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LEGAL UPDATE

Regulation No. 597/2026: Minimum Alternative Tax and Business Income Rules, Part Two

Regulation No. 597/2026 | Council of Ministers | 28 October 2026



NOVEMBER 2026 | Addis Ababa, Ethiopia

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1. Introduction

This is the second of a three-part series on Regulation No. 597/2026, which further amends the Federal Income Tax Regulation No. 410/2017. Part One examined the digital content taxation amendments and the expanded tax base. Part Two examines the minimum alternative tax regime, the minimum tax on commission income, the treatment of limited liability partnerships, and the revised rules on rental income and taxpayer categorization.

These amendments are significant for taxpayers whose declared tax falls below the minimum threshold, for commercial agents and wholesalers, for partnerships, and for Category "B" taxpayers. The minimum alternative tax has been clarified, its base has been defined, its interaction with carried-forward losses has been addressed, and its exemptions have been extended. The partnership rules introduce a withholding mechanism that makes the partnership the collection point for tax on distributed income. The rental and categorization rules resolve practical questions that had been left open.

2. Base for Minimum Alternative Tax

The Regulation introduces a new provision on the base for the minimum alternative tax. For taxpayers who declare, for the tax year, no taxable income or a loss, including where they declare that they have incurred neither a profit nor a loss, the gross income to be used as the basis for the annual minimum alternative tax is the total turnover derived from the sale of goods and services during the tax year.

For a taxpayer who declares that no business activity was conducted during the tax year, the gross income to be used as the basis is estimated by the Tax Authority on the basis of a study, in accordance with the Tax Administration Proclamation and directives to be issued by the Authority. This is a significant point. A nil return does not remove the taxpayer from the minimum tax; it shifts the basis to an estimate, and the estimate is to be made on a documented study rather than on the taxpayer's assertion.

After the minimum alternative tax payable by the taxpayer is computed, the advance tax paid quarterly in the tax year, the tax withheld at source from accounts payable, and the advance tax paid on goods imported into the country are deducted sequentially from the annual tax amount.

For the purposes of calculating the minimum alternative tax liability, the taxable turnover is determined by aggregating the total gross turnover derived from all business activities of the taxpayer, without any deduction, exclusion, or offset in respect of gross revenues from business activities that incurred a loss during the tax period. This prevents a taxpayer with both profitable and loss-making lines from reducing the turnover base by reference to the loss-making line.

3. Credit on Minimum Alternative Tax

Where it is established that the 2.5 percent minimum alternative tax paid by a taxpayer on the gross income derived from all business sources in a tax year exceeds the tax actually payable, the amount paid in excess may be carried forward and credited against tax payable in the subsequent five tax years.

The credit is granted only on two conditions. The first is that the taxpayer maintains books of account. The second is that the Tax Authority verifies that the tax liability of the taxpayer in the tax year in which the minimum tax was paid is lower than 2.5 percent of its gross income, and that the taxpayer has tax payable in excess of the minimum alternative tax payable in the year in which the credit is to be applied. The conditions are cumulative, and the credit is therefore not automatic.

The Regulation also addresses the interaction between the minimum alternative tax and carried-forward losses. The minimum tax applies to a taxpayer who is currently carrying forward losses from previous years. Where a taxpayer has a loss carried forward from previous tax years, the loss may only be deducted if the taxpayer has taxable income in excess of the amount required to satisfy the minimum alternative tax for the current tax year. The effect is that the minimum tax is paid first, and the carried-forward loss is available only against the excess.

4. Exemption from Minimum Alternative Tax

In addition to the exemptions in Article 23 Sub-Article (5) of the Proclamation, and subject to their liability to pay the regular business profit tax, public enterprises engaged in the supply of electricity and water, as well as in urban bus and rail transport services, whose supply tariffs are determined by the Government, are exempted from the minimum alternative tax.

The minimum alternative tax applies exclusively to income taxable under Schedule "C" of the Proclamation. It does not apply to income taxable under other Schedules or to income specifically exempted from tax under the law.

For the purposes of Article 23 Sub-Article (6) of the Proclamation, an entity under liquidation and a corporate body under debt restructuring refer to taxpayers on which court decisions are made in relation to bankruptcy, preventive restructuring, or debt reorganisation in accordance with the Commercial Code of Ethiopia.

Taxpayers who have not conducted business activities for more than six months within a tax year due to war, civil conflict, natural disaster, or supervening calamity are exempted from the minimum alternative tax. The exemption is time-bound and event-based, and it requires the taxpayer to demonstrate the duration of the interruption and the nature of the event.

5. Minimum Alternative Tax on Income from Commission

Commercial agents that are engaged in the sale of goods or services in the name of the importer, producer, or other service provider, and that transfer the selling price to their principal, pay the minimum alternative tax on their commission income.

Taxpayers who have a wholesale trade license and are engaged in the distribution of goods to other wholesalers or retailers based on a contract concluded with the importer or producer, and whose margin is determined by that contract, pay the minimum alternative tax on the margin paid to them.

Where a manufacturer or importer and a wholesaler have contractually determined the retail selling price, and the wholesaler's commission percentage is likewise fixed by the contract, the Tax Authority examines such contracts collectively when auditing the accounts of the importer or manufacturer. For the purposes of this provision, notwithstanding the existence of a price-determining contract, the minimum tax is calculated based on the price percentage set in the contract only if the wholesaler presents to the Tax Authority for audit the invoices showing the purchase price from the manufacturer or importer, the invoices for sales made to retailers or other parties, and other accounting documents relevant to the case.

It must be verified that the wholesaler has sold the goods or services at the price levels determined by the manufacturer or importer. If the submitted documents fail to verify this, or if it is established that transactions were conducted outside the terms of the agreement, the Authority applies the minimum tax based on the taxpayer's annual sales. Where a taxpayer who paid minimum tax by declaring that transactions were conducted in accordance with the price determined by the manufacturer or importer is found, during an audit, to have transacted outside the agreement, the minimum tax previously paid is recalculated within the period specified under the Tax Administration Proclamation, and the difference is payable by the taxpayer.

6. Limited Liability Partnerships

The Regulation introduces a new sub-section on the payment of tax by limited liability partnerships. "Income for distribution" means the total net profit of the partnership after all allowable deductions are made from the annual gross income. For this purpose, wages, drawings, guaranteed payments or dividends, and other payments to partners are not considered deductible allowed but are considered distributions of income. The provisions also apply to cooperative societies.

Each member of the partnership is individually liable for income tax on the income distributed by the partnership in a tax year in proportion to its respective shares. The partnership must withhold the tax from the income distributed to its members in accordance with Schedule "C" and remit the same to the Tax Authority. The share of each partner is determined by the partnership agreement, and where the agreement does not specify the share, the income is distributed equally to all partners. For the purpose of determining the member's total taxable income for the tax year, the gross

income derived by a member from the partnership is included in the calculation. Tax withheld by the partnership is a final tax on the income distributed to the member.

The partnership has the obligation to withhold tax from any distribution of income, including salary, to its partners. The obligation applies at the time of distribution of income or when the distribution is recorded in the name of the partner, whichever is earlier. Where a partnership has not distributed the income within three months from the end of the tax year, the tax is paid as though the distribution had been made.

The Regulation also addresses the annual financial report. A limited liability partnership must submit its annual financial report within the time limit prescribed under the Proclamation, on the prescribed form, and containing at least the gross income, expenses, and income distributed in the tax year; the names of all partners and their share from the distributed income or the income to be distributed; the total distribution made in a tax year and the total amount of tax withheld; and any other information required by the Tax Authority.

A partnership that fails to withhold tax, or fails to remit tax withheld, is liable to pay penalty for failure to file the return and for not paying taxes, as well as the interest thereon in accordance with the Tax Administration Proclamation, without prejudice to its liability regarding the tax payable under Article 102 Sub-Article (3) of the Proclamation. The partnership is exempt from withholding tax on payments it receives for services rendered in accordance with Article 97 of the Proclamation, but it retains the obligation to withhold tax on payments made for the purchase of goods and services in accordance with the same Article.

7. Rental Income and Categorization of Taxpayers

Article 15 Sub-Article (5) of the Proclamation applies only to Schedule "B" taxpayers who do not have the obligation to maintain books of account. Category "B" rental income taxpayers pay tax in accordance with Article 50 Sub-Article (3) of the Proclamation. A Category "A" individual taxpayer deriving rental income under Schedule "B" who fails to maintain books of account is taxed on 80 percent of the gross rental income, which is deemed taxable income and taxed in accordance with Schedule "B".

The Regulation replaces the sub-section on the category of taxpayers. The taxpayer category is determined based on the taxpayer's annual gross income falling under tax Schedules "B" and "C", as the case may be, in which the taxpayer is engaged. The determination is made separately for each tax year and applies for the whole of the tax year without change, subject to the rule that a taxpayer determined to be a Category "A" taxpayer for a tax year remains a Category "A" taxpayer for all future tax years. For the purposes of determining whether a taxpayer is a Category "A" or "B" taxpayer, the annual turnover is the gross income of the taxpayer for a year from Schedules "B" and "C", and it includes both taxable and exempt income. A reference to a Category "A"

taxpayer includes a Category "B" taxpayer to whom Article 50 Sub-Article (4) of the Proclamation applies.

The Regulation also provides that gross sales income of Category "B" taxpayers is determined based on a market study conducted by the Tax Authority every three years. In a year in which the market study is not conducted, the Tax Authority makes an inflation adjustment on the gross sales income of taxpayers based on the inflation index issued by the Ethiopian Statistics Service appropriate to the business activity. Where the annual gross income of a Category "B" taxpayer exceeds Birr 2,000,000, tax on the income exceeding that amount is computed at the highest rate of the tax schedule applicable to Category "B" taxpayers.

The Regulation sets out the progressive rate schedule for Category "B" taxpayers. The schedule applies rates of 2 percent, 3 percent, 5 percent, 7 percent, and 9 percent across the bands from zero to below Birr 2,000,000, with corresponding deductible amounts.

8. What Part Two Signals

For taxpayers whose declared tax falls below the minimum threshold, Part Two of the Regulation signals that the minimum alternative tax is not avoided by a nil return. The base is total turnover, the estimate is made on a study, and the credit for excess minimum tax is conditional and time-limited. The interaction with carried-forward losses means that the minimum tax is paid before the loss is absorbed.

For commercial agents and wholesalers, the minimum tax on commission and margin requires accurate contract documentation. The Authority will examine the contracts collectively, and the taxpayer must present the purchase and sale invoices and other accounting documents. Transactions outside the agreement trigger recalculation on annual sales.

For partnerships, the withholding mechanism makes the partnership the collection point. The distinction between distributions and deductible payments is important, and the three-month rule means that undistributed income is taxed as though distributed. For Category "B" taxpayers, the 80 percent rule for rental income and the revised categorisation rules resolve practical questions, but they also mean that the category determination has lasting consequences.

Part Three of this series will examine permanent establishment, withholding and refunds, foreign exchange losses, and the transitional and effective date provisions.

Disclaimer

This legal update is provided for general informational purposes only and does not constitute legal advice. The application of the Regulation may depend on the specific circumstances of a taxpayer, partnership, agent, or transaction, and on directives to be

issued by the Ministry of Finance and the Tax Authority. Professional legal and tax advice should be sought before relying on this update or taking any action.

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