopholes and, consequently, eroding fairness and consistency.[105]

It is crucial to acknowledge a significant paradox in tax administration arising from the tax system's complexity. This paradox arises from the tension between enforcing compliance and preserving simplicity. Notably, although a complex tax system offers opportunities for taxpayers to exploit loopholes and pursue sophisticated avoidance strategies, the comprehensive anti-avoidance provisions enacted to combat these practices may unintentionally generate new avenues for taxpayers to reduce their obligations.[106] Ironically, these specific pieces of legislation enacted to combat tax avoidance may inadvertently increase the complexity of the tax system, thereby reinforcing the very problems they are meant to resolve.

Therefore, considering the historical trajectory of Ethiopian income tax laws, it is plausible to assert that tax avoidance poses a clear threat to the legislative simplicity envisioned in the Ethiopian tax system and further compounds its existing legislative complexity.[107] This, in turn,

[103] Binh Tran-Nam, Annet Wanyana Oguttu, & Kyle Mandy, 'Tax Complexity and Tax Simplification: A Critical Review of Concepts and Issues' in Annet Wanyana Oguttu (ed), *Tax Simplification: An African Perspective* (Pretoria University Law Press, Pretoria, 2019), p.27.
[104] Ibid.
[105] Taddese, *supra* note 47, p. 87-88.
[106] Ibid., p. 17.
[107] Ibid., p. 126. In connection with this issue, Taddese argued that simplicity deficiencies plague the Ethiopian income tax system. Notably, multiple amendments, coupled with numerous subsidiary legislations and the incorporation of borrowed terminology from other jurisdictions without proper contextualization, have eroded the simplicity of the Ethiopian income tax system.

beyond adding layers of intricacy to the tax system, arguably has a spillover effect that undermines the principles of equity, certainty, and neutrality.

3.2.3. Efficiency or Economy

Efficiency in taxation refers to the tax system's ability to raise revenue with minimal economic cost.[108] As discussed above, the principal goal of taxation is to raise revenue to finance public goods. Achieving this requires efficient, effective tax collection relative to the costs of administering it. In this context, Adam Smith stated that "…every tax ought to be so contrived as both to take out and keep out of pockets of the citizen as little as possible, over and above what it brings into the public treasury of the state", which reflects the importance of designing taxes that achieve their revenue goals with minimal burden on taxpayers.[109]

Tax efficiency has been widely recognised as a core principle in Ethiopian tax policy. For instance, the 2002 and 2016 tax reforms, together with subsequent tax law amendments, were primarily driven by the goal of creating a more efficient tax system. [110] To this end, both the repealed 2002 Income Tax Law and the 2016 Income Tax Proclamation explicitly positioned efficiency as a central pillar of the tax framework.[111] This focus is further reinforced in Ethiopia's broader fiscal policy documents, including the 10-Year National Development Plan and NMTRS, which emphasise the importance of a modern, streamlined, and effective tax system.[112]

This policy orientation toward a modern and effective tax system necessarily makes addressing how tax avoidance affects the foundational principles that such reforms seek to advance. Here, assessing how tax avoidance undermines efficiency requires considering both its direct administrative and compliance costs and its indirect costs (deadweight loss) arising from distortions in economic behaviour.[113] In this regard, tax avoidance, on the one hand,

[108] Lena Hiort af Ornäs Leijon, Tax Policy, Economic Efficiency and the Principle of Neutrality from a Legal and Economic Perspective (Working Paper 2015:2, Uppsala University, (2015), P. 2.

[109] Piotr Eckhardt, *supra* note 72. Efficiency also connotes several things, such as simplicity of the tax, neutrality, certainty and administrative feasibility.

[110] Belete Addis *et al*, 'The 2016-Income Tax Reforms of Ethiopia', *supra* note 100, p. 11; Taddese, *supra* note 47, p. 147.

[111] Income Tax Proclamation No. 979/2016, *supra* note 5, para. 1.

[112] Ten Years Development Plan: A Pathway to Prosperity 2021-2030, *supra* note 44.

[113] Luigi Popescu, 'The Essence and the Role of Taxes - The Principles of Taxation', Annals-Economy Series, Vol.4, 2019, p. 15; Taddese, *supra* note 47, p. 77. An inefficient tax system causes 'dead-weight losses and hidden costs, leading to reduced activity, investment, and market distortions. Tax effects are distortionary but should be minimised for efficiency. High efficiency involves broad bases, few exemptions, and low tax rates. Since efficiency depends on the tax base, tax avoidance is inefficient.

significantly increases the direct costs of tax administration by compelling tax authorities to expand their enforcement efforts, as combating it consumes substantial resources, including money, time, and the time and resources of lawyers, accountants, courts, and tax administrations.[114] Equally, taxpayers incur heightened compliance costs for advisory fees, record-keeping, and litigation, especially if their transaction is labelled as an unacceptable tax avoidance practice.[115] Altogether, diverts resources from productive economic activity, thereby weakening the tax system's capacity to raise revenue cost-effectively.

Furthermore, tax avoidance also increases indirect costs in the form of deadweight losses.[116] Deadweight loss arises when taxpayers' tax considerations distort their economic decision-making, as they may substitute productive investments with less efficient financing structures to reduce their tax exposure.[117] This means that when taxpayers' transactions are primarily intended to avoid tax exposures rather than to advance genuine commercial objectives, capital, labour, and managerial efforts would be diverted towards tax-driven arrangements rather than value-creating activities.[118] Such distortions, in turn, create opportunity costs and reduce welfare, as economic outcomes would deviate from those that would prevail under a neutral and efficient tax system.[119]

Further, tax avoidance also undermines taxpayer voluntary compliance by eroding public confidence in the tax system. As Tylor observes, the perception that other taxpayers are unfairly circumventing their tax obligations can erode confidence in the fairness of the tax system, thus diminishing the willingness to comply voluntarily. [120] To make matters worse, such perceptions may foster reciprocal non-compliance by prompting some taxpayers to move beyond lawful taxpaying and engage in outright evasion. In this context, tax avoidance practices would indirectly undermine the culture of voluntary compliance upon which the Ethiopian income tax system, i.e., self-assessment, fundamentally depends.[121] Thus, arguably, tax avoidance exacerbates taxpayers' existing low-tax moral behaviour in their compliance.[122] And though

[114] Taylor, *supra* note 4, p. 17.
[115] Ibid.
[116] M. Feldstein, 'Tax Avoidance and the Deadweight Loss of the Income Tax, Review of Economics and Statistics', Vol. 81, No. 4, 1999, p. 674–680.
[117] Ibid
[118] J. Slemrod & S. Yitzhaki, *supra* note 71, p. 1423–1470.
[119] Ibid.
[120] Taylor, *supra* note 4, p. 17.
[121] Ibid.
[122] Abate Gashaw Ayele, *supra* note 21, p.10.

there is no evidence of a correlation, it may lead those who have not benefited from avoidance to engage in tax evasion.

3.2.4. Tax Neutrality

In the context of the principle of tax neutrality, the tax system should not influence taxpayers' economic decisions. Instead, individuals and businesses should make investments and other commercial decisions based solely on economic considerations, not on tax advantages.[123] In Ethiopia, the introduction of several tax laws, such as the 2002 VAT Proclamation, the 2002 Turnover Tax, and the 1994 Capital Gain Tax, underscores the commitment to ensuring tax neutrality.[124]

In the income tax context, the relevant preamble of the 1994 Capital Gain Tax states that levying tax on all gainful activities maintains neutrality and equity in the tax system, highlighting the significance of these laws in promoting tax policy attributes, namely, tax neutrality.[125] Similarly, Alemu, while discussing e-commerce taxation in Ethiopia, cited the principle of neutrality as justification for the introduction of the Electronic Transaction Proclamation No. 1205/2020.[126]

However, despite tax neutrality being recognised in the Ethiopian tax policy, the practice of tax avoidance fundamentally contravenes this principle. Notably, by incentivising taxpayers to enter into artificial or contrived arrangements, tax avoidance distorts the underlying motivation for transactions by shifting it from genuine commercial objectives to the pursuit of tax advantages.[127] This distortion, in turn, compromises the integrity of the tax system by influencing individual decisions and prompting taxpayers to structure transactions through artificial legal forms for tax-related reasons, ultimately discouraging fair competition among businesses by providing special preferences only to those who avoid tax, often through the use of tax experts.

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[123] Jennifer Chen Shu-Chien, 'Neutrality as Tax Justice: The Case of Common Consolidated Corporate Tax Base under the EU Law, 'The Review of European Law, Economics and Politics', Vol. 5, No. 1, 2018, p. 33–66. Despite the recognition of neutrality as a tax norm, Taddesse observed the principle of neutrality in its breach rather than in its observance. To this end, he cited the tax rate difference under Schedule D and Ethiopia's tax incentive regimes as the best example that presents a case against the neutrality of the income tax.; Taddese, *supra* note 47, p. 156.

[124] Taddese, *supra* note 47, p. 156.

[125] Ibid.

[126] Alemu Balcha, 'Taxation of Income from E-Commerce in Ethiopia: A Quest for Integrating Modern Rules of Taxation into Ethiopian Income Tax System', Jimma University Journal of Law, Vo. 15, 2023, p. 100.

[127] Taylor, *supra* note 4, p. 15.

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In general, the preceding section underscores the substantial influence of tax avoidance on the Ethiopian tax system, particularly its detrimental effects on revenue mobilisation and economic growth, and its diminution of core principles such as equity, simplicity, efficiency, and neutrality. This underscores the significance of tackling tax avoidance. In this context, the subsequent section analyses Ethiopia's income tax legislative framework and the measures implemented to mitigate tax avoidance.

4. Navigating GAAR under the Income Tax Proclamation No. 979/2016

The phenomenon of tax avoidance is as old as taxation itself, having emerged alongside the introduction of fiscal levies.[128] In tandem with the increasing dynamism and complexity of modern business transactions, tax avoidance has evolved significantly in both prevalence and sophistication.[129] Far from being a mere innocuous financial manoeuvre, this practice adversely and profoundly impacts revenue mobilisation, economic equity, and the integrity of the tax system. These, in turn, collectively undermine the ability of the Legislature and the National Treasury to formulate and execute the country's economic policies.[130] To address this challenge, many countries have implemented anti-avoidance measures (legislative and administrative).[131]

Coming to Ethiopia, despite the absence of clear anti-avoidance rules in successive income tax laws,[132] The 2016 ITP introduced SAAR and GAAR as explicit anti-avoidance measures. These rules, though with varying scopes, aim to detect unwarranted tax avoidance by taxpayers. SAAR, which includes income splitting, transfer pricing, and thin capitalisation (as articulated in articles 78, 79, and 47 of the ITP, respectively), focuses on a limited set of transactions and addresses specific instances of tax avoidance.[133] Moreover, the amendment of certain provisions of the 2016 ITP via Proclamation No. 1395/2025 can also be understood as a specific anti-avoidance measure, including measures to combat tax avoidance.[134]

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[128]Korinna Schönhärl, Gisela Hürlimann & Dorothea Rohde, 'The Ability and Intention of Not Paying Taxes in History: Some Introductory Observations' in Korinna Schönhärl, Gisela Hürlimann and Dorothea Rohde (eds), *Histories of Tax Evasion, Avoidance and Resistance* (Taylor & Francis, Abingdon, 2022) p.4.

[129] David G. Duff, 'Tax Avoidance in the 21st Century' in Chris Evans and Rick Krever (eds), *Australian Business Tax Reform in Retrospect and Prospect* (Thomson, Sydney, 2009) p.477.

[130] Ling Zhang, 'Tax Avoidance: Causes and Solutions', (master's thesis, Auckland University of Technology, 2007) p.23.

[131] David G Duff, *Tax Avoidance in the 21st Century', supra* note 129, p. 477.

[132]Mustefa Ali, 'Revisiting Ethiopian Income Tax Law on Tax Evasion and Avoidance: Special Emphasis on Share Companies' (LL.M. thesis, Jimma University), p. 40.

[133] A detailed analysis of these specific provisions is beyond the scope of this article.

[134] Explanatory note on the Income Tax (Amendment) Proclamation No. 1395/2025, *supra* note 86, p.3. As provided in the preamble, addressing existing tax avoidance practices and re-establishing alignment between the

However, while SAARs offer precision, their limited scope may mean they cannot address all tax avoidance practices.[135] Notably, their narrow, focused scope requires that the rule apply only to the particular schemes or situations explicitly mentioned in the law.[136] As a result, taxpayers may still engage in other forms of tax avoidance that fall outside the prescribed scenarios, exploiting gaps or loopholes not covered by the specific rules.

Given this, GAAR has been adopted under Article 80 of the ITP. As provided in Article 80, GAAR serves as a comprehensive safeguard, or a catch-all, against tax avoidance practices that may fall outside the reach of SAAR.[137] Accordingly, when a person engages in a scheme, through agreements, arrangements, promises, or undertakings, whether explicit or implied, and regardless of legal enforceability, with the sole purpose of obtaining a tax benefit, the authority may reassess the tax liability of the taxpayer and any parties connected to the scheme.[138] In this context, GAAR under Article 80 serves as a last resort, empowering tax authorities to address unacceptable tax avoidance practices that would otherwise escape scrutiny under the standard terms and statutory interpretation of the ITP. [139]

From a tax policy perspective, GAAR reflects the legislator's effort to curb abusive tax avoidance practices without impinging on legitimate tax planning.[140] Thus, the goal is to strike a balance between protecting the tax base and allowing taxpayers to manage their economic transactions in a tax-efficient manner. [141] Moreover, GAAR should not be designed to obstruct ordinary commercial transactions which enable taxpayers to legitimately take advantage of opportunities available to them in conducting transactions.[142] However, if a transaction is

tax system and the foundational principles of taxation is provided as the primary justification for the revision of the 2016 ITP.

[135] Christopher Evans, 'Containing Tax Avoidance: Anti-Avoidance Strategies' in John G. Head and Richard Krever (eds), *Tax Reform in the 21st Century: A Volume in Memory of Richard Musgrave* (Kluwer Law International, Alphen aan den Rijn, 2009) p.529.

[136] H. Michael Dolson, Kenneth Keung & Josh Kumar, 'Modern Overview of Specific Anti-Avoidance Rules, Canadian Tax Foundation', Vol. 14, 2018, p. 11

[137]The Institute for Fiscal Studies, *A General Anti-Avoidance Rule for Direct Taxes: A Response to the Inland Revenue's Consultative Document* (The Institute for Fiscal Studies, London, 1999), p. 13.

[138] Income Tax Proclamation No. 979/2016, *supra* note 5, Art. 80 (3).

[139] Ibid., Art. 80.

[140]Afton Titus, 'Designing a General Anti-Avoidance Rule for the East African Community—A Comparative Analysis', World Tax Journal, Vol. 11, 2019, p. 263.

[141] Christophe Waerzeggers & Cory Hillier, 'Introducing a General Anti-Avoidance Rule (GAAR)—Ensuring That a GAAR Achieves Its Purpose', Tax Law IMF Technical Note, Vol.1, 2016.

[142] Ibid.

arranged primarily or solely to secure a tax benefit (to avoid tax), it will attract the GAAR provision, irrespective of the form selected.[143]

4.1. Setting Ethiopian GAAR in Motion[144]

GAAR is not self-executing *per se*; instead, it operates through administrative determination and applies only where the tax authority concludes that a transaction constitutes tax avoidance. To this end, the ITP establishes a three-stage test or conditions, namely the scheme, tax benefit, and purpose of the transaction, for identifying abusive tax avoidance under Article 80. The three stages of GAAR may raise a few questions in interpreting and applying these tests. In particular, the questions of how the scheme is understood, how to identify tax benefits, and what purpose to consider when identifying the sole or dominant purpose of the scheme are important for evaluating the design of the GAAR.

4.1.1. Existence of Scheme

The initial requirement for implementing the anti-avoidance regulation under Article 80 is a taxpayer-undertaken 'scheme', broadly defined to include various agreements, arrangements, promises, and commitments, explicit or implicit, enforceable or not.[145] This broad definition gives the tax authority flexibility to identify what constitutes a 'scheme', especially when a taxpayer's arrangement involves multiple transactions or steps. It enables them to pinpoint specific elements that, individually, define a tax-driven arrangement.[146] Such an inclusive definition of 'scheme' may, arguably, have significant implications for the tax authority and the taxpayer.

On the one hand, the definition enables the tax authority to scrutinise a broad spectrum of financial arrangements, structures, or strategies that might otherwise exploit ITP loopholes, thereby enhancing its capacity to safeguard the tax base by capturing complex transactions intended to evade or mitigate tax liabilities. On the other hand, this discretionary power, although potentially effective in detecting tax avoidance, arguably may indeed introduce a

[143] Ibid.
[144] This article exclusively concentrates on the framework of GAAR, pinpointing and examining key concepts such as tax benefit, the purpose test, and series of transactions. The statutory interpretation and application of the GAAR by the tax authority and the Ethiopian court fall outside the scope of the discussion.
[145] VAT Proclamation No. 1341/2024, *supra* note 15, Art. 70. The provision similarly defines Scheme in a way to include any course of action, agreement, arrangement, understanding, promise, plan, proposal, or undertaking, whether express or implied and whether enforceable or not.; Excise Tax Proclamation No. 1186/2020, *supra* note 16, Art. 41.
[146] C. Waerzeggers & C. Hillier, *supra* note 141, p. 2.

certain level of uncertainty for taxpayers.[147] This is due to the importance of tax predictability; an overly broad definition may, arguably, leave taxpayers uncertain about whether their legitimate financial arrangements or planning strategies will be subject to challenge by tax authorities, potentially resulting in unintentional noncompliance.

4.1.2. Tax Benefit

The existence of a tax benefit is a prerequisite for invoking the provisions of GAAR.[148] The ITP defined a tax benefit or tax outcome linked to the scheme as a *reduction*, *postponement* (deferral), or any form of avoidance of a person's liability to pay tax.[149] This means that any arrangements, whether they involve re-characterisation of income, shifting of tax burdens, or other strategies, designed to secure unintended tax advantages would, arguably, be recognised as generating a tax benefit.[150] This indicates the importance of phrases such as 'reduction, postponement, or avoidance' for identifying tax benefits in connection with the scheme.

In this context, when identifying tax benefits, Article 80 (2) requires comparing the scheme's tax consequences with those that would have arisen, or might reasonably be expected to arise, if the scheme had not been entered into or executed.[151] To make this determination, the authority is allowed to employ a hypothetical scenario, such as rewriting a transaction, treating specific events as if they did or did not occur at a particular time, or involving particular third-party actions or to make corresponding 'adjustments' to the tax liability of any other person affected by the scheme.[152] The underlying policy intent of this provision arguably seeks an alternative postulate that achieves substantially the same non-tax results for the taxpayer as the actual transaction, but without the tax implications that the authority aims to counter by invoking the GAAR.[153]

Here, it must be noted that tax benefits associated with a scheme should not extend to incentives or concessions explicitly provided for in tax laws.[154] Otherwise, it would be against the very

[147] Karmen Mrakovčić, 'Effectiveness of the General Anti-Abuse Rule of the Anti-Tax Avoidance Directive' (Master's thesis, Tilburg University, 2019), p. 26.
[148] Income Tax Proclamation No. 979/2016, *supra* note 5, Art. 80 1(b) & (4) (b).
[149] Ibid.
[150] Richard Krever, 'General Report: GAARs' in Michael Lang et al. (eds), *GAARs – A Key Element of Tax Systems in the Post-BEPS World* (European and International Tax Law and Policy Series, vol.3, IBFD, Amsterdam, 2016), p.75.
[151] Income Tax Proclamation No. 979/2016, *supra* note 5, Art. 80 (2).
[152] Ibid.
[153] M. Greggi & K. Devos, 'A Comparison of Common Law and Civil Law Gaars: The Cases of Australia and Italy', International Tax Law Review, No.1, 2016, p.17–46.
[154] C. Waerzeggers & C. Hillier, *supra* note 141, p. 3.

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purpose of incentive provisions, which the legislator provides to promote certain behaviours or economic activities through tax incentives or concessions.[155] However, if the taxpayer seeks to obtain a tax benefit via incentive provisions in a manner that constitutes misuse or abuse of the tax law's provisions, it should attract the application of the GAAR.

Generally, the definition of tax benefit under the ITP is broader than the term 'tax avoidance' might imply. In this context, while this discretionary power is crucial for effectively addressing complex tax avoidance strategies that might otherwise escape scrutiny, it may also undermine the certainty and predictability of the tax system for taxpayers, as almost any arrangement that reduces, defers, or postpones tax liability could be classified by the authority as generating a tax benefit. Thus, the mere classification of an arrangement as a tax benefit could trigger the application of GAAR, potentially creating uncertainty regarding which transactions may be subject to challenge.

4.1.3. Purpose of the Scheme

The purpose of the scheme serves as a key analytical tool for assessing whether it was designed primarily to achieve a tax advantage rather than to fulfil genuine commercial or economic objectives.[156] In applying this requirement, countries adopt different approaches. For example, Canada adheres to the principle of economic substance over form, which assesses whether a transaction possesses genuine economic substance beyond its legal structure.[157] According to this approach, transactions may be disregarded, despite compliance with the letter of the law, if they lack bona fide purposes and are primarily driven by tax considerations. Conversely, the purpose test, adopted by Australia and the UK, examines the taxpayer's intent by asking whether the taxpayer's predominant aim was to secure a tax advantage rather than to pursue bona fide business objectives.[158]

[155] Ibid. For example, the ITP encompasses a range of tax incentives, including deductions (such as accelerated tax depreciation for certain encouraged assets or specific tax deductions for bad debts) and exemptions. These incentives are designed to encourage taxpayers operating in particular sectors. Additionally, the Ethiopian government has implemented a broad array of tax incentives aimed at attracting foreign direct investment (FDI) into the country. The preamble of the Investment Incentive Regulation highlights the government's objective of promoting investment and enhancing development equity. This is achieved through various tax incentives, such as income tax exemptions and tax holidays, offered to investors in select areas that stimulate investment, ultimately contributing to the equitable development envisioned by the legislator.

[156] E. D. Liptak, 'Purpose Requirement of the GAAR: Rethinking the "Subjective" vs "Objective" Debate, Business Tax and Company Law Quarterly', Vol. 14, No. 3, 2023, p. 1–14.

[157] J. Cassidy, 'To GAAR or Not to GAAR—That Is the Question: Canadian and Australian Attempts to Combat Tax Avoidance', Ottawa Law Review, Vol.36, 2004, p. 288-293.

[158] Ibid., p.293-298.

Coming to ITP, like most GAARs worldwide, the GAAR under Article 80 is fundamentally triggered by a purpose test, in which a transaction is labelled if the taxpayer's sole or dominant purpose is to obtain a tax benefit.[159] This makes determination of the taxpayer's true purpose central to the application of the GAAR. The pivotal question, therefore, is what standard should be applied to ascertain the taxpayer's true purpose. In this regard, because most commercial transactions are driven by multiple motives, including both tax and non-tax considerations, identifying the taxpayer's dominant purpose under Article 80 is inherently challenging. However, the provision appears to adopt a subjective test by requiring the tax authority to determine the taxpayer's purpose in undertaking the transaction rather than relying solely on objective characteristics.[160] Accordingly, the application of Article 80 depends largely on the interpretation of the surrounding facts and circumstances, leaving considerable room for administrative judgment. [161]

Besides, the provision, in determining the taxpayer's purpose, mandates that the authority have regard to the scheme's substance, reflecting the *substance-over-form* principle.[162] This allows the authority to look beyond the legal form and assess the transaction's economic reality. While adopting the substance of the scheme helps strengthen enforcement against transactions that exploit legal formalities, Article 80, unlike jurisdictions such as Canada, Australia, and South Africa, which supplement the purpose test with detailed statutory guidelines, offers no concrete criteria for assessing economic substance or dominant purpose. Thus, while Article 80 embraces the substance-over-form principle, it provides limited interpretative guidance, thereby advancing the tax authority with broad discretion in applying the GAAR.[163]

In sum, by empowering the authority with broad discretion to re-characterise transactions through the legal deeming of an event, Article 80 enables the adjustment of taxpayers' liabilities and the reallocation of tax positions among the parties concerned.[164] This framework, therefore, underscores the central role of GAAR as a potent regulatory instrument in tackling abusive tax avoidance practices, while simultaneously highlighting the significant discretionary power vested in the tax authority.

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[159] Income Tax Proclamation No. 979/2016, *supra* note 5, Art. 80 (1) (c).
[160] Krever, '*General Report: GAARs*', *supra* note 150, p. 7
[161] Ibid, p. 1; see also Waerzeggers & Hillier, *supra* note 141, p. 3.
[162] Income Tax Proclamation No. 979/2016, *supra* note 5, Art. 80 (1) (c).
[163] E D Liptak, *supra* note 156, p. 1–14.
[164] Technical Notes, *Federal Income Tax Proclamation No. 979/2016* (FDRE Ministry of Finance and Economic Cooperation, 2016) p. 189.

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4.2. Assessing Ethiopian Income Tax GAAR from a Tax Policy Perspective

GAAR under Article 80 of the ITP is a central legislative tool for addressing abusive avoidance schemes. Its adoption reflects the countries' broader commitment to protect the integrity of the tax system. Notably, in the current world, characterised by sophisticated tax-planning strategies, the introduction of GAAR serves as a residual safeguard by empowering tax authorities to recharacterize transactions that technically comply with the law but undermine its true purpose. From a tax policy perspective, however, the effectiveness of a GAAR depends not merely on its anti-avoidance ambition, but on its design, its alignment with core tax principles, and its balance with legal certainty.[165]

4.3. The Adoption of a Purpose-Centred Approach with Substantive Review

As discussed above, in terms of legislative design, the ITP adopts both a purpose test and substance-over-form principles. In doing so, the provision requires the tax authority to place the taxpayer's sole or dominant motive at the centre of the anti-avoidance enquiry. However, despite the provision further requiring the authority to have regard to the substance of the scheme, it neither defined that requirement nor accompanied it with interpretative guidelines, thereby making the GAAR assessment discretionary.[166] Thus, from a tax policy perspective, while the adoption of purpose and substance enhances the scope and flexibility of the GAAR, it broadens administrative discretion, which arguably reduces predictability in its practical application.

In comparison, in most other jurisdictions, i.e., Canada, South Africa, and Australia, to mention a few, income-tax GAARs are structured with additional qualifying guidelines governing their application.[167] While providing an exception or relief provision, Canadian GAAR, for instance, requires the authority or court to apply the GAAR only if the transaction results, directly or indirectly, in a misuse of the statute's relevant provisions.[168] Likewise, though with different terminology, South African and Tanzanian income tax GAARs empower their respective tax

[165] Judith Freedman, 'Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle', British Tax Review, No.4, 2005, p. 332-357.
[166] Hirko Alemu, *supra* note 20, p. 49.
[167] Lorika Anthea Tobias, 'An Analysis of the Evolution of the General Anti-Avoidance Rules and the Substance over Form Doctrine and Its Effectiveness to Combat Impermissible Tax Avoidance' (MSc thesis, University of Pretoria, 2014).
[168] Jinyan Li, 'Economic Substance: Drawing the Line Between Legitimate Tax Minimization and Abusive Tax Avoidance', Canadian Tax Journal, Vol.54, 2006, p. 35.

authority to apply the GAARs only if the transaction results in a 'misuse or abuse' of the statute.[169]

Similarly, the Australian GAAR, which adopts *the purpose* test to determine tax avoidance arrangements, as in Ethiopia, includes an exclusionary provision that exempts certain tax outcomes from classification as a *tax benefit*.[170] In addition, it requires the courts and the Commissioner of Taxation to consider eight specific factors to determine whether the taxpayer has such a dominant purpose.[171] These criteria are designed to guide the dominant purpose inquiry by grounding it in objective, observable considerations, thereby limiting purely subjective judgments. In general, the inclusion of specific guidelines and exclusion/exception clauses allows taxpayers to lawfully structure their affairs using these provisions without the risk of GAAR re-characterisation, thus promoting predictability and certainty for taxpayers and balancing the broad discretion created by GAAR.[172]

In contrast to other countries, Article 80 requires the tax authority to apply GAAR where the primary or dominant purpose of the scheme is to obtain a tax benefit, without additional interpretative guidance, such as indicators of abuse, statutory purpose analysis, commercial substance criteria, or exceptions.[173] This makes the design of the GAAR non-prescriptive, in that it provides broad language and discretion to the tax authority rather than a detailed, interpretative framework.[174] Thus, the absence of clearly defined qualifying standards arguably leaves the tax authority with broad and largely unchecked discretion in applying the GAAR,[175] which in turn would generate uncertainty regarding how purpose or motive will be assessed and what evidentiary threshold applies.

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[169] Salome Massaga, 'The General Anti-Avoidance Section: A Comparative Analysis of Section 80A of the South African Income Tax Act No. 58 of 1962 and Section 35 of the Tanzanian Income Tax Act No. 11 of 2004' (LLM thesis, University of Cape Town, 2015) p.30–36.

[170] Shu-Chien Chen, *supra* note 18, p. 91. The Australian GAAR specifically prevents GAAR from targeting the non-inclusion of income, the allowance of deductions, the incurrence of capital losses, or the granting of foreign tax credits from deliberate actions like entering agreements, making choices, declarations, elections, notices, or exercising options.

[171]These factors include how the scheme was entered or carried out, its form, timing, duration, tax outcome, changes in the taxpayer's and connected persons' financial positions, other consequences, and the relationship between parties.; Thaddeus Hwong and Jinyan Li, 'GAAR in Action: An Empirical Study of Transaction Types and Judicial Attributes in Australia, Canada, and New Zealand, Canadian Tax Journal', Vol. 68, 2020, p. 539.

[172] P. K. Schmidt & K. Buhmann, 'Taxation, General Anti-Avoidance Rules and Corporate Social Responsibility', FIRE Journal: UCPH Fiscal Relations Law Journal, No.2, 2020.

[173] G. Cooper, Tax Avoidance and the Rule of Law (IBFD Publication, 1997) p. 25.

[174] N. E. Suryani & K. Devos, 'The Proposed Design of an Indonesian General Anti-Avoidance Rule, World Applied Sciences Journal', Vol. 34, No. 12, 2016, p. 1785.

[175] Alexis Niall Brassey, Tax, GAAR and the Rule of Law (PhD dissertation, University of Cambridge, Faculty of Law, 2017) p.162.

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Here, it must be noted that a taxpayer whose transaction is subject to GAAR and consequently reassessed retains the right to challenge the assessment or request its amendment under Article 28 of the Tax Administration Proclamation (TAP).[176] The taxpayer may also object in accordance with Article 54 of the TAP and, where necessary, pursue an appeal within the tax administration under Article 56, or seek judicial review before a court of law pursuant to Articles 57 and 58, respectively.[177] Nevertheless, despite the availability of these remedies, the application of GAAR continues to generate uncertainty for taxpayers regarding the predictability and stability of their tax obligations.

4.4.Implications for the Core Tax Principles

From a tax policy perspective, adopting the purpose-and-substance-over-form principle under the ITP is not inherently problematic. These principles are widely recognised as legitimate and necessary in controlling abusive, yet sophisticated tax avoidance. The real challenge, however, arises from the absence of clear interpretive guidelines and explicit exceptions within the GAAR under Article 80. Thus, the lack of structured criteria arguably has significant implications for adherence to the core principles of Ethiopian tax policy, i.e., equity, certainty, efficiency, and neutrality, when applying the GAAR.

The primary and most immediate implication is evident in the principle of certainty.[178] Notably, while acknowledging that the tax authority should be vested with discretionary power to determine tax consequences, the absence of explicit interpretative guidelines or exceptions may lead to the provision being applied beyond its intended scope.[179] Such overextension arguably endangers the inclusion of legitimate commercial transactions that align with both the letter and the spirit of the law, thereby compromising principled and predictable enforcement of the GAAR.[180] Such ambiguity would further introduce uncertainty, making it difficult for taxpayers to structure their affairs with confidence while relying on legally available provisions.[181] Accordingly, the absence of explicit guidance and exemptions undermines the principle of certainty, which is fundamental in ensuring a predictable and stable tax system.

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[176] Federal Tax Administration Proclamation, 2016, Art. Art. 28, Proc. No. 983/2016, Fed. *Neg. Gaz.*, Year 22 No. 103.
[177] Ibid, Art. 54 & 56-58.
[178] Rebecca Prebble & John Prebble, 'General Anti-Avoidance Rules and the Rule of Law', *in The Routledge Companion to Tax Avoidance Research* (Routledge, 2017), p. 61–77.
[179] Taylor, *supra* note, 4, p. 85.
[180] Greg Travers, *The Tax Adviser's Guide to Part IVA: A Practical Guide to the Application of the General Anti-Avoidance Rule* (Tax Institute, Melbourne, 2014), p. 161.
[181] Jinyan Li, *supra* note 168, p. 42.

Again, despite the importance of GAAR in ensuring fairness by preventing taxpayers with access to sophisticated planning from obtaining disproportionate tax advantages.[182] The discretion granted to the tax authority in applying the GAAR without an anchor could, arguably, lead to uncertainty in its interpretation and application.[183] This uncertainty will result in unequal and selective enforcement of tax laws on taxpayers.[184] This is because only a portion of the pool of taxpayers who may have entered into similar transactions is subject to audit, and only some of those transactions might be identified as transactions to which the GAAR might apply, with the rule applied successfully only to a portion of this subset.[185] Thus, these procedural inconsistencies (the selective enforcement of the rule) ultimately undermine perceived fairness. Moreover, considering the cost of litigation, low- or middle-income taxpayers who lack the resources to challenge assessments may experience a disproportionate burden compared to well-resourced entities capable of litigation.[186]

Beyond concerns about certainty, a key implication of the GAAR's design relates to Efficiency. It authorises the tax authority to disregard artificial transactions that are primarily intended to secure tax advantages rather than genuine commercial outcomes, thereby ensuring economic efficiency. However, its subjective purpose test and undefined substantive requirement may raise administrative and compliance costs.[187] This, in turn, renders the enforcement of GAAR administratively intensive. Particularly in the absence of interpretive guidance, assessing taxpayers' intent and substantive facts may necessitate the tax authority's thorough investigation, comprehensive analysis of documentation, and, on occasion, litigation.[188] Equally, the inconsistent application of the rule, in turn, obliges the taxpayer to incur higher advisory and compliance costs to mitigate GAAR risk.

Similarly, GAAR under Article 80 is implemented to reinforce the principle of neutrality. Specifically, by targeting arrangements whose primary purpose is to secure a tax benefit, the GAAR ensures that business arrangements and financial decisions are motivated by genuine

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[182] Sigrid Hemels, 'Fairness and Taxation in a Globalized World' (26 February 2015) SSRN https://ssrn.com/abstract=2570750. Accessed Feb.16/2026.
[183] Alexander Ketut Wahyu Adiyanta, 'Assessing the Necessity of GAAR in Indonesia: A Comparative Evaluation of Global GAAR Frameworks and the Development of an Effective Statutory Model to Mitigate Tax Avoidance', Journal of Economics, Finance and Management Studies, Vol. 08, No. 02, 2025, p. 1367.
[184] E D Liptak, *supra* note 156, p. 1–14.
[185] Krever R, '*Policy Forum: Rethinking GAAR*, *supra* note 12, p. 620.
[186] Tax Administration Proclamation, 2016, *supra* note 176, Art. 2 (32).
[187] Matheus Peixoto Behrends, *supra* note 27, p. 2.
[188] Ibid.

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economic considerations rather than fiscal arbitrage. Consequently, this promotes neutrality by levelling the playing field and preventing any competitive advantage that may be obtained solely through aggressive tax planning. Nevertheless, the lack of clear interpretative guidelines and exceptions introduces uncertainty in applying the GAAR, ultimately fostering overly cautious behaviour among taxpayers and discouraging legitimate commercial transactions,[189] thereby undermining the very neutrality of the tax system the GAAR seeks to protect. [190]

Overall, from a fiscal policy standpoint, the ambiguity and uncertainty arising from GAAR's design endanger the fundamental principles of the income tax system, namely fairness, certainty, efficiency, and neutrality. Essentially, the implementation of GAAR functions as a tool that, although intended to protect the tax base, may unintentionally undermine the very integrity of the tax system it aims to defend. Therefore, unless the discretion granted to tax authorities is appropriately limited, governmental efforts to combat tax avoidance through legislative measures alone may inadvertently further complicate the tax system and sustain a cycle in which the tax system's objectives remain unfulfilled.

5. Concluding Remark

This article has critically examined tax avoidance and its implications for the Ethiopian tax system, with a particular focus on income taxation. Employing a doctrinal methodology within an analytical framework centred on core tax policy goals and principles, the article examined the effect of tax avoidance on key tax policy goals and principles, alongside an evaluation of whether the design of GAAR under Article 80 upholds or undermines the principles it seeks to protect.

Accordingly, this article highlights that even though the Ethiopian tax policy provides for generating adequate revenue, propelling economic growth, modernising tax administration as its fiscal objective, and embodying the principles of equity, efficiency, certainty, and neutrality, the long-standing threat of tax avoidance poses a serious threat to the integrity of the tax system. In response to this, the Income Tax Proclamation No. 979/2016 provides SAAR, including transfer pricing, thin capitalisation, and income splitting, to address such avoidance. It also introduced GAAR as a catch-all provision to address tax avoidance.

[189] Eshaan Singal, 'Navigating the Labyrinth: Understanding GAAR and Its Impact on Tax Avoidance' (8 June 2024) https://www.taxtmi.com/article/detailed?id=12680 , accessed on 21 February 2026.
[190] Taylor, *supra* note 4, p. 181.

In addition, this article argues that whilst SAARs are significant for enforcing specific measures against tax avoidance, their efficacy in countering sophisticated and intricate tax-avoidance strategies remains uncertain. Owing to this, the GAAR is regarded as the ultimate measure to protect the integrity of the income tax base and the overall tax system. Accordingly, this article investigates the design of the GAAR and its implications for maintaining the integrity of the tax system. The article argued that the GAAR stipulated under Article 80 of the ITP, aside from instructing the authority to consider the substance of the scheme, does not encompass explicit guidelines for evaluating whether the taxpayer's motivation for the undertaking is primarily or solely to obtain a tax benefit. This, in turn, potentially grants the tax authority substantial discretion and a degree of ambiguity in the application of the GAAR.

Of course, GAAR by its design should be flexible, and at times, vesting discretionary power in the tax authority is necessary to combat sophisticated and complex tax avoidance practices. Equally, the design of GAAR, while flexible and discretionary, should also provide taxpayers with assurance that their arrangements fall outside the GAAR's scope. In this regard, specific guidelines and exemption rules are used as primary tools by countries such as Australia, Canada, and South Africa to balance the tax authority's discretion in applying GAAR. By contrast, the article argued that the absence of exemptions or interpretive guidelines in Article 80 of the ITP arguably entrusts the tax authority with excessive discretion. This unfettered discretion, coupled with underdeveloped tax administration, would arguably breed uncertainty and lead to uneven and selective enforcement of the GAAR. This, in turn, arguably, undermines the foundational principles of the tax system, such as equity, certainty, efficiency and neutrality, which GAAR is intended to protect.

Hence, to mitigate tax avoidance while achieving the GAAR's intended objectives, this article recommends providing specific guidelines for the tax authority to determine whether the taxpayer's motive was solely or predominantly to obtain a tax benefit. These specific measures would at least ensure that transactions made solely for tax advantage from bona fide business purposes are easily and coherently determined. Furthermore, the article recommends the tax authority to interpret and implement the rules in harmonious alignment with bedrock tax principles, including equity, certainty, simplicity, and neutrality. This, in turn, would effectively curb abusive tax avoidance practices while qualifying the tax authority's discretion.

Conflict of Interest

The author declares no conflict of interest.