Transitional Years in Business Income Taxation under the Ethiopian Income Tax Law: A Case Comment

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Abstract

Profit taxes conventionally are paid annually. However, in case of a change in taxpayers' accounting years, the time between the end of the last year and the beginning of the new year is taxed separately as a transitional year. This comment addresses the issue of whether a change in tax rates can have a similar effect of creating two separate transitional years within a tax year. To this end, a review has been made of the relevant provisions of income tax law, related literature, and comparative lesson from the U.S. experience. A dispute occurred in ERCA v MIDROC Gold (Federal Supreme Court Cassation Division, File No. File No. 130705,07 Sep. 2017) because the mining income tax rate was reduced from 35% to 25% on 26 July 2013, bifurcating the tax year of 2013. The Federal Tax Appeal Commission, the Federal High Court, the Federal Supreme Court, and the Federal Supreme Court Cassation Bench all decided that mining income taxes are paid on the aggregate annual taxable income not by dividing the year into months. Although the mining income tax law has been incorporated into the new income tax law since 2016, the relevance of the precedent in this case that tax years are indivisible endures. This author disagrees with the above decisions and argues that a clear provision in the income tax law for transitional years in case of a change in tax rates effective in the middle of tax years is necessary.

Keywords: *Business income, tax year, accounting period, tax rate, transitional tax year*

Introduction

The main theme in this article is whether tax years in the taxation of business income are divisible. It has to do with the triadic interplay between the tax year, annual taxable income, and the tax rate applicable for the determination of the annual tax due. Writing this article is oriented by a case. A dispute arose between *ERCA vMIDROC Gold*,[1] whether two tax rates can apply in the determination of MIDROC Gold Mines PLC (hereinafter MIDROC Gold)'s income tax for the tax year of 2013. The dispute followed a mining income tax rate reduction from 35% to 25% in July 2013.[2] At the heart of the dispute was whether the tax year can be divided into two in order to apply these two tax rates in this single tax year. The Ethiopian Revenues and Customs Authority (hereinafter ERCA) argued that the tax year is divisible and that the tax should be computed by applying the 35% and 25% tax rates using the proportion method and summing these two proportions for the total annual tax. MIROC Gold argued for the indivisibility of the tax year and claimed that the new 25% tax rate prevailed in the tax year.

As can be seen from the laws, the 25% rate was effective from 26 July 2013.[3] This shows that the 35% rate was effective through 25 July 2013. Accordingly, it seems imperative for the application of these two rates in the tax year to be a point of dispute. The Federal Tax Appeal Commission (FTAC), the Federal High Court (FHC), the Federal Supreme Court (FSC), and the Cassation Division of the FSC (Cassation Bench) decided for MIDROC Gold. The purpose of this comment is to examine the appropriateness of these decisions in light of the relevant provisions of the relevant law and accepted rules of statutory interpretation, particularly from the perspective of whether tax years are absolutely indivisible. Although similar experiences in this regard seem limited, the experience of the U.S.A. has also been consulted.

The article has four sections. Section one presents the facts of the case and the rulings of the judicial organs. Section two presents a brief discussion about transitional tax years in the determination of profit taxes. This section expounds that although conventionally business income taxes are paid every twelve months, there are exceptions for business income taxes to be

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[1] Ethiopian Revenues and Customs Authority *v* MIDROC Gold Mines PLC, Federal Supreme Court Cassation Division, File No. 130705, decision of 07 Sep. 2017(30 Meskerem 2010 E.C) (Unpublished) (hereinafter called *ERCA v MIDROC Gold*).

[2] Mining Income Tax (Amendment) Proclamation, Proclamation No. 802/2013, Fed. Neg. Gaz., Year 19, No. 58, (hereinafter called Proc. No. 802/2013), Article 2;Mining Income Tax (Amendment) Proclamation, Proclamation No. 23/1996, Article 2, Fed. Neg. Gaz., Year 2, No. 11, (hereinafter called Proc. No. 23/1996).

[3] Proc. No. 802/2013, *Id*., Article 3.

paid in times less than twelve months. Section three presents the author's comments and analysis of the case. It is argued here that the way the case was settled unduly applied the new tax rate retroactively and at the same time failed to strike the proper balance between the interests of the parties to the litigation. Section four presents some prospects for the future. It argues that to avoid fairness problems which are inescapable consequences of the precedent in *ERCA v MIDROC GOLD* the income tax law should be revisited to clearly provide for the application of transitional tax years in cases of change in tax rates amidst tax years. Finally, the article ends with a conclusion.

1. *ERCA v MIDROC Gold*: Summary of Facts and Court Rulings

Before 1993, mining income was taxed under the main income tax law, Proc. No. 173/1963, although with a different higher rate of 51%.[4] When the special mining tax law was introduced in 1993 by the Transitional Government of Ethiopia, the rate was provided to be 35% for small-scale mining and 45% for large-scale mining.[5] Through time, the tax rate for income from large-scale mining was consecutively reduced to 35% in 1996[6] and again to 25% in 2013.[7] The new re-amendment to the mining income tax law, which reduced the tax rate from 35% to 25%, was

[4]Tadesse Lencho, *Towards Legislative History of Modern Taxes in Ethiopia, 1941-2008*, Journal of Ethiopian Law, Vol. 25, No. 2, 124 (2012).

[5] Mining Income Tax Proclamation, Proclamation No. 53/1993, Neg. Gaz., Year 52, No. 43, (hereinafter called Proc. No. 53/1993), Article 3. When the FDRE Constitution was adopted in 1995, while the power to tax income from small-scale mining operations is given to the states, the power to tax income from large-scale mining operations is given jointly to the Federal Government and the sates. See FDRE Constitution, Article 97(8) cum Article 98(3.)

[6] Proc. No. 23/1996), supra note 2, Article 2.

[7] Proc. No. 802/2013, supra note 2, Article 2. Following the new income tax law that has been enacted in 2016, the mining taxation has been incorporated back to the income tax law, with lower tax rate of 25%. See Federal Income Tax Proclamation, Proclamation No. 979/2016, Fed. Neg. Gaz., Year 22, No. 104 (hereinafter called Proc. No. 979/2016), Article 37(3) and 100(1)(b). Whether the continuous reduction of mining tax rates for large-scale mining from 45% to 35% and further to 25% was backed by dictating economic realities seems questionable. Usually, the reasons for enacting or amending a law are highlighted in preambles or separate object clauses. Neither of the amendments to the mining tax law, however, had stated reasons. Only roughly expressed in the preambles of both amendments was the fact that amending the law was necessary. See Proc. No. 23/1996, supra note 2 and Proc. No. 802/2013, supra note 2, Preambles. Moreover, while mining taxation has been incorporated to the income tax law, it does not seem there is sufficient reason to justify taxing mining income at 25% whereas other corporate profits are taxed at 30% rate. See Proc. No. 979/2016, *Id*., Compare Article 19(1) and Article 37(3). Lowering mining tax rate is not, however, unique to Ethiopia. Studies show that African countries, generally, impose lower corporate tax rates for mining than the general tax regime, and particularly, African countries under tax Multinational Corporations involved in the mining sector. See M. Moore et. Al., *Taxing Africa: Coercion, Reform and Development*, 89-111(London: ZED Books, 2018) (hereinafter called Taxing Africa) and Bertrand Laporte, Céline De Quatrebarbes and Yannick Bouterige, *Mining Taxation in Africa: The Gold Mining Industry in 14 Countries from 1980 TO 2015*, (2017) <halshs-01545361> at 12.

effective from 26 July 2013, i.e., almost bifurcating the tax year of 2013 at the middle.[8] Following this, MIDROC Gold reported that its taxable income for the tax year of 2013 was ETB 1, 976, 578, 000.40 (One Billion Nine Hundred Seventy-Six Million Five Hundred Seventy-Eight Thousand Birr and Forty Cents). Then, having computed its tax liability at the rate of 25%, it reported that the tax due for it to pay would be ETB 494, 144, 500.10 (Four Hundred Ninety-Four Million One Hundred Forty-Four Thousand Five Hundred Birr and Ten Cents). However, after stating that it had paid ETB 500, 000, 000.00 (Five Hundred Million Birr) withholding taxes in advance, it claimed a refund of ETB 5, 855, 499.90 (Five Million Eight Hundred Fifty-Five Thousand Four Hundred Ninety-Nine Birr and Ninety Nine Cents).

ERCA's Large Taxpayers Branch Office Tax Assessment and Collection Department, however, revised MIDROC Gold's tax declaration. It divided the taxable income that MIDROC Gold reported into two proportions and computed the tax for the income generated from 01 January to 25 July (206 days) at a 35% rate on the one hand and the income generated from 26 July to 31 December (159 days) at 25% rate using proportion method. Taking the sum of these two proportions, it decided that the tax due was ETB 605, 699, 313.12 (Six Hundred Five Million Six Hundred Ninety-Nine Thousand Three Hundred Thirteen Birr and Twelve Cents). The proportional calculation it used was:

$$1{,}976{,}578{,}000.40 * 206 * 35\%/365 = 390{,}441{,}846.02$$

$$1{,}976{,}578{,}000.40 * 159 * 25\%/365 = 215{,}257{,}467.10$$

$$390{,}441{,}846.02 + 215{,}257{,}467.10 = 605{,}699{,}313.12$$

Then, deducting the withholding tax that MIDROC Gold declared that it had paid, the Department computed an extra tax due of ETB 105, 699, 313.12 (One Hundred Five Million Six Hundred Ninety-Nine Thousand Three Hundred Thirteen Birr and Twelve Cents). Adding late payment interest and a penalty it noticed MIDROC Gold to pay ETB 112, 773, 768.14 (One Hundred Twelve Million Seven Hundred Seventy-Three Thousand Seven Hundred Sixty-Eight Birr and Fourteen Cents) tax. MIDROC Gold appealed to the Tax Review Committee within ERCA's Head Office, which confirmed the tax decision. MIDROC Gold, then, appealed to the

[8] Proc. No. 802/2013, supra note 2, Article 3.

FTAC, which reversed the Review Committee's decision.[9] ERCA appealed to the FHC. The FHC,[10] FSC[11], and the Cassation Bench[12] respectively affirmed the FTAC's decision.

Throughout the litigation, ERCA argued that since Proc. No. 802/2013 which provided for a 25% tax rate was effective only from the time of its publication in the Federal Negarit Gazeta on 26 July 2013, Proc. No. 23/1996 which provided for a 35% tax rate was effective in the time from 01 January to 25 July. According to this, ERCA argued, these two rates were effective in their time sphere within the same tax year. It added that applying the new law, i.e., Proc. No. 802/2013 retroactively beginning from 01 January 2013 was against the provision of the Proclamation, therefore, the tax should be determined in two proportions, then, these two proportions should be summed up for the annual tax due. On the contrary, MIDROC Gold argued that since the tax rate was amended before the tax year of 2013 was finalized, the prevailing tax rate for the whole tax year of 2013 was 25%, not 35%. MIDROC Gold added that so long as the tax has to be determined based on the aggregate amount of the annual taxable income, no provision in the law allowed dividing the tax year into two fractions of time and computing the tax payable based on two different tax rates.

The FTAC, FHC, FSC, and the Cassation Bench reasoned that the mining income tax law, issued in consideration of the special nature of mining income taxation, provided for the accounting year for mining income taxation to be the Gregorian calendar year ending on 31 December. They also added that the mining income tax law provided for mining income tax to be determined on annual basis calculating the annual aggregate amount of taxable income after all allowable deductions are subtracted from the annual gross income not by dividing the tax year into months. Accordingly, they applied the 25% rate for the total annual tax. The author disagrees with the view that the tax year is indivisible and particularly with the way the case has been settled. The concern of this comment is not only the way the case was settled but the case's future implications. As it will be made clear in the discussions below, since 2016 the mining income tax law has been incorporated into the new income tax law, the precedent in this case that tax years are indivisible will have a bearing effect not only on the mining business but also on

[9] MIDROC Gold *v* ERCA, FTAC, File No. 950, decision of 13 Nehasie 2007 E.C., (Unpublished)
[10] ERCA *v* MIDROC Gold, FHC, File No. 170680, decision of 03/05/2008 E.C., (Unpublished)
[11] ERCA *v* MIDROC Golg, FSC, File No. 123093 decision of 22/09/2008 E.C., (Unpublished)
[12] FasikaTadesse, *Midroc Comes Out Victorious in Tax Dispute*, Addis Fortune, [Vol. 18, No. 914] Oct 30, 2017, availabe at https://addisfortune.net/articles/midroc-comes-out-victorious-in-tax-dispute/, accessed on 25/10/2018, (hereinafter called FasikaTadesse).

the taxation of other business income. This being as it may, is there any legal or scientific basis for the argument that tax years are indivisible? Let us see this in the next section.

2. Tax Years in Business Income Taxation: Between Annual Taxes and Transitional (Short) Tax Periods

According to conventional knowledge, taxes on the profit from business operations are paid for a twelve months period called a tax year.[13] According to this, profit taxes are assessed and determined after all deductible costs and expenses are deducted from the gross income generated in the respective tax year on annual basis.[14] This twelve months period is called the "normal tax year."[15] This normal tax year is oftentimes aligned with the calendar year or the government's fiscal year.[16] Alignment of the tax year with the government's budget year is common for those taxpayers who did not maintain books of account and records for their tax purposes.[17] However, different jurisdictions also allow their taxpayers to opt for another twelve months of tax year than the calendar year or government's fiscal year and to change their accounting year.[18] Especially, taxpayers who are required to keep books of account and records and hence have to determine their incomes and deductions accordingly are allowed to have their own taxable year coinciding with their accounting year.[19] It has to be noted here that in the change from one tax year to another, there may be lacunae for taxpayers to escape payment of taxes due, and hence tax jurisdictions do control the process of the change in tax years by setting application procedures and requirement for taxpayers to demonstrate the reasons for the change.[20]

The case for the unity of the tax year - the payment of profit taxes annually coinciding with the calendar year, the government's fiscal year, or the taxpayer's accounting year - can be defended from the perspective of the principle of simplicity in taxation.[21] The demand for simplicity in taxation is an age-old principle. For example, as early as 1662 William Petty,

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[13] Reuven S. Avi-Yonah, Nicola Sartori, and Omri Marian, *Global Perspectives on Income Taxation Law*, 77-80 (Oxford University Press, 2011) (hereinafter called Global Perspectives on Income Taxation Law)
[14] *Id*., at 77. See for example of the Ethiopia case Proc. No. 979/2016, supra note 7, Articles 18-27.
[15] Lee Burns and Richard Krever, *Taxation of Income from Business and Investment*, in Tax Law Design and Drafting (volume 2; International Monetary Fund: 1998; Victor Thuronyi, ed.,) (hereinafter called Taxation of Income from Business and Investment) at 20.
[16] *Ibid*.
[17] Global Perspectives on Income Taxation Law, supra note 13, at 77.
[18] Taxation of Income from Business and Investment, supra note 15, at 20-21.
[19] Global Perspectives on Income Taxation Law, supra note 13, at 77.
[20] Taxation of Income from Business and Investment, supra note 15, at 21.
[21] Global Perspectives on Income Taxation Law, supra note 13, at 77 & 78.

demanding proper timing to tax collection for simplicity in tax compliance, said that the 'Prince' cannot make a judgment of the proper season to demand his presents for not knowing the trade.[22] Simplicity is measured in terms of collection/administrative costs for governments and compliance costs for taxpayers.[23] The government's administrative costs include the time and money wasted in the implementation of the tax system.[24] Taxpayer's compliance costs, on the other hand, include "the value of … time spent learning tax law, maintaining records for tax purposes, completing and filing tax forms, and responding to any correspondence from the tax administration."[25] Compliance costs also include "amounts paid to others to conduct any of these tasks" on the taxpayer's behalf.[26] The principle of simplicity requires the tax law to be easily comprehensible, and provisions for exemptions, exclusions, deductions, and preferential rates in the law to be limited.[27] This promotes taxpayer compliance because taxpayers have few complex provisions to learn and comply with, and minimizes administrative costs because tax personnel has few complex provisions to understand and enforce.[28] This also broadens the tax base allowing optimal taxes to be collected with lower tax rates.[29] The simplicity of the tax law also helps reduce tax expenditures which are tax losses due to special provisions allowing exemptions, exclusions, deductions, credits, or preferential rates.[30] The determination of the tax year to be on annual basis – one way to make the tax system simple - also contributes to reducing the government's administrative costs and taxpayers' compliance costs.[31]

In another way, as exceptions to the twelve months tax year, there are cases where profit taxes can be determined and paid for a period of less than a year (less than twelve months). These exceptions may be named differently in different tax jurisdictions. For example, in the USA they are called shorter tax periods.[32] In the Ethiopian case, they are interchangeably called

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[22] William Petty (1662), *A Treatise of Taxes and Contributions*, in Steven G. Medema and Warren J. Samuels (eds.), The History of Economic Thought: A Reader, 48-49 (Rutledge, Taylor and Francis Group, 2003).
[23] Global Perspectives on Income Taxation Law, supra note 13, at 15-16; Joshua E Greene, *Public Finance: An International Perspective*, 110-111(World Scientific Publishing Co. Pte. Ltd., 2012)(hereinafter called Greene, Public Finance).
[24] Global Perspectives on Income Taxation Law, supra note 13, at 16.
[25]*Id*., at 15-16.
[26]*Id*., at 16
[27]Greene, Public Finance, supra note 23, at 110.
[28] Ibid.
[29] Ibid.
[30] Ibid.
[31] Global Perspectives on Income Taxation Law, supra note 13, at 77 & 78.
[32] See Internal Revenue Service, Department of Treasury, *Accounting Periods and Methods*, 2-3 (Publication No. 538, Rev. Nov. 1995)(hereinafter called Accounting Periods and Methods).

transitional accounting years and transitional years.[33] There may be various reasons for adopting such provisions for transitional years. On the one hand, transitional years prevent transition problems such as an extended tax year above twelve months in case taxpayers change their accounting year from one to another.[34] For example, assume that XYZ Co. PLC is an Ethiopian registered business firm involved in copper mining. It used to use the Gregorian calendar year beginning on 1st January to 31st December. If it changes its accounting year to the fiscal year beginning on 1st Hamle (July), it will have a transitional year from 1st January to June 30.[35] For the case of the transitional year in case of change in the taxpayer's accounting year, the transitional year is defined as a period "commencing at the end of the taxpayer's last complete tax year to the beginning of the changed tax year."[36] "Non-existence in the entire tax year" is also a reason for the application of a short or transitional tax year.[37] The case for this is that if a business, be it that of a sole proprietorship or a company begins operation amidst the tax year, the time from the beginning of its business to the end of the tax year will be taxed separately and independently for itself, and this is called short tax period.[38] These all show that although corporate income taxes, conventionally, are paid annually, the tax year is not an absolutely indivisible divine unity.

An issue of interest here is whether short or transitional tax years can apply to solve transition problems connected with a change in tax rates in the middle of a tax year or anytime before a tax year is finalized. Literature and comparative experience in this perspective seem scanty. However, the tax system in the U.S.A. has a solution for this. The Internal Revenue Code of the U.S.A. provides that "[I]f any rate of tax … changes, and if the taxable year includes the effective date of the change …tentative taxes shall be computed by applying the rate for the period before the effective date of the change, and the rate for the period on and after such date …."[39] According to this, "the tax for such taxable year shall be the sum of that proportion of each

[33] Proc. No. 979/2016, supra note 7, Article 2(21)(c) and Article 28(5). In the former law the term "transitional year" was used. See Income Tax Proclamation, Proclamation No. 286/2002, Fed. Neg. Gaz., No. 8, Year 34(hereinafter called Proc. No. 286/2002)(now repealed), Article 64(5);Taddese Lencho, *Ethiopia-Corporate Taxation* (IBFD, 2014) at 21.
[34] Taxation of Income from Business and Investment, supra note 15, at 21; 26 U.S. Code § 441(a)(1); Global Perspectives on Income Taxation Law, supra note 13, at 78.
[35]Example adopted from Accounting Periodsand Methods, supra note 32, at 3.
[36] Taxation of Income from Business and Investment, supra note 15, at 21.
[37] Accounting Periods and Methods, supra note 32, at 3.
[38] Ibid; 26 U.S. Code § 441(a)(2); Global Perspectives on Income Taxation Law, supra note 13, at 78.
[39] 26 U.S. Code § 15 (a)(1).

tentative tax which the number of days in each period bears to the number of days in the entire taxable year."[40] This provision clearly shows that the tax year is not indivisible. If the tax rate changes before the tax year end, possibly creating two conflicting tax rates in the same tax year, the tax year is divided into two short tax years to enforce the two tax rates, determining provisional taxes for each fraction time, and the tax due for the entire tax year is calculated by taking the summation. The term used in this provision is not "transitional tax year" or "transitional year", but rather "tentative taxes". However, whether it is called "transitional year," "transitional tax year," "transitional period," "short tax year," or "tentative taxes" does not make a difference. The effect is that the tax year is divided into two to enable the application of two different tax rates within a single tax year.

The Ethiopian income tax law has used the terms "tax year" and "accounting year" nearly interchangeably. For this, on the one hand, it defines "tax year" and it provides that while the tax year for sole proprietors is the government's fiscal year covering from Hamle 1 to Sene 30 Ethiopian calendar, with the possibility of change upon written permit by the tax authority, the tax year for corporate businesses is their accounting year.[41] With respect to the accounting years of taxpayers, it provides that sole proprietors use the fiscal year as their accounting year unless they are allowed to use a different time by the tax authority in writing whereas corporate businesses use their own accounting year.[42] It also provides that the accounting year is a twelve months period where taxpayers account for their financial balance.[43] It prohibits taxpayers from changing their accounting years except upon prior written permission from the tax authority and upon fulfillment of the conditions the latter may attach.[44] The tax authority may revoke the permission to change the accounting year if taxpayers fail observance of the conditions attached thereto.[45] With respect to the application of transitional years, the law provides that in case taxpayers change their accounting years, the time between the last tax year and the beginning of the new tax year is treated separately as a full tax year and is called a "transitional year."[46] Although the law is silent, taxpayers who begin running a business amidst a tax year will be

[40] *Id., § 15 (a)(2).*
[41] *Proc. No. 979/2016*, supra note 7, Article 2(21)(a) & (b).
[42] *Id.,* Article 28(1)(a) & (b).
[43] *Id.*, Article 28(2).
[44] *Id.*, Article 28(3).
[45] *Id.*, Article 28(4).
[46] *Id.*, Article 28(5). A similar provision was included in the former law. See *Proc. No. 286/2002*, supra note 33, Article 64(5).

taxed for a period of fewer than twelve months beginning from the date of their start-up for business to the end of the tax year, whether we call this a short tax year as is called in the U.S.A. or a transitional year.

An issue here is whether a transitional year can apply due to a change in tax rates in the middle of a tax year bifurcating the tax year. The author believes that the provision for transitional years with respect to business income taxation in cases of change in the taxpayer's accounting year shall apply to cases of change in tax rates effective amidst a tax year. For this, incorporating a clear provision in the Income Tax Proclamation through amendment may be imperative. Courts could also do this through interpretation by analogy.[47] Analogy means treating case alike if their similarity outweighs their difference.[48] As we have seen earlier, the purpose of the provision in the income tax law for a transitional tax year is to avoid transitional problems of confusion and controversy as to how the change in the accounting year shall be treated for the purpose of profit tax determination. Similarly, the determination of annual tax is the tripartite interplay between "tax year", "taxable income" and "tax rate." This means that the tax due for a tax year is computed by the multiplication of the profit (taxable income) earned in the tax year by the tax rate provided for in the law. Then, if the change of the accounting year is treated by the application of a transitional tax year, the same should similarly apply to the change of tax rate, for similar transition problems are likely to occur in cases of change in tax rates in the middle of tax years. What has to be noted here is also that although the twelve months tax year has significance for simplicity of tax administration and compliance, dividing the tax year into two fraction times in exceptional circumstances will never create any visible inconvenience. It is also practically being implemented in cases of change in taxpayers' accounting years and there is no known problem to be created when it is used in case of change in tax rates.

A typical case demanding the division of the tax year into two transitional tax periods due to a change in the tax rate was *ERCA v MIDROC Gold*. It is unfortunate, however, that the Cassation Bench has wasted its opportunity to examine the case duly from this perspective and decided it simply limited to the reading of the seemingly clear but shallow provisions of the law. The following section presents the author's analysis and comments on the case briefly.

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[47] What is only prohibited is establishing crimes by analogy. See, for example, Criminal Code of the Federal Democratic republic of Ethiopia Proclamation No. 414/2004, Fed. Neg. Gazeta, Article 2(3).

[48] John H. Farrar, *Reasoning by Analogy in the Law*, in Bond Law Review, Vol. 9: Iss. 2, Article 3, 149 (1997) (hereinafter called John H. Farrar)

3. Critique on *ERCA v MIDROC Gold*

ERCA v Midroc Gold had attracted divided opinions. When it was pending in the FTAC, many of ERCA's Public Prosecutors opined that the law was plain and the tax should be calculated using the two tax rates whereas others argued that the purpose of the new law was to favor the taxpayer by lowering the tax rate, hence the tax for the whole tax year should be calculated at 25% rate.[49] The author also observed that legal officers in the Ministry of Revenue, as currently is, agreed with the decisions doubting that two tax rates can apply in a single tax year.[50]According to the author's view, there is no legal provision or science in taxation and tax law which prohibits dividing the tax year into two, and hence, the decisions of the FTAC, the FHC, the FSC, and the Cassation Bench are indefensible for the following two reasons.

First, applying the 25% rate retroactively from 01 January 2013 goes against the express provision of Proc. No. 802/2013 for it to be applicable from 26 July 2013. If the retroactive application of the 25% rate were the parliamentary intent, expressly providing so would have been possible. Although there is no prohibition of retroactivity of tax statutes in Ethiopia, according to the author's view, tax laws should not be applied retroactively, at least, in cases the legislature did not provide so. The debate in other countries, similarly, is also on the validity of retroactive tax bills enacted by the legislature.[51]There is no issue of retroactive application of tax statutes the retroactive application of which is not provided by the legislature. In our case, the parliament did not provide for the 25% rate to be applied retroactively from 01 January. A tax bill can also be made to begin application from the first day of the tax year either retrospectively or prospectively. For example Proc. No. 286/2002 was provided to prospectively apply for incomes generated from 01 Hamle 1994 E.C., i.e., for the fiscal year of 1995 E.C. whereas it was in force from 27 Sene 1994 E.C.[52] This was not the case in the case of our discussion. In this case, Proc. No. 802/2013 had been unduly applied retroactively from the beginning of the tax

[49] The author was one of the ERCA's Public Prosecutors assigned to the litigation in this case, and, had been discussing on the matter with many of the Public Prosecutors who were in the ERCA's Head Office. For a report of different opinions after the case was decided by the Cassation Bench, see FasikaTadesse, supra note 12.

[50] The author, in the due course of writing this article, has discussed on the matter with former colleagues in the Legal Service Department of the Ministry of Revenues.

[51] For an earlier analysis on the issue in the case of U.S.A. for example, see Ralph R. Neuhoff, *Retrospective Tax Laws*, 21 St. Louis L. Rev. 001 (1935). There are also arguments that retroactive tax norms that affect taxpayers' rights are contrary to the principle of legal security in taxation. On the limits of the retroactive tax laws, see Agustin Jose Menendez, *Justifying Taxes: Some Elements for a General Theory of Democratic Tax Law*, 282-288 (Springer Science + Business Media Dordrecht, 2001).

[52] Proc. No. 286/2002, supra note 33, Article 120.

year of 2013, based on a wrong understanding that the tax year is indivisible and two tax rates cannot apply in one tax year.

Second, the FTAC, the FHC, the FSC, and the Cassation Bench failed to balance the interest of ERCA (tax authority) and MIDROC Gold (taxpayer). Balancing is settling conflicts between fundamental principles, both accepted in the legal system, by determining the proper boundary between them.[53] Its essence is that it is settling conflicts, not in an "all or nothing" approach or giving a zero value to either of the conflicting values.[54] The government's legal power to levy and collect taxes on the one hand and taxpayers' legal right to pay only taxes due according to law always conflict.[55] The case of our discussion is a manifestation of the conflict between the government's power to tax and the taxpayers' rights regarding the enactment, application, and interpretation of taxing bills. However, while striking a balance between the interests of ERCA, i.e., collecting taxes according to the law, and MIDROC Gold, i.e., paying taxes due only according to the law was required and simply possible, neither of the FTAC, the FHC, the FSC, and the Cassation Bench tried to. In this case, ERCA lost totally and MIDROC Gold took all. What has to be understood, however, is that this precedent, unless changed, may disadvantage taxpayers. For example, if the tax rate increases in the future in a similar way, taxpayers will be taxed according to the higher rate for the whole tax year. This argument was raised by the ERCA. The FTAC, the FHC, the FSC, or the Cassation Bench did not try to understand the issue.

An issue possible to arise here is whether these judicial organs can balance conflicting interests appearing before them for their decision apart from interpreting and applying the law. This question may relate to the constitutional debates on the role of the judiciary in legal engineering. However, without needing to delve into these debates, although the judicial business of balancing conflicting interests, oftentimes, is raised in connection to constitutional interpretation, it suffices to say here that balancing is also important in the day-to-day judicial duty of adjudication. It is part of any legal system and is effectuated by choosing the decision that yields the greatest benefit from among two or more possible ways of legal construction.[56] If we adhere to the legal model of judicial responses to legislative ambiguity, as the purpose of the

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[53] Aharon Barak, *The Judge in A Democracy*, 164-167 (Princeton and Oxford: Princeton University Press, 2006) (hereinafter called The Judge in A Democracy).

[54] Ibid.

[55] For an historical account on this, see Chantal Stebbings, *The Victorian Taxpayer and the Law: A Study in Constitutional Conflict* (Cambridge University Press, 2009).

[56] See Alexander Aleinikoff, *Constitutional Law in the Age of Balancing*, in The Yale Law Journal, Vol. 96, Number 5, 943, (April 1987).

law is to govern human activity, the goal of legal interpretation is to bridge the gap between the law and social behavior.[57] In bridging the gap, judges are required to choose the way of statutory construction that best resolves the dispute before them giving due weight and examination to all possible reasons when the law is indeterminately leading to more than one infallible interpretation with different outcomes.[58] Through this, they can come to a conclusion that best balances the conflicting interests involved in the cases they are faced with to settle.

As already stated above, when the case of our discussion, *ERCA v MIDROC Gold*, was underway, some argued that the relevant law was clear, and so needed no interpretation, and that the case has to be decided in favor of the tax authority. For the author, however, the relevant legislation creates ambiguity not only as to which tax rate would apply to the tax year of 2013 but also in the process of determination of the taxable income. The taxpayer (MIDROC Gold) argued that before thinking about the applicable tax rate the annual taxable income should be determined by deducting all allowed deductions from the gross sales. Then, it goes, the issue of which tax rate to apply upon the taxable income of the tax year should follow, for which it argued the newly proclaimed 25% should prevail over the prior 35%. The tax authority (ERCA), on the other, argued that so long as there are two legally binding tax rates, we should divide the taxable income of the year along the line of the time these rates are applicable as per the law and determine the tax due applying these two rates respectively. Each party uses the law to support its interest. Pursuant to the provisions of the law, both arguments are not easily fallible. A certain way of construction was required to put a dividing line between these interests.

Now, the question comes: how should have the case been settled? Perhaps, the issue would not have occurred had the legislature provided for Proc. No. 802/2013 to be applicable either retroactively from the beginning of the tax year of 2013 or proactively from the beginning of the tax year of 2014. Now, the issue is how to fill this gap. Similar to interpretation in law, the interpretation of tax statutes is subject to debate.[59] On the one hand, based on the view that the

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[57] See The Judge in A Democracy, supra note 53, at 3-19 and Aharon Barak, *A Judge on Judging: The Role of a Supreme Court in a Democracy*, in Harvard Law Review, Vol. 116: 16,28-36 (2002). It is also important not to forget the attitudinal model to judicial responses to legislative ambiguity which holds that judges do exploit legislative ambiguity in the sense they "decide cases in ways that further their ideological preferences." For the review of legislative ambiguity and the judicial responses to it, see Adam C. Pritchard and Joseph A. Grundfest, *Statutes with Multiple Personality Disorders: The Value of Ambiguity in Statutory Design and Interpretation*, in Stanford Law Review, Vol. 54: 627,637-650 (Apr. 2002).

[58] Steven J. Burton, *Judging in Good Faith*, 3-34 & 38-61 (Cambridge University Press, 1992)

[59] The debates on interpretation in law vary between Textualism (New Textualism), Intentional-ism (Originalism) and to Purposive-ism regarding the substantive approaches of interpretation and between Strict Constructionist Rule,

taxpayer is a party weaker than the government as in penal laws, there is an argument that doubts in tax statutes should benefit taxpayers.[60] On the other, especially in connection to combating tax shelters, there is an argument for the purposive approach to the interpretation of tax statutes.[61] The author will never delve into the details of the arguments about whether or not the taxpayer is always weaker than the tax authority (government). Chinua Asuzu, one who opposes the argument in favor of taxpayers asked: "Is it necessarily correct to say that the taxpayer is always weaker than the Government? Is the Microsoft Corporation weaker than the Government of South Sudan?"[62] His allegation is true. Let alone in a young state like South Sudan, the lack of equipped human resources is one of the challenges for African countries to tax Multinational Corporations, especially those involved in the mining sector.[63] This being so, what has to be noted is that "there are no special principles of construction applicable only to fiscal legislation[s]."[64] Tax disputes can be settled using the approaches and canons of interpretation used in the interpretation of other statutes.

Accordingly, for the settlement of this case, the tax year of 2013 should have been divided into two transitional years. As already said above, in Proc. No. 286/2002, which was in force while the case was in litigation, it was provided that if the taxpayer's accounting year is changed from the Ethiopian budget year to the Gregorian calendar year or vice versa, the time between the last tax year and the beginning of the new tax year is taxed separately and named as a *transitional year*.[65] Similarly, the provision in the income tax law for a transitional tax year, which, as argued above is applicable to cases of change in tax rates, should have been applied to the change in the mining income tax rate in the case of our discussion. This argument is supported by the contrary reading of the provision in the mining tax law, which provided that

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Literal (Plain Meaning) Rule, Golden Rule, Mischief Rule and Rules of Analogy regarding the technical canons of interpretation. For example, see Aharon Barak, *Purposive Interpretation in Law*, 12-12 (Princeton and Oxford: Princeton University Press, 2005); The Judge in A Democracy, supra note 38; Chinua Asuzu, *Remember Lot's Wife! Interpretation of Tax Statutes*, available at http://ssrn.com/abstract=1920702, retrieved on 17/10/2018, (hereinafter called Remember Lot's Wife); and John H. Farrar, supra note 48.

[60] Florence N. Dollo, '*Tax Legislation and the Lawyer's Training Needs- An African Perspective*', cited in Remember Lot's Wife, *Id*., at 25.

[61] Shannon Weeks McCormack, *Tax Shelters and Statutory Interpretation: A Much Needed Purposive Approach*, University of Illinois Law Review, Vol. 2009, No. 3.

[62] Remember Lot's Wife, supra note 59, at 26.

[63] Taxing Africa, supra note 7, at 106.

[64] Vinelott J (1982), *Interpretation of Fiscal Statutes*, cited in Remember Lot's Wife, supra note 59, at 24.

[65] Proc. No. 286/2002, supra note 33, Article 64(5), emphasis added.

other tax laws cannot be applicable to matters covered by the mining income tax.[66] A contrary argument can be raised here that the provision for transitional years resulting from the income tax law could not apply to the taxation of mining incomes. Because, the mining tax law, had provided for the tax year to be the Gregorian calendar year beginning on 01 January and ending on 31 December for the purpose of mining income taxes.[67] However, it did not make a difference with respect to the fact that corporate profit taxes are payable annually.[68] It can easily be understood that the provisions in both laws for profit taxes to be paid on annual basis were provided with a presupposition that there will be a single tax rate applicable to the tax year without any controversy. Therefore, the unity of the tax year did not apply to cases where controversy arises due to the existence of two legally binding tax rates competing for application in a single tax year. According to this, the provision in the mining income tax law for the tax year to be the Gregorian calendar year did not preclude a change of tax rates in the middle of a tax year and the resultant controversy as to which tax rates could apply. Hence, the solution is the application of a transitional year by dividing the tax year into two using the date when the new law was proclaimed as a dividing line.

According to this, the tax year of 2013 should have been divided into two transitional tax years; the tax for the income earned between 01 January and 25 July should have been computed at a 35% rate, and the income earned between 26 January and 31 December at 25% tax rates respectively; and the total tax due for the tax year should have been the sum of the amounts determined for these transitional tax years. In this way, it was possible to avoid the undue retroactive application of the new law on the one hand and to strike a balance between the interests of the parties to the case on the other. More importantly, this would have been a precedent enabling us to avoid possible similar future controversies.

Lastly, a point that has to be raised is the misunderstanding on ERCA's part. According to the author's understanding, if the times from 01 January to 25 July and from 26 July to 31 December were treated separately as transitional tax years, the tax should have been computed by determining two separate taxable incomes for each transitional tax year vouching all transactions conducted within these transitional tax years, not by using proportion method. As already said earlier, however, ERCA, improperly, took the annual taxable income that MIDROC

[66] Proc. No. 53/1993, supra note 5, Article 14
[67] Id., Article 2(2).
[68] Compare Article 4 of *Proc. No. 53/1993, Id.*, with Article 18 of *Proc. No. 286/2002*, supra note 33.

Gold reported as an aggregate amount and divided it proportionally into two based on the number of days of the tax year. In addition to this, even throughout the litigation, although ERCA argued for the tax year to be divided into two and the two tax rates to be applied respectively, it did not expressly argue that the times from 01 January to 25 July and from 26 July to 31 December should be treated as "transitional tax years."Moreover, it did not argue that its argument was supported by the analogical interpretation of the provision for a transitional tax year in the income tax law in case of a change in the taxpayer's accounting year. Because of this, ERCA's argument to divide the tax year into two was seen as strange by the law. Had ERCA applied the treatment of transitional tax years properly in determining the tax and expressly argued for in the litigation, the author thinks, this might have helped the FTAC, the FHC, and the FSC or at least the Cassation Bench to think of the nature of the case.

4. Future Implications of *ERCA v MIDROC Gold*: The Need for Transitional Years in Business Income Taxation

ERCA v MIDROC Gold has an inescapable implication for the future. Whether the tax year can be divided into two in cases of change in tax rates amidst tax years will possibly continue to be an issue. Following the enactment of the new income tax law in 2016, the taxation of mining income has been incorporated back into the income tax law, however, with a lower tax rate of 25%.[69] On another way, to avoid possible controversies in case of disparity between the fiscal year and taxpayers' accounting year, the law provides that in case the taxpayers' accounting year did not conform to the fiscal year, the law applicable to the accounting year is the law applicable to the budget year finalized within the taxpayer's accounting year.[70] This provision is a new introduction by the new law. There was no similar provision in the former law. As one can easily grasp from its letter, this provision is a precursor to the possibility that disputes may arise due to the enactment of laws with an effective date beginning from the Ethiopian budget year. Let us use an illustration for this provision. Assume ABC Co. S.C. is a company running a telecommunication services business in Ethiopia. Its accounting year is the Gregorian calendar year beginning from 01 January to 31 December. On 30 Sene E.C., the Ethiopian government enacted a new tax law effective from the next day, i.e., 01 Hamle E.C. According to this

[69] See Proc. No. 979/2016), supra note 7, Article 37(3) and 100(1)(b).
[70] *Id*., Article 28(6).

provision, the new law will not apply to ABC Co. S.C.'s profit tax for the accounting year ending in the next 31 December. The older law will apply.

A little bit tricky issue can be raised here: does this provision apply for a change in law varying the preexisting provisions on imposition of taxes, exemptions, or tax rates whether by increasing it or reducing it? The rough answer for this is, inescapably, yes. According to this, the provision may seem to solve all possible controversies regarding the application of transitional tax years. However, the implementation of this provision will create two basic problems. The first possible problem arises when a new tax law is issued to be effective in the middle of the tax year dividing the accounting year of even those taxpayers using the fiscal year as their accounting year. Because no one will be certain that the legislature will always make its tax laws applicable from the beginning of the government's fiscal year. In this case, the dispute becomes unavoidable as to which law applies for the tax year. Resolving such the issue will not be possible unless there is a clear provision in the law or unless we can have a well-developed precedent that in case of similar disputes the tax year is divisible into two transitional years and both tax rates apply respectively, whether we call them transitional years, short tax years, temporary tax years or else. What is all needed is transitional problems like this should be solved by dividing the tax year and applying the relevant laws respectively.

The second possible problem relates to those taxpayers using an accounting year different from that of the fiscal year. In like cases, a dispute is potential because of the difference in the amount of tax to be due when assessed based on the old and new law. The best example of this can be the case of our discussion, *ERCA v MIDROC Gold*. To see the possible controversy, let us assume that the above provision was applicable to the case. Proc. No. 802/2013 with a 25% tax rate was effective from 26 July 2013, which is only days after the beginning of the fiscal year of the 2006 Ethiopian calendar. Needless to mention, the former law, i.e., Proc. No. 23/1996, with 35% was effective through 25 July 2013, which is only days after the end of the fiscal year of 2005 E.C. The debate in the case was which tax rate applies to the taxpayer's accounting year of 2013. It is also clear according to the newly introduced provision that the fiscal year finalized within the taxpayer's accounting year of 2013 was the fiscal year of 2005E.C., whereas the fiscal year of 2006 E.C. unquestionably, goes beyond the taxpayer's accounting year of 2013. According to this, it becomes clear that the former law providing for the 35% tax rate would apply. Therefore, it would have been taxed at a rate of 35% for the whole tax year of 2013.

Speaking from the letter of the law, this does not seem to have a problem. Because the law is clear. The problem with this provision, however, is not only that the taxpayer would claim to be taxed according to the latter law, simply because the latter law is advantageous to it. It will also raise the question of inequality in case of similar changes in the law in the future. Let us assume that a similar case to the case in the future. According to this those taxpayers using the Ethiopian fiscal year as their accounting year will be favored by the change in the law because they will be taxed according to the new law providing for a lower tax rate of 25%. Whereas those taxpayers using the Gregorian calendar years as their accounting year will be disadvantageous, because the new law issued in the middle of their accounting year will never apply to that accounting year, rather, the old law provides for a higher tax rate of 35% will apply for them to end of that accounting year. The six months period covered by the change in the tax rate goes advantageous to those taxpayers using the fiscal year as their accounting year and disadvantageous to those taxpayers using the Gregorian calendar year as their accounting year. The former pay less and the latter pay more, but for the same span of time.

To show the problem in terms of the amount of tax, let us see one hypothetical case once again. Assume the Ethiopian Parliament amends the income tax law to reduce the tax rate for companies involved in sectors than mining from 30% down to 25%, in order to make it equal with the income tax rate for mining companies to be effective beginning from 01 Hamle 2015 E.C (i.e., 08 July 2023). Assume also that EFG Co. PLC uses the Gregorian calendar year as its accounting year and earns a taxable income of 1, 976, 578, 000.40 (One Billion Nine Hundred Seventy-Six Million Five Hundred Seventy-Eight Thousand Birr and Forty Cents) ETB in its 2023 accounting year, i.e., the period from 01 January 2023 – 31 December 2023. According to the above provision, its income tax will be:

$$1,976,578,000.40 * 30\% = 592{,}972{,}400.12.$$

On the other side, the income tax for a company that uses the Ethiopian fiscal year as its accounting year for the tax year of 2016 E.C. fiscal year will be:

$$1{,}976{,}578{,}000.40 * 25\% = 494{,}144{,}500.10.$$

Unavoidably, EFG Co. PLC has to be taxed at a 30% rate for the time from 01 January 10 July 07, 2023, G.C.; however, it is visible that these two taxpayers pay different amounts of tax for the same span of six months time (i.e., the six months from 08 July to 31 December). This

inequality can be rectified by dividing EFG Co. PLC's accounting year of 2023 into two and letting it pay for two transitional years separately, its total annual tax being the sum. According to this, the tax for the time from 01 January to 07 July will approximately be:

$$1{,}976{,}578{,}000.40 * 30\% * \frac{187}{365} = 303{,}797{,}331.02.$$

Similarly, the tax for the time from 08 July to 31 December will approximately be:

$$1{,}976{,}578{,}000.40 * 25\% * \frac{178}{365} = 240{,}980{,}057.58.$$

The total income tax payable for the entire tax year, then, becomes:

$$303{,}797{,}331.02 + 240{,}980{,}057.58. = 544{,}777{,}388.60.$$

The 5% difference between the 30% and 25% tax rates leads to a difference of about 48,195,011.52 ETB in the amount of total annual tax., i.e.,

$$592{,}972{,}400.12 - 544{,}777{,}388.60 = 48{,}195{,}011.52$$

If the change was to bring about an increase in the tax rate, the disadvantage goes vice versa. The problem raised in relation to changes in tax rates also applies to changes in the provisions providing for the impositions of tax or exemptions, and to changes in allowed deductible costs and expenses affecting the amount of tax payable as well, if such changes in the law occur. The problem affects companies involved in the mining sector and in other sectors alike. The transitory provision in the new income tax law does not fully rectify these problems. Article 101(1) of Proclamation No. 979/2016 reads: "Subject to the Tax Administration Proclamation, the laws hereby repealed shall continue to apply for the tax year preceding the tax year in which this proclamation enters into force". According to this, as this law was enacted in August 2016, it might be said that the repealed law (i.e., Proc. 286/2002) applies to the entire tax year of 2016. However, Article 103 of the proclamation makes it clear that the proclamation "shall apply on income derived as of 8th day of July 2016". This means it came into force as of 01 Hamle 2008 E.C., unavoidably bifurcating the tax year of those taxpayers using the Gregorian calendar as their tax year. Interestingly, the proclamation has effectively avoided disputes similar to *ERCA v MIDROC Gold* because it has adopted the 25% tax rate for mining income and the 30% tax rate for other companies from the laws it repealed. However, controversies are probable in future

increases or decreases in tax rates, as one cannot be certain that the legislature will retain the 30% and 25% tax rates forever.

The solution for this anomaly is dividing the tax year into two short/transitional tax periods according to the time of the change in the law and applying both the old and the law respectively. It has to be clear that this will not create any intolerable costs and inconveniences both in the eyes of the taxpayers and the tax administration as it will be an exception to the unity of the tax year applicable in exceptional cases of change in tax laws effective in the middle of tax years. It is not also a new introduction, as it is already known in the case of changes in taxpayers' accounting year. It is the conviction of this author that dividing the tax year into transitional years in such exceptional instances could be developed through judicial interpretation, most importantly through the binding interpretations of the Cassation Bench. It is unfortunate, however, that the Cassation Bench, contrarily, established a precedent through its interpretation in *ERCA v MIDROC Gold* for the indivisibility of the tax year. Whether the Cassation Bench can change its precedents by giving different interpretations in future similar cases has become doubtful.[71] To avoid similar controversies and particularly the inequality problems raised above, revisiting the income tax law to incorporate clear provisions for transitional years in cases of change in tax rates effective in the middle of tax years bifurcating the tax year into two and creating two different tax rates competing for application in the tax year is imperative. If there is a view that cases like *ERCA v MIDROC Gold* are rare and not pressing to amend the existing law, the recommendation may be considered for future revisions. This author, however, holds that cases like *ERCA v MIDROC Gold* are not necessarily rare. We know only *ERCA v MIDROC Gold* because we have no studies about how other mining companies reacted to the reduction of the mining income tax rate in 2013.

Conclusion

Conventionally, business income taxes are paid annually. Exceptionally, however, when the taxpayer's accounting year changes from the Ethiopia Budget year to the Gregorian calendar year and vice versa, according to the income tax law, the time between the last tax year and the

[71] Compare Article 10(4) of the Federal Court Proclamation No. 25/1996 (as amended by the Federal Courts Proclamation Re-amendment Proclamation, Proclamation No. 454/2005 (now repealed) with Article 10(2) of the Federal Courts Proclamation No. 1234/2021. In the former, the Cassation Bench was expressly allowed to change its precedents whereas in the latter that express power has been omitted.

beginning of the new tax year is separately treated as a transitional year. This shows that the tax year is not indivisible. Indeed, the tax year can be divided into transitional years to accommodate such instances of exceptional nature. The law is not clear whether a change in tax rates amidst the tax year can have a similar effect of dividing the tax year into transitional tax periods. The author in this comment argues that revisiting the Income Tax Proclamation is demanding to include a clear provision to the effect that the tax year be divided into two in case of change in tax rates dividing the tax year into two and creating two effective tax rates within the tax year. Courts, especially the Cassation Bench, could have established a precedent to this effect through interpretation. However, the Cassation Bench missed such an opportunity in *ERCA v MIDROC Gold*. In this case, the FTAC, the FHC, the FSC, and the Cassation Bench decided that mining income taxes are payable annually not by dividing the tax year on monthly basis. In effect, the Cassation Bench establishes a precedent that tax years are indivisible. The author disagrees with these decisions. He argues that the provision for transitional tax periods in case of change in taxpayer's accounting year should apply to cases of change in tax rates as in this case by analogy. Therefore, an express provision to this effect is imperative either through an amendment to the income tax law or incorporating a similar provision in future revisions.