

# MONTHLY LEGAL UPDATE

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## WORLD SUSTAINABLE TRANSPORT DAY

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### Top Update

#### NBE Directive on Risk-based Capital Adequacy No. 95/2025

The NBE Directive No. 95/2025 requires banks to adopt a Basel-aligned risk-based capital framework with minimum ratios of 7% CET1, 9% Tier 1, and 11% total, fully effective by December 2026.

## What's Covered this Month?

Welcome to the November 2025 edition of the TSA Legal Update! This newsletter brings you key legal developments to help you stay informed and navigate the evolving legal landscape.

In this issue, we cover:

1. Ministry of Finance Clarification on the Income Tax (Amendment) Proclamation No. 1395/2025
2. NBE Directive on Risk-based Capital Adequacy No. 95/2025
3. NBE Directive on Foreign Exchange Exposure Limits No. /SBB/96/2025



# 1. Ministry of Finance Clarification on the Income Tax (Amendment) Proclamation No. 1395/2025

The Ministry of Finance (MoF) issued an interpretive letter to clarify uncertainties under the Income Tax (Amendment) Proclamation No. 1395/2025, addressing key areas such as Alternative Minimum Tax, transitional obligations, dividend taxation, accounting rules, rental income, investment incentives, and the repeal of the Turnover Tax regime.

## **Alternative Minimum Tax (AMT): Scope, Application, and Exemptions**

The MoF clarifies that AMT applies differently depending on the nature of the taxpayer's business activities. A clear distinction is drawn between commercial agents, who act on behalf of another merchant, and wholesalers/distributors, who purchase goods in their own name.

While Commercial agents are required to pay AMT only on the commission they earn, Wholesalers/distributors must generally calculate AMT on their annual gross sales revenue. However, where their profit margin or selling price is fixed by contract or by a legally authorized body, AMT applies only to the portion they are allowed to retain. Evidence of such contract or legal mandate must be submitted. The MoF also warns that contracts imposing minimum retail prices (other than for products such as fuel where this is legally permitted) violate competition laws and cannot serve as grounds for limiting the AMT base.

For transport associations that rent members' vehicles and retain only a fixed small percentage, AMT applies on the full amount received from employers, not merely the retained portion, because transactions with members are treated under fair market value principles. Taxpayers providing commission-based or service-based activities, including metered taxi app providers, must calculate AMT on their total annual commissions or service fees.

Taxpayers previously exempt from income tax before July 1, 2017 are not subject to AMT for the 2017 tax year, since they did not have taxable income during the relevant period.

Where a business's account was closed before July 1, 2017 but the tax was filed after that date, AMT still applies based on when income was earned, not when returns were submitted.

AMT exemptions for bankruptcy or debt consolidation are available only when the court has formally determined bankruptcy or opened reorganization proceedings. General loan restructuring with banks does not qualify for exemption.

Where taxpayers do not provide documentation of annual gross revenue, tax authorities must estimate the income in accordance with the Tax Administration Proclamation.

## **Tax Obligations of Previously Exempt Taxpayers and Transitional Rules**

The MoF confirms that taxpayers who were exempt under other legislation remain exempt for income earned before July 1, 2017 EC. The Amendment Proclamation applies only to income earned after this date. Similarly, income earned from government treasury bills and government bonds before July 1, 2017 EC remains governed by the previous rules.

## **Dividend Taxation and Undistributed Profits**

The Amendment Proclamation increased the dividend tax rate to 15%, effective August 1, 2017 EC. The applicable tax rate depends on when the obligation to pay the tax is triggered, not when the underlying profits were earned. Thus, profits earned before 2016 but distributed after August 1, 2017 EC are subject to the new 15% rate. Where companies fail to distribute profits or capitalize them within the required 12-month period, they become liable for tax on undistributed profits. If the deadline for this obligation falls after August 1, 2017 EC, the 15% rate applies.

## **Accounting Requirements, Rental Income, and Investment Incentives**

Category A taxpayers with multiple business lines must maintain separate accounting records for each business to avoid distortions in taxable income. This requirement applies to income earned on or after July 1, 2017 EC; consolidated accounts may still be accepted for the 2017 tax year.

AMT applies only to Schedule “C” business income and does not apply to rental income under Schedule “B”. Nevertheless, Category A and B taxpayers must still make quarterly advance tax payments on rental income, consistent with Article 89 of the Proclamation.

The MoF also clarified that investors enjoying income tax holidays under the current investment incentive framework are not subject to AMT during their incentive period.

For entities such as limited liability partnerships and mutual investment funds, which are not subject to business profit tax, loss carry forward is not permitted. However, these entities remain responsible for filing obligations, withholding obligations on purchases, and compliance with tax administration rules.

The 50,000-birr cash-payment limit affects only income tax deductibility, not VAT input deduction. Cash payments exceeding this threshold are disallowed as deductible expenses and may trigger penalties on the seller. The threshold applies separately to each sub-TIN a taxpayer may hold.

## **Repeal of the Turnover Tax (TOT) Proclamation and Its Continuing Effects**

The MoF reiterates that TOT applies only to transactions completed before the repeal of the Turnover Tax Proclamation and before VAT registration, where applicable. Supplies made after the repeal are not subject to TOT, even if the underlying contract predates the repeal. Suppliers who became VAT-registered after signing TOT-subject contracts must charge VAT on supplies made thereafter.

Any TOT collected after the repeal is not legally valid, and taxpayers collecting it may face criminal penalties. TOT paid before the repeal date and the one-month transition period of the VAT Registration Regulation remains valid and must be remitted to the tax authority. Receipts issued after the cut off date cannot be used as deductible expenses.

# 2. NBE Directive on Risk-based Capital Adequacy No. 95/2025

The National Bank of Ethiopia (NBE) issued Directive SBB/95/2025, replacing the previous flat 8% capital rule with a Basel-aligned, risk-sensitive framework. The Directive introduces a three-tier capital structure with minimum risk-weighted ratios to boost resilience and governance. Banks must comply by December 31, 2026, with reporting starting March 2026.

## Core Components of the Directive

### I. Scope and Applicability

Directive SBB/95/2025 applies exclusively to banks covering both standalone and consolidated banking groups where the parent must incorporate subsidiary risks into group capital calculations. This ensures systemic risks are captured both at the entity and group level, reducing regulatory arbitrage.

### II. Capital Structure and Minimum Ratios

The Directive adopts a three-layer capital regime comparable to Basel III, each serving a different prudential function:

- **Common Equity Tier 1 (CET1) – minimum 7% of RWA:** Highest-quality capital, including ordinary shares, statutory reserves, and retained earnings, forms the core foundation of the bank's resilience.
- **Additional Tier 1 (AT1) - (CET1 + AT1) – minimum 9% of RWA:** Hybrid instruments that absorb losses while the bank continues operating, providing an additional buffer above CET1.
- **Total Capital (Tier 1 + Tier 2) – minimum 11% of RWA:** "Gone-concern" or loss-absorbing capital, including subordinated debt and provisions, primarily protecting depositors and the financial system in case of insolvency.

These ratios are materially higher than the outgoing flat rule, reflecting NBE's intention to anchor resilience against operational challenges, market fluctuations, and potential insolvency in the banking system.

### III. Risk-Weighted Assets (RWA) Framework

Banks must calculate capital requirements based on a more granular RWA structure:

- **Credit Risk:** Standardized approach with risk weights by asset type and external ratings.
- **Market Risk:** Coverage of interest rate, equity, foreign exchange, and commodities exposures.
- **Operational Risk:** Basel III Standardized Approach with Business Indicator Component and Internal Loss Multiplier based on historical losses.

### IV. Board Accountability and Supervisory Review

Under the new banking framework, boards must integrate capital adequacy into governance and strategy, approve capital plans, oversee ICAAP, and ensure ratios stay above regulatory minimums. They must embed capital considerations in key decisions, maintain documentation, review and submit capital strategies to NBE every 1–3 years, and act promptly on supervisory recommendations.

### V. Reporting, Transition Periods, and Regulatory Flexibility

According to the Directive, banks are required to:

- Submit quarterly reports beginning from the quarter that ends March 31, 2026.
- Comply with all provisions of the Directive, including minimum capital ratios starting from December 31, 2026.
- The National Bank of Ethiopia may, in writing, extend the application period of Directive SBB/9/95 and Article 5.5 of Directive SBB/78/2021 based on its assessment of a bank's level of implementation of the Directive.

### 3. NBE Directive on Foreign Exchange Exposure Limits No. /SBB/96/2025

The National Bank of Ethiopia (NBE) issued Directive SBB/96/2025, replacing SBB/27/2001 with a new prudential framework for managing foreign exchange exposures. Effective November 10, 2025, it sets comprehensive rules to enhance stability, reduce exchange-rate risks, and ensure disciplined, transparent Foreign exchange operations for all banks.

#### **Prudential Requirements and Exposure Limits**

Under this Directive, banks are required to include all foreign-currency-denominated assets and liabilities in their exposure calculations, unless the customer has contractually assumed the exchange-rate risk in writing. The Directive imposes a strict ceiling on overall foreign exchange exposure, limiting it to  $\pm 18\%$  of Tier 1 capital, meaning a bank may hold no more than 18% long or 18% short relative to its Tier 1 capital, calculated at the close of each business day. While banks may establish internal policy limits for individual currencies, the aggregate exposure across all currencies must remain within the prescribed threshold. Continuous intra-day monitoring and consolidated assessments, including subsidiaries and forex bureaus where applicable, are mandated to ensure comprehensive risk capture.

#### **Computation Methodology**

Exposure calculations must account for both net spot positions (the difference between foreign currency assets and liabilities in a particular currency, which appear directly on the balance sheet including all accrued income and expenses) and net forward positions (all amounts to be received less all amounts to be paid in the future in a particular currency as a result of foreign exchange transactions that have already taken place, including spot transactions not yet settled). The method requires banks to convert all currency positions into Birr using the closing mid-rate, aggregate long and short positions separately, and measure overall exposure against the regulatory cap.

#### **Breach and Rectification**

Any breach of the exposure limits must be corrected immediately, with full correction required by the next business day, or the bank will face administrative sanctions.

#### **Reporting Obligations**

Banks must submit daily exposure reports to the NBE by 12:00 noon of the following business day, using prescribed templates.

#### **Internal Controls**

The Directive requires banks to maintain robust governance structures over foreign exchange operations. Boards and senior management must exercise active oversight, supported by quarterly internal audit reports to the Board and automated management information systems capable of accurately computing exposures.

#### **Special Treatment for DFIs**

Development finance institutions, including the Development Bank of Ethiopia, may be subject to modified enforcement measures in recognition of their unique funding structures.

#### **Noncompliance**

The Directive introduces a stringent penalty regime. Financial sanctions include 10% interest charges on unrectified excess exposures, daily fines for late reporting, and significant penalties for misreporting or manipulation. Non-financial sanctions may restrict or suspend core banking activities such as foreign exchange operations, branch expansion, access to NBE facilities, and acquisition of additional fixed assets. Persistent non-compliance may trigger further administrative measures under the broader banking proclamations 1359/2025 and 1360/2025.



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