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LEGAL UPDATE

Addis Ababa City Administration Revenue Bureau Issues 2018 E.C. Desk Audit Guideline — Part Two: Sector-Specific Focus Areas and Digital Income

Desk Audit Guideline for the 2018 E.C. Tax Year | Addis Ababa City Administration Revenue Bureau | September 2019 E.C.

OCTOBER 2026



Addis Ababa City Administration Revenue Bureau Issues 2018 E.C. Desk Audit Guideline, Part Two: Sector-Specific Focus Areas and Digital Income

1. Introduction

This is the second of a three-part series on the Desk Audit Guideline issued by the Addis Ababa City Administration Revenue Bureau for the 2018 E.C. tax year. Part One examined the verification of payroll and employment tax, the scrutiny of the balance sheet, the testing of the profit and loss statement, and the identification of income reduction and expense inflation. Part Two examines the sector-specific focus areas that the Guideline sets out for auditors, and its treatment of digital content and digital income. Part Three will address documentation standards and practical implications.

The sector-specific sections are significant because they move the Guideline beyond generic verification and into the operating characteristics of particular industries. The Guideline does not apply a single template to all taxpayers. It identifies, for each sector, the indicators that are most likely to reveal under-declaration or unsupported expenses, and it directs auditors to test those indicators against the taxpayer's records and against third-party data. The digital income section is equally significant, because it brings a category of activity that has often operated outside formal tax administration into the scope of the desk audit.

2. Sector-Specific Focus Areas

2.1. Manufacturers

For manufacturers, the Guideline directs auditors to examine production capacity and capacity utilisation, input-output ratios, and the treatment of by-products and waste. The logic is that a manufacturer's declared sales can be tested against its productive capacity and against the inputs it has purchased. Where declared output is significantly below installed capacity without a satisfactory explanation, or where the input-output ratio is inconsistent with the industry norm, the auditor is directed to examine the difference. The treatment of by-products and waste is also relevant, because these can generate income that is not always recorded in the sales line.

2.2. Importers and Wholesalers

For importers and wholesalers, the Guideline directs auditors to examine customs declarations, cost differences between customs valuation and declared purchase prices, transport and freight costs, and the reconciliation of purchases with sales and closing inventory. The customs declaration is a third-party document that establishes the value of imported goods, and the Guideline treats differences between the customs valuation and the declared purchase price as an indicator requiring explanation. Transport and freight costs are also examined, including the allocation of air and land freight between the cost of goods and other expenses. The reconciliation of purchases,

sales, and closing inventory is the central test, because a wholesaler's gross margin depends on the accuracy of all three figures.

2.3. Retailers

For retailers, the Guideline directs auditors to examine stock turnover, credit sales, and the relationship between purchases and sales. Stock turnover is used as an indicator of whether the declared sales are consistent with the volume of goods purchased and held. A retailer with a low stock turnover relative to the industry norm may be holding undeclared stock or may have understated sales. Credit sales and receivables are also examined, because these can be used to shift income between periods or to record sales that did not occur.

2.4. Construction Contractors

For construction contractors, the Guideline directs auditors to examine the stage of completion of projects, progress and final payment certificates, the percentage of completion method, and the treatment of advances and retention. The percentage of completion method is the accounting basis on which construction revenue is recognised, and the Guideline requires the auditor to test whether the method has been applied consistently and whether the revenue recognised is supported by payment certificates approved by the consultant or engineer. Advances and retention are also examined, because these can be recorded in a way that defers revenue recognition or understates the contract value.

2.5. Service Providers

For service providers, including consultants and lawyers, the Guideline directs auditors to examine professional qualifications, client lists, contracts, advances, and the payment of employment income tax on staff. The client list and the contracts are the primary evidence of the service provider's revenue, and the Guideline requires the auditor to test whether the declared income is consistent with the number and value of the engagements. Advances are examined because they can be received and not recorded as income. The payment of employment income tax on staff is also examined, because service providers may engage professionals whose remuneration is not properly declared.

2.6. Commercial Property Leasing

For commercial property leasing, the Guideline directs auditors to examine lease agreements, stamp duty payment, and the reconciliation of declared rental income with third-party data. The lease agreement establishes the contractual rent, and the Guideline requires the auditor to test whether the declared rental income is consistent with the agreement. Stamp duty payment is examined because the lease agreement is a chargeable instrument, and the absence of stamp duty may indicate that the agreement has not been disclosed. Third-party data, including information from tenants

and from market rent studies, is used to test whether the declared rent is consistent with the market.

3. Digital Content and Digital Income

The Guideline addresses income derived from digital content creation and online platforms. It identifies the categories of digital income that fall within the tax net, and it confirms that digital content creators are taxable. The categories identified include revenue from video-sharing platforms, social media platforms, affiliate marketing and product placements, fan contributions and crowdfunding, membership fees, online sales of digital or physical goods, barter and non-monetary payments, live streaming revenue, advertising and sponsorship, and brand deals and endorsements. The breadth of the list is notable. It covers not only direct payments from platforms, but also indirect benefits such as barter arrangements and product placements, which are often not recorded as income.

The Guideline directs auditors to examine whether digital income has been included in the declared income, and to test the declared figures against platform records, bank statements, and other third-party data. It also addresses the treatment of income from ride-hailing platforms and from associations providing transport services, and it addresses the application of the alternative minimum tax, including the circumstances in which it applies and the categories of taxpayers that are exempt from it. The digital income section is therefore an attempt to bring a fast-growing and often informal category of activity into the desk audit process, and it places the burden on digital content creators to demonstrate that their declared income is complete.

4. What Part Two Signals

For taxpayers in the sectors identified, Part Two of the Guideline signals that the desk audit will be conducted with reference to the operating characteristics of the sector. Manufacturers should expect their capacity and input-output ratios to be tested. Importers and wholesalers should expect their customs declarations and inventory reconciliations to be examined. Retailers should expect their stock turnover and credit sales to be reviewed. Construction contractors should expect their payment certificates and revenue recognition to be tested. Service providers should expect their client lists and contracts to be examined. Property lessors should expect their lease agreements and declared rents to be tested against third-party data. Digital content creators should expect their platform income and non-monetary benefits to be brought within the scope of the audit. In each case, the Guideline provides the auditor with the indicators to test and the evidence to use, and it places the burden on the taxpayer to explain any difference.

Part Three of this series will address documentation standards and practical implications.

Disclaimer

This legal update is provided for general informational purposes only and does not constitute legal advice. The application of the Guideline may depend on the specific circumstances of a taxpayer, transaction, or return, and on the practice of the relevant revenue office. Professional legal and tax advice should be sought before relying on this update or taking any action.

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