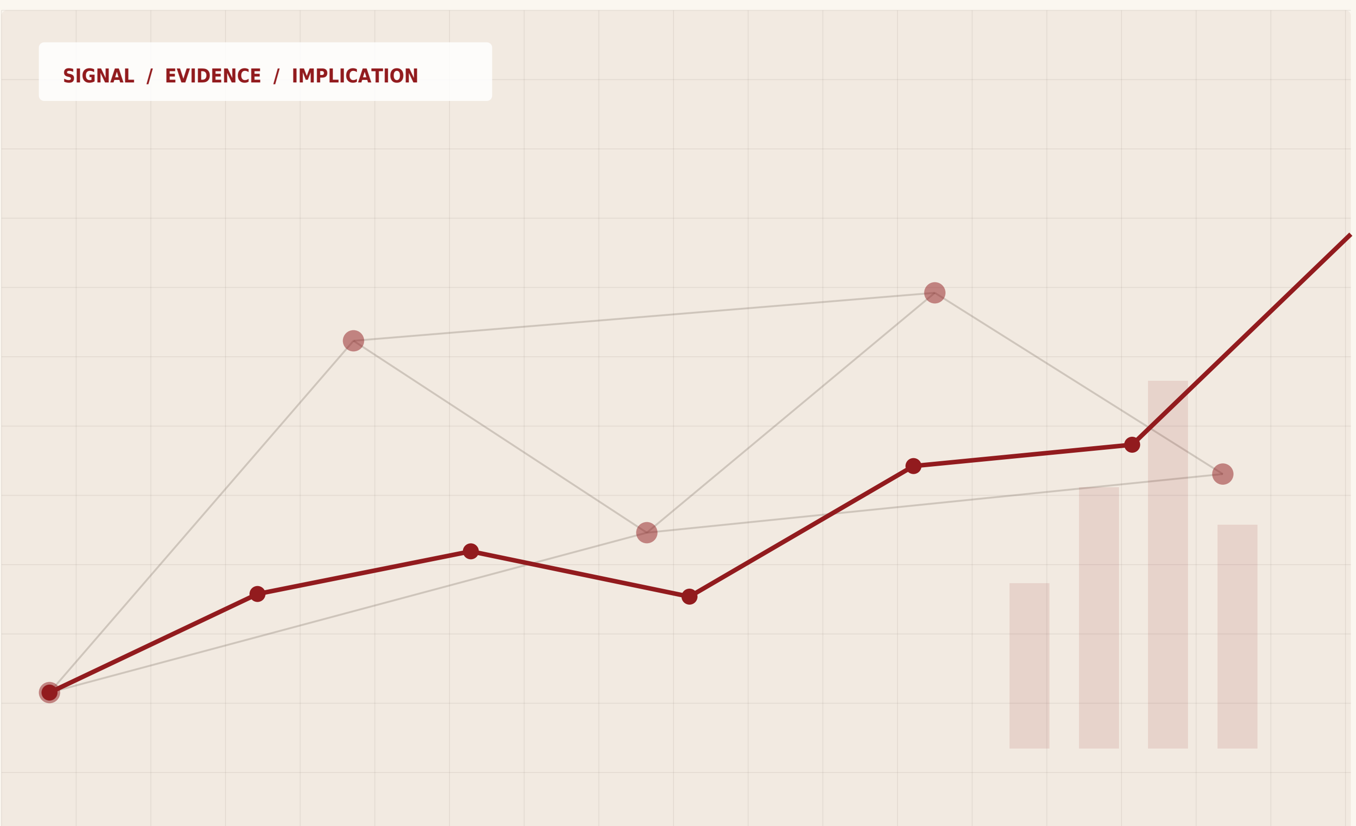
MACRO / POLICY / TAX

FISCAL BRIEF / JUNE 2026

Ethiopia's Tax Reform

The Revenue Constraint, the New Legal Framework, and What the Collection Surge Really Means



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PRIMARY-SOURCE INTELLIGENCE

KEY INDICATORS AT A GLANCE

7.5%	11%	13.2%	51%
Tax-to-GDP (FY2022/23) *MoF Ethiopia; IMF Country Report 25/189*	**Tax-to-GDP target (4yr)** *Ministry of Revenue; Finance in Africa, Aug 2025*	**Sub-Saharan Africa median** *IMF Country Report 25/189, July 2025*	**Tax effort vs potential** *IMF SFA estimate; Country Report 25/189*

ETB 1T+	76%	MAT	15%
Tax collected (10mo FY24/25) *Ministry of Revenue, May 6, 2026; 74.6% YoY increase*	**Tax revenue growth Q3 FY24/25** *IMF Third Review (Country Report 25/188)*	**Min. Alternative Tax (new)** *Income Tax Proclamation 1395/2025; July 17, 2025*	**VAT rate; ETB 2M threshold** *VAT Proclamation 1341/2024; from ETB 500k*

DATA INTEGRITY NOTE *Tax-to-GDP ratio of 7.5% is for FY2022/23, the most recent year with verified IMF data. The ETB 1 trillion milestone covers the first ten months of FY2024/25 (to May 2026) and includes both federal and regional collections. The 74.6% nominal growth figure is year-on-year and is substantially driven by birr devaluation effects; real growth in tax collection is materially lower. The 11% tax-to-GDP target is from the Ministry of Revenue's public commitment; the IMF programme parameters use more conservative annual increment targets. Single-source claims are flagged inline.*

01 THE PROBLEM: WHY 7.5% TAX-TO-GDP IS ETHIOPIA'S BINDING FISCAL CONSTRAINT

Ethiopia Collects Half Its Tax Potential. That Is the Constraint Underneath Every Other Fiscal Priority.

Ethiopia's tax-to-GDP ratio stood at 7.5% in FY2022/23, its lowest in more than a decade and among the lowest in sub-Saharan Africa, where the median is 13.2% (IMF Country Report 25/189, July 2025). The IMF's Stochastic Frontier Analysis estimates Ethiopia's tax effort at 51% of potential, meaning the country is collecting approximately half of what its economic structure should yield. The gap is not primarily a function of poverty or informality, though both play a role. It is a function of policy choices, administrative capacity constraints, and a tax base that has narrowed over time as GDP growth outpaced revenue mobilisation.

- **THE FISCAL ARITHMETIC:** The IMF programme requires Ethiopia to raise the tax-to-GDP ratio to support debt sustainability, reduce dependence on monetary financing, and fund social spending commitments including the Productive Safety Net Programme. The National Medium-Term Revenue Strategy (NMTRS, FY2024/25 to FY2027/28) targets a 1 percentage point increase per year, reaching 11% within four years. Each percentage point of GDP at current levels represents approximately ETB 90-100 billion in additional annual revenue at FY2024/25 prices. The Ministry of Revenue has publicly committed to reaching 10% within three years; the IMF programme parameters are more conservative.
- **THE PEER COMPARISON:** Kenya collects approximately 15-16% of GDP in tax revenue. Rwanda collects 13-14%. Uganda collects 13-15%. Ethiopia at 7.5% collects less than half of Kenya's rate from an economy with a population more than twice as large. The IMF's Selected Issues Paper (Country Report 25/189) identifies the main structural factors behind Ethiopia's revenue underperformance: a large informal economy, a small formal corporate sector, low VAT productivity, a decline in trade tax yields following tariff reforms, and bracket creep that was not corrected until 2025.
- **WHAT 76% REVENUE GROWTH MEANS IN CONTEXT:** Government tax revenues grew 76% in Q3 FY2024/25 year-to-date (IMF Third Review, Country Report 25/188). The Ministry of Revenue announced that total tax collection by federal and regional governments had exceeded ETB 1 trillion by May 2026, a 74.6% increase over the same period of the prior year (Ethiopian Business Review, May 2026). These are dramatic numbers. They require contextualisation: the primary driver is the birr devaluation. When

the birr depreciates 100%+, nominal birr tax revenues from trade, VAT on imports, and corporate income tax all rise in proportion, without any real improvement in compliance or base broadening. The real test of the reform agenda is whether revenue as a percentage of GDP increases, not whether nominal collections rise after a currency adjustment.

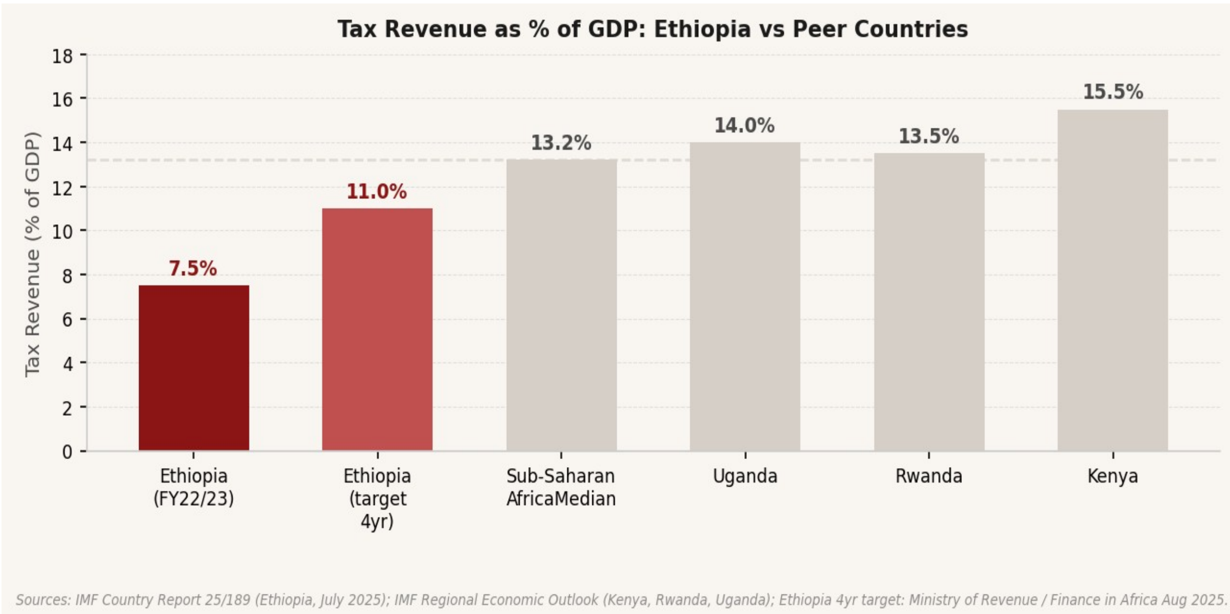

Figure 1: Tax Revenue as % of GDP: Ethiopia vs Peer Countries | Sources: IMF Country Report 25/189 (July 2025); IMF Regional Economic Outlook; Ministry of Revenue / Finance in Africa (Aug 2025)

02 THE REFORM PACKAGE: THREE LAWS, ONE ADMINISTRATION OVERHAUL

July 2024 to July 2025: Ethiopia Enacted Three Major Tax Reforms in Thirteen Months.

Between July 2024 and August 2025, Ethiopia passed three significant pieces of tax legislation and launched an administration modernisation programme backed by IMF technical assistance. The sequencing is notable: the tax reforms were designed in parallel with the FX liberalisation and IMF programme, as part of a integrated fiscal strategy to reduce Ethiopia's dependence on monetary financing and external budget support.

- **THE VAT REFORM (PROCLAMATION 1341/2024, AUGUST 2024):** The new VAT law enacted in August 2024 made four material changes. First, it expanded the VAT base significantly by bringing previously exempt sectors, including financial services (partially), construction, and professional services, into the VAT net. Second, it introduced VAT obligations on non-resident digital service providers, the first time Ethiopia has taxed cross-border digital services — platforms including streaming services, cloud computing, and software-as-a-service now face VAT registration requirements if supplying Ethiopian recipients, though enforcement mechanisms for foreign entities remain underdeveloped. Third, it raised the VAT registration threshold from ETB 500,000 to ETB 2 million, reducing compliance burden on small enterprises while expanding the base among medium-sized businesses. Fourth, it shifted from quarterly to monthly VAT filing, increasing the frequency of revenue collection and improving the government's cash flow management.
- **THE INCOME TAX REFORM (PROCLAMATION 1395/2025, JULY 2025):** The Income Tax Amendment Proclamation, approved by the House of People's

Representatives on July 17, 2025, addressed three problems simultaneously. Bracket creep: high inflation since 2016 had pushed employees into higher income tax brackets despite no real income growth, increasing effective tax rates at lower income levels. The reform adjusted thresholds for the first time in nine years, reducing the average effective rate for those earning GDP per capita equivalent from approximately 21.5% to 20%. Minimum Alternative Tax (MAT): the reform introduced a MAT of 2.5% on annual business turnover, applicable when a company's corporate income tax liability falls below the MAT threshold. This addresses systematic cost overstatement, a major compliance gap. Digital economy: businesses deriving income from digital services provided in Ethiopia are now subject to income tax at a rate not exceeding 5% of revenue.

- **THE ADVANCE TAX SCHEME (IMPLEMENTED AUGUST 2025):** The advance tax mechanism, introduced under Article 89 of the amended income tax law, requires companies to make quarterly advance payments against estimated annual tax liability. The first cycle began in August 2025 for companies using the Gregorian calendar. This is a cash flow tool as much as a compliance tool: it reduces the government's revenue volatility by distributing collections across the year rather than concentrating them at annual filing. A Domestic Revenue Mobilisation Task Force, chaired by State Finance Minister Eyob Tekalign, was established to monitor compliance and close gaps.

INVESTOR RELEVANCE

The MAT is the reform with the most direct implication for foreign investors. Under the previous system, companies could systematically overstate costs to reduce reported profits, driving corporate income tax liability below its economic level. The MAT creates a floor: 2.5% of annual turnover is owed regardless of reported profit. For investors planning Ethiopia market entry, the effective minimum tax rate is now modelled against turnover, not solely against projected profitability. For established businesses with high cost structures, the MAT requires recalibration of tax planning assumptions.

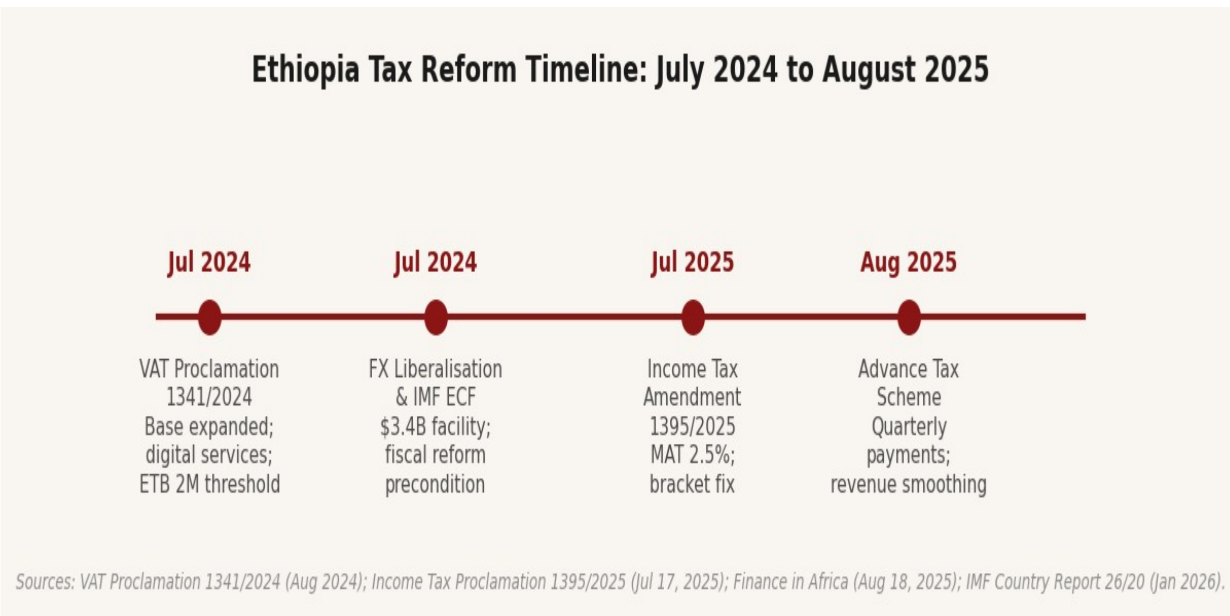

Figure 2: Ethiopia Tax Reform Timeline: July 2024 to August 2025 | Sources: VAT Proclamation 1341/2024; Income Tax Proclamation 1395/2025; Finance in Africa (Aug 2025); IMF Country Report 26/20

03 THE ADMINISTRATION GAP: WHY POLICY REFORM IS NECESSARY BUT NOT SUFFICIENT

The 2024 TADAT Assessment: Marked Improvement, Significant Gaps, and the Capacity Problem That Determines Whether the Revenue Strategy Succeeds.

Tax administration quality is the binding constraint between tax policy and tax revenue. Ethiopia can design optimal tax laws and still collect 51% of potential if the administration cannot enforce them. The Tax Administration Diagnostic Assessment Tool (TADAT) assessment conducted in July-August 2024 provides the most rigorous independent evaluation of where Ethiopia's administration stands and where the gaps remain.

- **WHAT THE 2024 TADAT FOUND:** Ethiopia received four "A" scores (meeting or exceeding international good practice) for: timely filing of tax declarations, dispute resolution, taxpayer registration, and accurate reporting and payment in the large taxpayer segment. This represents a material improvement from the 2016 assessment, when the best score was a single "B" and the majority of indicators received "D" scores. The improvement reflects genuine investment in tax administration over the past eight years, including the rollout of Electronic Sales Registration Machines (ESRMs), e-filing, e-payment, and the Electronic Single Window for customs. However, two areas of persistent weakness were identified: accurate reporting and risk management among non-large taxpayers, and systematic compliance risk assessment. The administration has not yet conducted an overall taxpayer compliance behaviour study.
- **THE INFORMAL ECONOMY PROBLEM:** Ethiopia's informal economy is estimated at 30-40% of GDP (IMF estimates). This is not primarily a tax administration problem, though better administration can reduce it at the margins. Formalisation is a function of registration incentives, the cost-benefit ratio of operating formally, and the presence of enforcement. The IMF's National Medium-Term Revenue Strategy notes that the VAT threshold increase from ETB 500,000 to ETB 2 million is partly designed to reduce the incentive for businesses to remain below the threshold. The risk is that it reduces the number of VAT-registered businesses in the short term, narrowing the base before formalisation of larger businesses compensates.
- **THE DIGITAL TAX ENFORCEMENT PROBLEM:** Both the VAT Proclamation and the Income Tax Amendment explicitly bring digital economy actors into the tax net. The policy intent is clear. The enforcement challenge is significant: how does the Ethiopian Revenue and Customs Authority (ERCA, now Ministry of Revenue) compel compliance from a foreign streaming platform or cloud service provider with no physical presence in Ethiopia? The VAT reform requires foreign non-resident digital service providers to register and file monthly returns, but the mechanisms for identifying non-registrants, assessing liability, and enforcing collection against entities with no Ethiopian assets are not yet described in implementing regulations (as of June 2026). This is a structural gap common to most economies attempting digital services taxation — Ethiopia is not behind the curve, but it is implementing without the enforcement infrastructure that makes the policy effective.
- **LARGE TAXPAYER CONCENTRATION RISK:** The IMF notes that Ethiopia's tax base is highly concentrated in the Large Taxpayer Office (LTO), which handles a small number of enterprises that account for a disproportionate share of total revenue. This concentration creates both administrative efficiency (easier to monitor) and vulnerability (disruption to one large taxpayer materially affects aggregate revenue). Broadening the contributing base to medium and small taxpayers requires investment in branch-level administration capacity that the TADAT assessment found to be the weakest element of the system.

04 WHAT THE REVENUE STRATEGY MEANS FOR INVESTORS AND BUSINESSES

Three Direct Implications of Ethiopia's Tax Trajectory for Capital Allocation and Operating Cost Modelling.

Ethiopia's tax reform is a long-term programme, not a completed event. The three laws enacted in 2024-2025 are structural changes that will take years to reach their revenue potential, and the administration reforms required to enforce them are ongoing. For investors and businesses operating in or entering Ethiopia, the trajectory has three direct implications.

- **IMPLICATION 1: THE EFFECTIVE TAX RATE IS RISING:** The combination of the MAT (2.5% of turnover floor), revised income tax thresholds, expanded VAT coverage, and advance tax requirements means that the effective tax burden on formal businesses is rising, not falling. This is by design: the revenue strategy is explicitly targeting the formal sector compliance gap rather than raising rates. For investors modelling post-tax returns, the appropriate assumption is that the effective rate over the next three to five years will move closer to the statutory rate as enforcement improves, and that the MAT provides a binding floor that was absent before July 2025.
- **IMPLICATION 2: INVESTMENT INCENTIVES ARE BEING RATIONALISED:** The NMTRS explicitly includes "rationalising income tax exemptions and holidays" as a reform measure. The Minimum Alternative Tax applies even within investment-incentive periods in some structures: where a company's income tax holiday reduces liability below the 2.5% turnover floor, the MAT applies. Investors who modelled their Ethiopia returns assuming extended tax holidays at near-zero effective rates should verify their assumptions against the amended income tax proclamation and implementing regulations.
- **IMPLICATION 3: THE TAX-TO-GDP TRAJECTORY MATTERS FOR FISCAL STABILITY:** For investors assessing Ethiopia's macro risk, the tax revenue trajectory is a leading indicator of fiscal stability. If the Ministry of Revenue achieves its 1 percentage point per year tax-to-GDP increase, Ethiopia reduces its dependence on monetary financing, external budget support, and debt rollovers as the primary sources of fiscal gap closure. That trajectory supports the macro stability that investment returns depend on. If the trajectory stalls — as it did repeatedly between 2015 and 2023 — the fiscal adjustment falls on expenditure or monetary accommodation, both of which are negative for the investment environment.

THE HONEST ASSESSMENT

Ethiopia's tax reform package is substantive and ambitious. The three laws enacted in 2024-2025 address real structural weaknesses: bracket creep, digital economy evasion, the absence of a profit floor, and a VAT registration threshold that incentivised businesses to stay small and informal. The implementation gap is equally real. A 7.5% tax-to-GDP ratio does not reach 11% through legislation alone. It requires: an expanded and capable administration, a formalisation of the informal economy that the reforms alone will not deliver, enforcement mechanisms against digital economy actors that are not yet operational, and sustained political commitment to collecting from constituencies with the ability to resist. The 74.6% nominal revenue growth in FY2024/25 is an important milestone. It is partially a devaluation effect and should not be presented as evidence that the structural gap has closed.

05 EDITOR'S OUTLOOK

From 7.5% to 11%: The Revenue Gap, the Reform Tools, and the Distance Between the Two.

THE BOTTOM LINE

Ethiopia's tax-to-GDP ratio of 7.5% is the lowest in more than a decade and approximately half the sub-Saharan African median. The IMF estimates Ethiopia collects 51% of its tax potential. Closing that gap is the fiscal precondition for reducing monetary financing, supporting debt sustainability, and funding the social spending commitments built into the IMF programme. The reform package enacted in 2024-2025 is the most comprehensive set of tax changes Ethiopia has implemented in a decade. The VAT Proclamation expanded the base and introduced digital services taxation. The Income Tax Amendment introduced a Minimum Alternative Tax, adjusted brackets for inflation, and brought digital income into scope. The advance tax scheme smoothed the government's revenue profile. The TADAT 2024 assessment showed significant administrative improvement from 2016. The distance between the current position and the 11% target remains large. The informal economy, the enforcement gap on digital taxation, the concentration risk in the Large Taxpayer Office, and the limited branch-level administration capacity are structural constraints that legislation does not resolve. The trajectory is the right one. The timeline is ambitious. For investors, the relevant frame is not whether Ethiopia reaches 11% on schedule, but whether the reform momentum is sustained enough to deliver the fiscal stability that underpins return on investment.

Sources: IMF Country Report 25/189 (Ethiopia Tax System: Structure, Performance, and Benchmarking, July 2025); IMF Country Report 25/188 (Third ECF Review, July 2025); IMF Country Report 26/20 (Fourth ECF Review, January 2026); IMF-authored National Medium-Term Revenue Strategy FY2024/25-FY2027/28 (MoFED); Finance in Africa (Advance Tax Scheme, August 18, 2025); Ethiopian Business Review (ETB 1 Trillion milestone, May 2026); TaxDev/IGC (Income Tax Proclamation 1395/2025 analysis, August 2025); Ethiopian Tribune (VAT Proclamation 1341/2024 analysis, July 2025); TADAT Assessment Ethiopia 2024 (Ministry of Revenue / TADAT Secretariat); The Africa Report (Tax-to-GDP shortfall, October 2025); VATCalc (Ethiopia VAT digital services, July 2025).