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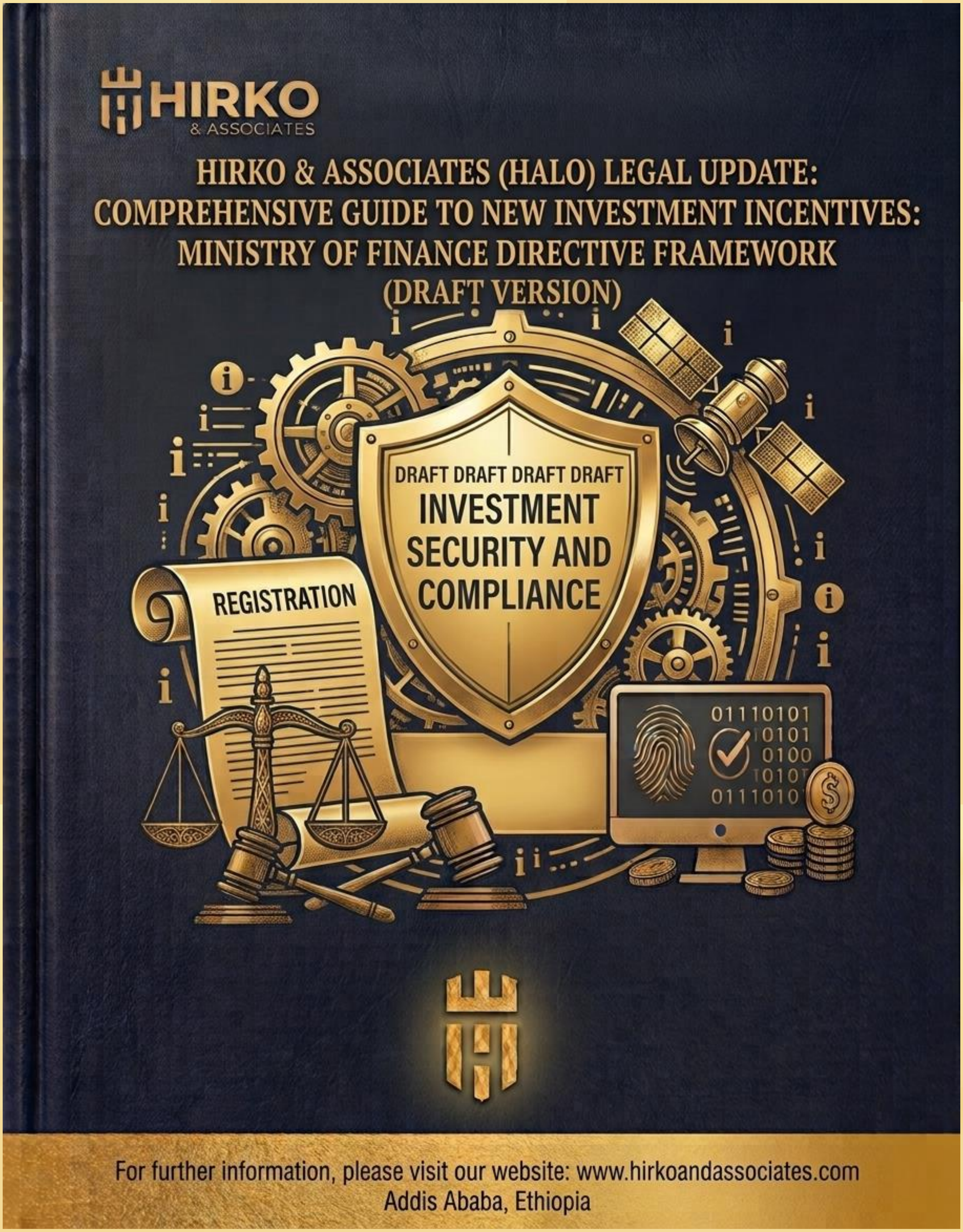

Ministry of Finance Issues New Draft Investment Incentive Directive: A Complete Overhaul of the Incentive Framework

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I. INTRODUCTION

In August 2026, the Ministry of Finance released a draft directive titled "Directive Issued for the Implementation of Investment Incentives" (the "Draft Directive"). The Draft Directive is intended to operationalize the Investment Incentives Council of Ministers Regulation No. 586/2026 (the "Regulation"), which was published on 23 February 2026 and substantially restructured Ethiopia's investment incentive framework.

The Regulation and the Draft Directive represent a significant departure from the previous incentive regime established under Regulation No. 517/2022 and its implementing Directive No. 1064/2025. The revised framework moves away from the traditional model of full income tax holidays and toward reduced income tax rates, performance-based incentives, enhanced accountability, and more detailed compliance requirements. The changes are therefore relevant not only to prospective investors but also to existing investors whose incentives were granted under the previous framework.

This legal update highlights the principal changes introduced by the new framework, explains the principal eligibility and compliance requirements, and considers their practical implications for existing and prospective investors.

II. THE NEW REGULATORY FRAMEWORK

The Investment Incentives Regulation

Regulation No. 586/2026, published on 23 February 2026, provides the legal foundation for the revised investment incentive regime. It replaced Regulation No. 517/2022, as amended by Regulation No. 566/2025. Among the most significant changes are the replacement of full tax holidays with reduced income tax rates, the introduction of a more performance-oriented incentive structure, the establishment of a USD 10 million minimum capital threshold for eligibility for reduced income tax rates subject to the treatment applicable to SMEs, the introduction of deductible capital expenditure, and the revision of customs duty and tax incentives.

The Draft Implementing Directive

The Draft Directive is intended to translate the broad framework established by the Regulation into operational procedures. It addresses eligibility, application and documentation requirements, monitoring and reporting obligations, administrative consequences for non-compliance, and transitional arrangements. Because the Draft Directive remains a draft, its provisions should be distinguished from the provisions of Regulation No. 586/2026 that are already in force.

III. THE SHIFT FROM TAX HOLIDAYS TO REDUCED TAX RATES

One of the most consequential changes is the restructuring of the income tax incentive. Under the previous framework, qualifying investors could receive complete exemption from income tax for specified periods, generally depending on the investment activity and location. Under the new framework, the principal incentive takes the form of a reduced income tax rate, generally at 5% or 15%, rather than a complete exemption.

The new framework also introduces a USD 10 million minimum capital threshold for eligibility for the reduced income tax incentive, subject to the separate treatment of SMEs. The incentive periods under the new framework may extend from five to fifteen years, but the benefit is applied at the reduced rate rather than at a zero rate. This means that an investor's effective tax burden will depend not only on whether the investor qualifies for an incentive, but also on the applicable reduced rate, the duration of the incentive, the investment activity, and the location of the investment.

IV. TRANSITIONAL TREATMENT FOR EXISTING INVESTORS

The new framework contains important grandfathering arrangements. Regulation No. 586/2026 preserves incentives that were already granted under the repealed incentive regulations until the expiry of the relevant incentive period. This is particularly important for investors that structured their investments and financial projections on the basis of an existing tax holiday.

The Regulation also provides an election mechanism for investors that obtained an investment permit before the issuance of the new Regulation. Such investors may continue to benefit from the previous regime or, where advantageous, elect to be treated under the new regime. This should be approached as a comparative exercise rather than an automatic migration, because the relative benefit will depend on the investor's remaining incentive period, taxable income, applicable reduced rate, capital expenditure, and other qualifying circumstances. The transitional framework also preserves exemptions granted to mining and petroleum investors under agreements approved by the Council of Ministers before the effective date, subject to the terms and duration of those agreements.

The Draft Directive further provides that investors licensed before the issuance of the Directive generally continue to benefit from the incentive framework applicable when their licenses were issued, subject to the specific transitional limitations stated in the Draft Directive. Accordingly, existing investors should review the date and legal basis of their investment license and incentive approval before determining whether the new regime applies to them.

V. KEY FEATURES OF THE DRAFT IMPLEMENTING FRAMEWORK

Purpose and Scope

The Draft Directive is designed to establish clearer and more accountable procedures for implementing investment incentives, promote consistent and fair administration by authorised government bodies, and protect public revenue while preserving investors' legal rights. Its scope extends to investors eligible for tax and customs incentives under the Regulation and also addresses certain government institutions, higher education institutions, civil society organisations, and associations implementing development projects.

Assembly of Completely Knocked-Down Goods

The Draft Directive clarifies the treatment of completely knocked-down, or CKD, assembly. Assembly of goods imported in CKD form may be treated as manufacturing for incentive purposes where the prescribed local value addition requirement is satisfied. The Draft Directive identifies a minimum local value addition of 30%, or another percentage determined by the Ministry, and applies this treatment to the assembly of vehicles, aircraft, trains, drones, and machinery. The significance of this provision is that an activity which might otherwise be characterised simply as assembly can qualify for incentives where it satisfies the prescribed manufacturing criteria.

Expansion and Upgrading

Expansion and upgrading projects are treated as new investments for purposes of incentive eligibility. Consequently, an investor cannot assume that an expansion automatically inherits the incentive status of the existing investment. The expansion must satisfy the applicable eligibility criteria and minimum capital requirements for a new investment and must fulfil the relevant conditions and preconditions.

VI. INCOME TAX INCENTIVES

General Eligibility Requirements

The Draft Directive establishes documentary conditions for obtaining an income tax incentive. The investor must have an investment licence covering an eligible sector, a business licence issued by the competent government authority, and a support letter from the relevant investment authority confirming completion of the investment and requesting the income tax incentive. These requirements indicate that eligibility is not based solely on the investor’s proposed activity; the investor must also demonstrate completion and satisfy the relevant administrative conditions before the incentive is recognised.

Special Economic Zones

The Draft Directive provides a distinct incentive framework for Special Economic Zone developers and sub-developers. The applicable reduced income tax rate is 5% for ten years in Addis Ababa, Dire Dawa, and regional capitals, and 5% for twelve years in other areas. The framework also provides a five-year dividend tax exemption and a Minimum Alternative Tax exemption corresponding to the applicable incentive period, subject to the detailed conditions of the Draft Directive.

SEZ enterprises are generally subject to a 15% reduced income tax rate for the period specified for the relevant activity in the Draft Directive’s sector schedule, with an additional year available for enterprises located outside Addis Ababa, Dire Dawa, and regional capitals. Fertiliser manufacturing receives a distinct reduced rate of 5% for ten years.

Startups and Startup Ecosystem Builders

The Draft Directive expressly addresses startups and startup ecosystem builders. Eligible startups may benefit from a 5% income tax rate for ten years together with a five-year dividend tax exemption. Startup ecosystem builders receive a different set of incentives, including a 100% exemption from capital gains tax on the sale of ownership interests, a five-year dividend tax exemption, and a Minimum Alternative Tax exemption for three years, subject to the limitation relating to the amount of loss incurred.

Environmental Protection Incentives

The Draft Directive introduces incentives linked to environmental performance. Companies participating in carbon trading or emissions trading systems recognised by the Environmental Protection Authority may qualify for a 15% income tax rate for ten years. Investors that previously used non-renewable energy and subsequently use at least 50% self-generated renewable energy in their production or operations may qualify for a 15% rate for five consecutive years. A similar five-year reduced-rate incentive is available to qualifying investors using at least 50% of production inputs derived from locally sourced recycled materials.

The environmental incentives are subject to evidentiary requirements. In particular, the Draft Directive requires an annual energy audit report certified by the competent authority where applicable. The practical effect is that environmental performance must be demonstrated through verifiable records rather than merely asserted by the investor.

Investments Outside Special Economic Zones

Investors operating outside SEZs and undertaking activities listed in the relevant sector schedule may receive a 15% reduced income tax rate for the period prescribed for the activity. Investors located outside Addis Ababa, Dire Dawa, and regional capitals may receive an additional year. Location therefore becomes an important component of incentive planning, because the same qualifying activity may receive a different duration depending on where the investment is established.

VII. DEDUCTIBLE CAPITAL EXPENDITURE AND SCIENTIFIC RESEARCH

Deductible Capital Expenditure

The new framework introduces a deductible capital expenditure incentive for qualifying capital goods and construction materials used in eligible investment activities. The Draft Directive sets a minimum investment threshold of USD 2 million, or its equivalent in Birr. The qualifying capital goods must be owned by the taxpayer and used wholly and exclusively to generate taxable income, or used proportionally where only part of the asset is used for taxable income-generating activities. The expenditure must constitute capital expenditure rather than operating expenditure, the allowance begins from the period in which the relevant capital goods are placed into use, and the investor must maintain accurate accounting records.

Where capital goods are leased rather than owned, the deduction is limited to the actual lease payments. The distinction is important because the incentive is linked to qualifying capital expenditure and cannot simply be treated as a general deduction for all investment-related operating costs.

Scientific Research

The Draft Directive also permits deductions for qualifying scientific research undertaken internally or through a third party. Scientific research is framed as activity in the natural or applied sciences intended to advance human knowledge. Qualifying expenditure may include expenditure incurred by the business or contributions made to a scientific research institution. The Draft Directive excludes expenditure on depreciable or intangible assets, land and buildings, and expenditure relating to establishing the existence, location, quantity, or quality of natural resources.

VIII. CUSTOMS DUTY AND TAX INCENTIVES

Special Economic Zones

SEZ developers, sub-developers, administrators, and enterprises may import qualifying capital goods and construction materials with customs duty and tax incentives without the same quantity or timing limitations applicable to investments outside SEZs. This creates a comparatively flexible customs incentive framework for SEZ-related investments.

Investments Outside Special Economic Zones

For investments outside SEZs, investors engaged in activities included in the relevant sector schedule may import qualifying capital goods and construction materials with customs duty and tax incentives up to the issuance of the business licence. The timing of the business licence is therefore significant because it can affect the availability of the customs incentive.

Phased Investments

The Draft Directive recognises the practical reality of phased investment projects. Where an investment is implemented in phases, qualifying imports for subsequent phases may continue after issuance of the business licence if the phased implementation is reflected in the business plan and implementation agreement, the goods imported for earlier phases have been verified as having been used for their intended purpose, and the investor has complied with the implementation agreement. This provision can be particularly important for large projects whose capital expenditure and construction programme extend over several stages.

IX. COMPLIANCE AND REPORTING REQUIREMENTS

Accounting Records and Separate Reporting

The Draft Directive places greater emphasis on documentary and accounting compliance. Investors benefiting from income tax incentives are required to submit accounting records to the Tax Authority in accordance with the applicable income tax legislation. Where an investor operates in two or more incentive-eligible investment fields, the income attributable to each investment must be reported separately. Failure to submit the required accounting records may invalidate the incentive for the relevant tax period, while late submission may result in administrative penalties under the applicable tax administration framework.

Monitoring of Goods Imported with Incentives

The monitoring requirements also extend to goods imported under customs duty and tax incentives. Investors authorised to import construction materials must submit, every three months, a certificate from the authority that issued the construction permit confirming that the materials are being used for their intended purpose. Investors receiving incentives for capital goods, construction materials, or vehicles must also provide evidence to the Customs Commission demonstrating proper use. These requirements reinforce the principle that customs incentives are conditional benefits tied to the approved investment purpose.

X. ADMINISTRATIVE CONSEQUENCES AND FORCE MAJEURE

Late Financial Statements

Investors benefiting from tax incentives are required to submit financial statements within the period prescribed by the applicable income tax legislation. Late submission may attract administrative penalties under the tax administration framework. The compliance requirement is therefore not limited to the initial approval of an incentive; maintaining the incentive requires continuing compliance with tax reporting obligations.

Force Majeure Circumstances

The Draft Directive recognises limited circumstances in which non-compliance may result from events beyond the investor’s control. Where an investor can demonstrate that its accounts were closed and income could not be declared because of a man-made or natural disaster affecting the area of investment activities or because of war, and the competent investment authority confirms the circumstances, the investor may be exempted from penalties and interest or may be permitted to continue benefiting from the incentive. This relief is conditional and requires appropriate evidence and confirmation.

XI. CANCELLATION OF INCENTIVES

Grounds for Cancellation

The Draft Directive permits cancellation of a tax incentive where the benefit was obtained on the basis of false or fraudulent information or documents, where the investment activity covered by the investment licence has been terminated, or where the investor fails to submit complete financial statements or fulfil other applicable obligations. These grounds demonstrate that the incentive is conditional upon both the accuracy of the information submitted and the continued performance of the underlying investment and compliance obligations.

Cancellation Procedure and Consequences

The cancellation process provides an opportunity for the investor to respond. The relevant tax or investment authority is required to notify the Ministry in writing, after which the Ministry requests an explanation from the investor within ten days. If the investor does not respond or the explanation is considered unsatisfactory, the Ministry may decide to cancel the incentive and notify the investor.

Where a tax holiday is revoked, the investor may be required to pay the taxes that had previously been exempted, together with applicable interest and penalties. The financial exposure associated with cancellation therefore extends beyond the loss of the future incentive and may include recovery of previously forgone tax benefits.

XII. TRANSITIONAL ARRANGEMENTS

The transitional framework is intended to protect existing investments from an abrupt loss of benefits while allowing eligible investors to take advantage of the new regime where it is more favourable. Investors that were granted incentives under the repealed incentive regulations generally continue to receive those incentives in accordance with the applicable transitional rules. Investors that obtained an investment licence before issuance of the new Regulation may, where permitted, benefit from the new Regulation if it provides a better tax incentive.

The transitional framework also preserves incentives granted to mining and petroleum investors under the applicable sector-specific legal framework. In addition, investors that obtained an investment licence before issuance of the Draft Directive generally continue under the regulations and directives applicable when their licences were issued, subject to the specific exclusions and limitations contained in the transitional provision.

The Draft Directive specifically limits the application of this transitional protection in relation to commissioning raw materials, construction materials, capital goods permitted after issuance of a business licence, and unlimited quantities of permitted spare parts. Investors should therefore examine the nature and timing of each import rather than assuming that all previously available customs benefits are automatically preserved.

XIII. PRACTICAL IMPLICATIONS FOR INVESTORS

Existing Investors

Existing investors should first establish the legal basis, duration, and remaining balance of their existing incentives. Investors that obtained their permits before the new regime should then compare the remaining benefit under the old framework with the benefit potentially available under the new framework. The transitional election should be assessed commercially and tax-wise, because a lower reduced tax rate may not necessarily produce a better outcome than a longer remaining tax holiday, and the answer will depend on the investor's expected taxable income and investment profile.

The grandfathering arrangements nevertheless provide important protection because existing incentives generally remain available until expiry. Investors should maintain the records necessary to establish their entitlement and should not assume that the transitional rules eliminate continuing reporting and compliance obligations.

New Investors

For new investors, the revised framework requires more careful incentive planning at the investment design stage. The USD 10 million capital threshold for reduced income tax incentives is a significant consideration, particularly for projects whose proposed capitalisation is close to the threshold. Investors must also consider the applicable performance requirements, the sector in which the investment will operate, the location of the project, the timing of licensing, and whether the investment will be implemented in phases.

Small and Medium-Sized Enterprises

SMEs are treated separately under the new framework. The Draft Directive indicates that the Ministry will issue further directives concerning SME incentives in consultation with the relevant government institutions. The source document also notes that the relevant treatment is connected to enterprises operating in technology, construction, manufacturing, and service sectors recognised by the Ministry of Labor and Skills. The precise benefit available to a particular SME should therefore be assessed against the applicable implementing instruments once issued.

Financial Institutions

Financial institutions are subject to specific exclusions from certain incentives. In particular, the source document notes that the stock-market-listing incentive does not apply to financial institutions under the relevant provision of the Regulation. This is an example of why the general incentive framework should not be assumed to apply uniformly across all investment sectors.

XIV. CURRENT IMPLEMENTATION STATUS

As of August 2026, Regulation No. 586/2026 has been published and is in force. The Draft Directive, however, remains under review. Existing investors therefore need to distinguish between rights and obligations arising directly from the Regulation and provisions contained only in the Draft Directive. The Ministry is also expected to issue additional implementing directives to operationalise aspects of the revised framework.

The Draft Directive is expected to become effective following the applicable registration and publication process. Until that process is completed, investors should treat the Draft Directive as a proposed implementing framework rather than as a final source of enforceable obligations.

XV. CONCLUSION

The new investment incentive framework represents a substantial change in the structure of investment incentives in Ethiopia. The most important policy shift is the movement from full income tax holidays toward reduced income tax rates, accompanied by a higher capital threshold for reduced-rate eligibility, performance-oriented requirements, new capital expenditure and scientific research deductions, and targeted incentives for startups and environmentally responsible investments.

For existing investors, the transitional and grandfathering arrangements are particularly significant because they preserve existing incentives while creating an opportunity, in appropriate cases, to move to the new regime where it provides a better outcome. For new investors, incentive eligibility will require greater attention to capitalisation, sector, location, project structure, licensing, performance commitments, and continuing compliance.

The revised framework also places greater emphasis on accountability. Accounting records, separate reporting, verification of imported goods, financial statement filing, and proper use of incentive-supported imports are increasingly important to maintaining eligibility. Investors should therefore evaluate not only the headline tax benefit but also the administrative and compliance requirements attached to that benefit before making investment decisions.

Disclaimer

This update is provided for informational purposes only and does not constitute legal advice. Investors and businesses should obtain advice based on the specific facts of their investment, the final version of the implementing directive, and any subsequent directives or administrative guidance issued by the competent authorities.