

Tax Law

Teaching Material

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General Introduction

Tax Law (s) is a branch of public law. As important sources of public revenue, taxes are very important part of the daily functioning of a government. Accordingly, this teaching material tries to address, even though briefly, the basic component of tax law, especially in Ethiopia. Accordingly, the material deals with the following.

Chapter One introduces students to the basic concepts, principles and underlying assumptions of the many tax laws of Ethiopia at present. Furthermore, this chapter will look at the major tax reforms of 2002. It will also attempt to introduce students to the division of revenue powers under the Ethiopian Constitution, the major tax laws and institutions of Ethiopia, and the underlying principles common to all tax laws.

Chapter Two will introduce the students to the Income Tax in Ethiopia. It will start with a brief look at the history of income taxes in Ethiopia and will go on to look at different concepts and definitions involved in income taxation. Then after, it will look at the different schedules of Income taxation followed by the country.

Chapter three will introduce you with VAT (new area of taxation). In the portion, what is VAT, its historical background, merits and demerits, subjects of VAT, exemptions, collection and generally administration in Ethiopia will be given high attention.

Chapter four will be devoted to cover turnover tax and related concepts. Here too, its features, subjects, mode of valuation, and administration are covered.

In chapter five, emphasis is given to excise tax. Reasons to introduce, historical background, products subject to it, obligations of tax payers and administration are thoroughly dealt.

The next chapter, chapter six comes up with customs duty. As the main responsible organ; powers of Ethiopian customs authority regarding the overall administration of

goods imported or exported is exhaustively discussed. Time of control, treatment of transportations, declarations, examinations, ware houses, valuation, tariff classifications and calculation of duties, and powers and duties of customs officers and customs police are portions covered in the chapter.

Chapter seven is all about stamp duties starting with defining stamp duty, it goes through bases of the duty, rates and model of valuation. Time of payment, exemptions and penalties imposed on persons that obscure administration are analyzed.

Chapter eight, the last chapter, introduces survey of regional taxes. In this very chapter, emphasis rests on agricultural income taxes, property taxes and other taxes where regions have strong control of taxation.

Chapter One: General Introduction

1.1. Definition and Classification of Taxes

Taxes are important sources of public revenue. Public goods and services¹ are normally subject to collective consumption, thus requiring that we put some of what we earn into government hands. Public goods are normally supplied by public agencies due to their natures of non-rivalry and non-excludability. The nature of consumption of public goods is such that consumption by one does not reduce consumption for others. Besides, consumption of public goods by an agent does not exclude others from doing same. Such nature of public goods therefore makes them impossible for private suppliers to avail them at market prices like other commodities. Government intervention in the supply of public goods is, therefore, inevitable and can only be done if the public pays taxes for the production and supply of such goods.²

To that end, immediately and directly, any government's priority is the generation of revenue money by means of which it can procure such services and goods necessary for the performance of its functions. In the past, government sought to undertake this duty through numerous ways amongst which tributes and booty, feudal services, grants, aids, military duty and cultivation of crown lands are known to be the most prominent ones. Later on, with civilization and the modernization of states, governments started to procure revenue indirectly by means of revenue collected in the form of money from the citizens of the state in which the government in question exercises its functions. Therefore, so long as a system of private property subsists, individuals must contribute from their property for the support of government. Such contributions are due from those citizens of a state over whom a government may directly exercise jurisdiction, as with respect to their property, or for whom any of its functions may be directly performed, as for the defense of their persons or property. All in all, from the point of view of the

¹ Public goods and services refer to roads, power, municipal services, and other public infrastructures

² Ethiopian Chamber of Commerce and Ethiopian Business Development Services Network, Taxation in Ethiopia, Addis Ababa, 2005

individual, tax is a contribution whereas from the point of view of the government tax is a collection or procurement.

A number of authors have tried to define the term 'tax'; however, it is hard to say that these attempts at coming up with a definition for the term have been successful (mainly owing to the fact that too great precision is attempted in a single sentence). The best way to understand the term is to state the fundamental idea of a tax and afterwards to note its leading characteristics. Accordingly, in general terms, tax can be defined as a contribution from individuals out of their private property for the maintenance and defense of government, so that it may perform its functions and the ends of the state be realized.³ In simpler terms, "tax is a financial charge or other levy imposed on an individual or a legal entity by government"⁴.

Taxes are a portion of private wealth, exacted from individuals by the State for the purpose of meeting the expenditure essential to carrying out the functions of government. Taxation in some form is an invariable attribute of an organized political society, and, under whatever name it exists, it becomes sooner or later the principal means of raising revenue for public purposes; it is thus the correlative to the services which government performs for the community. Acting under a natural impulse, men organize themselves into political societies for common safety and to secure the advantages which arise from combination; only by such union is the development of human powers possible or progress in civilization attainable. All organization implies administration, and this involves expenditure which must be met by public income. Economic separation of functions tends to increase with the complexity of society, and the more advanced the organization, the more numerous become the duties of government, the more elaborate and costly its machinery, and the larger the common fund requisite to meet expenditure incurred for the common good.⁵

³ Seligman, *Essays in Taxation*, pp. 1-7

⁴ Gebrie Worku Mengesha, *Tax Accounting in Ethiopian Context*, 2nd Ed., Alem Printing Press, Ethiopia, 2008

⁵ *Ibid*

To the citizen of the modern state, taxation, however disagreeable it may be, seems natural. It is difficult to realize that it is essentially a recent growth and that it marks a comparatively late stage in the development of public revenue; it is more difficult to realize that each age has its own system of public revenue, and that the taxes of today are different from those of former times; it is still more difficult to perceive that our ideals of justice in taxation change with the alteration in social conditions.⁶

Taxes are contributions from the national dividend; they must ultimately come out of the annual earnings of the nation. The private income of a nation is the index of the capacity of the people to pay taxes, since it is the real source of public revenue. Labor and wealth employed productively by individuals create a fund which can be drawn upon; hence, as Adam Smith urged, the importance of measures which remove restraints on production, and which tend to stimulate the enterprise of people.⁷

Taxes are defined to be burdens, or charges, imposed by "the legislative power of a state upon persons or property," to "raise money for public purposes." It is a power inherent in sovereignty, and without which constitutional government cannot exist. It is vested in the Legislature by the general grant of the legislative power whether specially enumerated in the Constitution among the powers to be exercised by it or not. Coming particularly to the case of Ethiopia, the Constitution of the Federal Democratic Republic of Ethiopia, while enumerating the powers and duties of the Federal Government in Article 51 clearly states that the levying of taxes and the collection of duties on revenue sources is among the duties of the government.⁸ In addition to this, Article 52 goes on and enumerates the powers and functions of state governments, amongst which is the levying and collection of taxes and duties on revenue sources reserved to the States.⁹ When taxes are levied; the citizen is liable for their payment at the time and in the manner required and provided by the law authorizing their assessment and collection.

⁶ Ibid

⁷ Armitage-Smith, George, Principles and Methods of Taxation, J. Murray, London

⁸ Article 50(10), Constitution of the Federal Democratic Republic of Ethiopia, Proclamation No. 1/1995 [Hereinafter referred to as the FDRE Constitution]

⁹ Article 52(2)(e), FDRE Constitution

As can be evidenced from the discussion above, the basis of taxation is wealth. If wealth is the basis, then the classification of taxes might be made to depend on that of wealth. Such a method, although tried, has been found impracticable, because the processes of shifting render it impossible to ascertain the final incidence with sufficient accuracy for classification. It has also been suggested that we might use the different specific means employed by nations to measure benefit or faculty. But here, again, we meet with difficulties that are almost unsurpassable; for in that case the classification will depend on the theory adopted as to the correct measures. If we adopt the benefit theory, our classification will depend on the different indices of benefit chosen. If we adopt the faculty theory, then our classification will be according to the indices of faculty. But we are not at liberty to adopt one or the other of these theories exclusively, because no nations have done so in practice, and their taxes are some of them based on the one theory, or at least best explained thereby, and some on the other, while many combine both or may be interpreted in either way. At the same time, many taxes that could not be justified on either basis are retained by the nations on grounds of general expediency, because they yield considerable revenue, or because they have been long in use. If, therefore, we adopt a classification presupposing either theory, we shall find many taxes that do not conform to it. In as much as no consistent plan for the measurement of taxation has been adopted by any country, no uniform method of classification upon "natural" grounds can be found.¹⁰

These difficulties are inherent in the matter that we are attempting to classify and such classification will not help us to ascertain the real nature of the things studied. These difficulties have not always been regarded as unsurpassable, and many brave attempts have been made to overcome them, but with so little uniformity as to mark the failure. There are almost as many classifications as writers. The least satisfactory of all are those that attempt to find some natural arrangement. Those which have the most apparent success accept the official names used by the treasury departments of the different nations, and give them merely such limitation as is necessary to use them scientifically.

¹⁰ Carl Copping Plehn, Introduction to Public Finance, 2nd Ed., Macmillan Company, New York

A tax is a compulsory contribution of persons toward the needs of government. It follows from this definition (a) that a tax involves coercion upon its bearers, (b) who are in every case, either natural or legal persons, and (c) a specific public purpose as its end. Taxation includes the processes of levying, collecting, and paying taxes. Though taxes were historically voluntary contribution toward the expenses of government, gradually they were transformed into obligatory actions. At the present time, payment of taxes is obligatory in all civilized nations. The bearer of the tax is in all cases a person. Property belongs to some one, and when it is taken by means of taxation, the owner bears the burden. There can be no vital relation of obligation between inanimate property and the living state. The duty of supporting the state rests upon those who receive protection from it. While a large measure of the protection which the subject receives from the sovereign takes the form of security of possession, the thing possessed is but an incident in the relationship of the state and the individual. The third element in the definition of a tax is a specific public purpose as its object. Taxes are levied for the benefit of government as a whole, not for the advantage of individuals or of a particular class. Justification of taxation must rest on the will of the people expressed by legislation: when its results are applied otherwise than for the good of the general public, taxation can no longer be defended.¹¹

A commonly applied classification of taxes is into direct and indirect taxes. The classification of taxes into direct and indirect owes to the relationship between the nature of the taxes and the reason for payment of the taxes. A direct tax is one for which the formal and economic incidence are essentially the same, i.e. the taxpayer is not able to pass the burden to someone else. Accordingly, direct taxes are paid entirely by those persons on whom they are imposed. On the other hand, an indirect tax is a tax whereby the taxpayer's burden to pay the tax can easily be passed on to another person. Generally, the tax incidence of an indirect tax is on the ultimate consumer; however, sometimes, sellers might absorb such indirect taxes so as to be competitive in the market in which they are operating. The major types of direct taxes in Ethiopia are personal income tax, rental tax, business profit tax, withholding tax and such other taxes like taxes from

¹¹ Ibid

loyalties, from games of chance, dividends or property taxes. The major types of indirect taxes in Ethiopia are value added tax, custom duties, stamp duties, excise tax and turn over tax.¹²

1.2. General Theories and Principles of Taxation

Taxation is the earliest and most prevalent form of government interference with the economic life of individuals and business enterprises. The right of the chief authority to collect taxes, and the general policy which determines who is to be taxed, how much the tax shall be, and for what purposes it shall be levied has always been a controversial issue. The tremendous increases in public spending accompanying recent depressions and war periods have brought the question of taxation to the mind of each and every citizen. Moreover, the extension of the powers of governments and the creation of modern greater states has necessitated larger revenue for the administration of states. As such, the development of general taxation was inevitable.

When dealing with taxation, it is unavoidable to have important and complicated questions popping up into our heads. Some common questions include those such as:

- If public revenue contains returns from non-tax sources and from taxation, is it possible to increase the former?
- Is it to the advantage of the common that this should be done?
- When we take the revenue obtained by taxation, how ought the burden to be distributed?

The answers to questions like these will be governed by the view we take of the function of the State. Considering the possible solutions to such questions (issues) has led to the development of certain theories pertinent to taxation.

An individualistic theory would lead, so to speak, to man having as little as possible to do with the State. Every person needs, say, protection and justice, and experience shows that

¹² Id. 4

these can best be obtained in a society; the taxes he/she pays may be a quid pro quo, a payment for the services rendered. However, such a view was evidenced to lead to absurd conclusions. Does it not cost just as much to protect a man not blessed with very much of this world's goods as it does to protect a rich person? If we consider only real property, it may be that the cost of protecting it does not increase proportionately with the amount and, at any rate, "if security is to be sold like an ordinary commodity, there ought, on the strictest commercial principles, to be some allowance made to the purchaser of a large quantity."¹³ The requirement that everybody share an equal amount of revenue is equally absurd.

On the other hand, a State can be considered as the most definite institution in society; and, further, since from one point of view wealth has no meaning except in a society, the part played by that society in the production of wealth may be looked upon as making the State "the residual owner of all income which exceeds the requirements of maintenance and normal growth".¹⁴ A further extension of the same idea would be for the State to attempt to level the existing large inequalities in the incomes of its individual members by a heavily graduated tax. Thus, the socialistic ideal is widely different from the individualistic one. Is it possible to arrive at the golden mean?

As a preliminary to this it seems necessary to get rid of any sort of a priori reasons for an individualistic or a socialistic view of the functions of government; it may be argued that it is impossible to lay down any general principles which apply to every case of State interference. Each example has to be judged on its own merits statistics can help us here, but it is difficult to see the use of applying any hard and fast rule. If this be the case, we reach the faculty or ability theory of taxation. Provided that the sole aim in imposing taxation is to obtain revenue, then a reasonable distribution of taxation could surely be based upon the citizens' 'abilities to pay'. The difficulty comes in when we try to assign a definite meaning to this idea; at the present time, it is the most generally accepted theory, but possibly that is because it is so conveniently vague. 'Ability to pay' has at least three

¹³ Bastable, Public Finance, p. 299

¹⁴ J. A. Hobson, Taxation in the New State, p. 76.

different and distinct meanings. We may consider it entirely from the point of view of equity or from that of the consumption, or of the production of wealth.

If taxation is to be levied solely to obtain revenue, then equality may be a very desirable ideal at which to aim. But what does equality mean? Obviously everybody should not pay an equal share of taxation, and there are three important possible forms of distribution which have been suggested from time to time; each is intended to secure equity and each supposed to be based on the 'ability to pay'.

The first is the pure proportional form; taking income as the standard, it is laid down that the criterion of ability to pay would be attained by taxpayers paying in proportion to their income proportion being considered in the strict mathematical sense of the word. This is perhaps the view of Adam Smith, but surely it must be repudiated by common sense, as a single example will show. Suppose that a quarter of a man's income was required by the State; then a man earning 10 Birr a week would pay 25 cents, and the one getting 2 Birr a week would pay 10 cents each week; the first man might now no longer be able to keep a motor cycle, while the latter would hardly be able to feed his wife and family.

Such considerations as these have led men to think of a progressive or graduated form of distribution, in which the rate of taxation levied increases with the size of the income. But another aspect of the matter can well be brought in here. J. S. Mill says; "Equality of taxation", therefore, as a maxim of politics, means equality of sacrifice. It means apportioning the contribution of each person towards the expenses of government, so that he/she shall feel neither more nor less inconvenience from his/her share of the payment than every other person experiences. But he/she is considering only the consumption aspect of income. He is asking, in effect, "How much ought a man to pay in taxation and how much ought he to have left for his own consumption?" But surely we ought to consider also his production as well as his consumption of wealth. "In estimating a man's faculty or ability to pay we must not alone think of the burden imposed on him in parting with his property or income, but we must also consider the opportunities he has enjoyed

in securing that property or income.¹⁵ If this is so, we have a plain case that equity requires a graduated rate of taxation; many higher incomes (and the so-called “unearned” incomes) are obtained as the result of particular privileges particularly that of inheritance and this legal or social privilege enjoyed in the production of an individual's income increases its "ability to pay." The strongest argument against this graduated form of taxation seems to be that it checks saving. But so also, in a way, does any form of taxation; a progressive system affects most considerably the very large incomes, but it encourages saving among the middle classes and the people with relatively small incomes.

It should be noticed that although income and inheritance taxes are the particular ones to which graduation is most easily applicable, yet progression can also be realized to a certain extent by levying heavy taxes on luxuries and the better kinds of a number of articles. Thirdly, we come to a form of distribution which may be called a qualified proportional one. Here, once again taking income as the standard, "equality of sacrifice" can be obtained (it is said) by exempting a certain amount of income and levying a uniform or possibly a slightly graduated rate of tax on any income above that limit. This is, of course, the way in which our present income tax works, which allows "a personal allowance" of 135, or 225 " in the case of an individual whose wife is living with him/her to be free of income tax.

The two central principles of taxation relate to the impact of tax on efficiency (concerned with the allocation of resources) and equity (concerned with the distribution of income). As the major principles of taxation in any system, it is worth taking an in-depth look at “efficiency” and “equity (fairness)”.

A good tax system should be efficient in that it should be able to waste as little money and resources as possible. Efficiency can be measured against three standpoints: administrative costs, compliance costs and excess costs. These three relate to the cost of operation of the tax system, to its flexibility and certainty. Administrative costs are the

¹⁵ Seligman, *Essays in Taxation*, p. 339.

costs to the government (and ultimately to the taxpayer) of collecting tax revenue. In order to collect taxes, the government must hire collectors to collect the revenue; data entry clerks to process the tax returns; auditors to inspect questionable returns; lawyers to deal with disputes; and accountants to track the flow of money. All these costs are those that are incurred by the government to administer the tax system. Compliance costs, on the other hand, are the costs (other than the taxes themselves) of making tax payments to the government. In order to comply with their obligation to pay taxes, citizens are bound to incur certain costs. These compliance costs include not only the money that people spend on accountants, tax preparers and/or tax lawyers, but also the time spent in filing tax returns and keeping records. The third aspect of efficiency, excess burden, relates to tax-induced change in behavior displayed by tax payers. When the government levies taxes on goods, it distorts consumer behavior as people are bound to buy less of taxed goods and more of other goods. Thus the intrinsic value of goods is shadowed by the taxes which are imposed on the goods. In general the larger any of these costs get, the worse it is for efficiency.¹⁶

The other major principle of taxation is that the burden of tax should be distributed fairly. Accordingly, equity or fairness is further highlighted by two principles: the ability-to-pay principle and the benefits principle. The ability-to-pay principle holds the idea that the amount of taxes that people pay should be based on their ability to pay. This principle implies two things:

- i) Horizontal Equity: People in equal positions should be made to pay the same amount of taxes.
- ii) Vertical Equity: A tax system should distribute the burden of paying taxes fairly across people with different abilities to pay. Thus, people who earn more should pay more than those people who make less than them.

¹⁶ Gebrie Worku Mengesha, Tax Accounting in Ethiopian Context, 2nd Ed., Alem Printing Press, Ethiopia, 2008

1.3. General Introduction to Fiscal Federalism and Division of Revenues under the Ethiopian Constitution

As a subfield of public economics, fiscal federalism is concerned with "understanding which functions and instruments are best centralized and which are best placed in the sphere of decentralized levels of government".¹⁷ In other words, it is the study of how competencies (expenditure side) and fiscal instruments (revenue side) are allocated across different (vertical) layers of the administration.

It may be noted that the ideas of fiscal federalism are relevant for all kinds of government, unitary, federal and confederal. The concept of fiscal federalism is not to be associated with fiscal decentralization in officially declared federations only; it is applicable even to non-federal states (having no formal federal constitutional arrangement) in the sense that they encompass different levels of government which have de-facto decision making authority. This however does not mean that all forms of governments are 'fiscally' federal; it only means that 'fiscal federalism' is a set of principles that can be applied to all countries attempting 'fiscal decentralization'. In fact, fiscal federalism is a general normative framework for assignment of functions to the different levels of government and appropriate fiscal instruments for carrying out these functions. The questions arise: (a) How federal and non-federal countries are different with respect to 'fiscal federalism' or 'fiscal decentralization' and (b): How fiscal federalism and fiscal decentralization are related (similar or different)? While fiscal federalism constitutes a set of guiding principles, a guiding concept that helps in designing financial relations between the national and sub-national levels of the government, fiscal decentralization on the other hand is a process of applying such principles. Federal and non-federal countries differ in the manner in which such principles are applied. Application differs because unitary and federal governments differ

¹⁷ Oates, W.E. 1999. 'An Essay on Fiscal federalism', Journal of economic Literature, 37(3):1120-49
JSTOR [Hereinafter referred to as Oates]

in their political & legislative context and thus provide different opportunities for fiscal decentralization.¹⁸

An original definition of fiscal federalism states that "fiscal federalism" concerns the division of public sector functions and finances among different tiers of government. In undertaking this division, Economics emphasizes the need to focus on the necessity for improving the performance of the public sector and the provision of their services by ensuring a proper alignment of responsibilities and fiscal instruments. While economic analysis, as encapsulated in the theory of fiscal federalism, seeks to guide this division by focusing on efficiency and welfare maximization in determining optimal jurisdictional authority, it needs to be recognized that the construction of optimal jurisdictional authority in practice goes beyond purely economic considerations. Political considerations, as well as historical events and exigencies, have in practice, played major roles in shaping the inter-governmental fiscal relations in most federations.¹⁹

Even in non-federal states, there has been a growing movement towards greater fiscal decentralization in recent years. Some analysts have attributed this to globalization and deepening democratization the world over on the one hand and increasing incomes on the other.²⁰ Other specific reasons for increasing demand for decentralization are:

- Central governments increasingly are finding that it is impossible for them to meet all of the competing needs of their various constituencies, and are attempting to build local capacity by delegating responsibilities downward to their regional governments.
- Central governments are looking to local and regional governments to assist them on national economic development strategies.
- Regional and local political leaders are demanding more autonomy and want the taxation powers that go along with their expenditure responsibility.²¹

¹⁸ Ibid

¹⁹ Ibid

²⁰ Ibid

²¹ Ibid

Moreover, in recent years, decentralization has become a feature of reform agenda promoted and supported by the World Bank (as stated in the World Bank Report of 1997) and other multilateral institutions. The rationale for this has been in part that decentralization promotes accountability. It is not therefore surprising that by 1997, 62 of 75 developing nations had embarked on one form of decentralization or another.²²

Fiscal federalism in Ethiopia has been adopted within a unique political landscape of ethnic federalism. The TPLF-led government that replaced the Dergue has redrawn the political map of the country and adopted ethnic based federal structure of government. This experiment has been formalized in the 1994 Constitution. However, the constitutional provisions operate with political centralism that has remained to be the distinguishing feature of the current political system.

Fiscal federalism derives its nature and characteristics from constitutional provisions as well as the state of economic development, the pattern of income and resource distribution, and the institutional capacity of the system. The constitutional provisions define the framework within which decision-making would be exercised and establishes the vertical and horizontal structures that find meaning within the prevailing socio-economic environment of the system. The vertical structure defines the assignment of fiscal decision-making power between the federal and lower tiers of government. The horizontal structure outlines the nature of interaction across cross-sections of government levels. This aspect addresses how regional governments interact to each other especially when there are externalities and spillovers. The main economic rationale behind fiscal decentralization is improving efficiency of public resource utilization, creating enabling environment for private sector development and the growth of the national economy. The theory of fiscal federalism addresses three issues related to fiscal decision-making: assignment of responsibilities and functions between the federal government and the regional governments, the assignment of taxation power and the design of inter-governmental transfer (subsidy) of fiscal resources coupled with provisions about the

²² Peter Ozo-Eson, Fiscal Federalism: Theory, Issues and Perspective, 2005, [Available Online], available at <http://www.dawodu.com/eson1.htm>

borrowing windows to sub-national governments. These factors give rise to a third issue of the relative size of the public sector in the national economy. It is therefore the dynamics of these processes and public policy choices that ultimately shapes the performance of the fiscal sector and its impact on the national economy.

An important aspect of the exercise of fiscal federalism is the assignment of fiscal functions to the federal and the sub-national governments and the appropriate means of financing these responsibilities. The theory of fiscal federalism does not provide a clear-cut separation of fiscal responsibilities that would promote economic efficiency and resource distribution. The broad thrust of normative theory is that expenditure responsibilities in areas of macroeconomic stabilization and redistribution functions should remain within the domain of the federal government whereas allocation functions should be assigned to lower levels of government.²³ The argument is based on the reasoning that lower levels of government have limited capacity and policy instruments to provide stabilization and redistribution functions. Due to the nature of the responsibilities, the federal government usually assumes macroeconomic stabilization and income redistribution functions and make sure that regional governments would not take measures that are not compatible with such functions. Moreover, there are functions such as national defense and foreign affairs that have national public good character and hence usually assigned to the central government.

Fiscal decentralization and the assignment of functions can generate economic efficiency of the public sector. If preferences are heterogeneous across jurisdictions, which is most likely the case, decentralized decision-making power as to the provision of local public goods and services improves efficiency by tailoring services to the preferences of the local population. The main argument is that local governments are closer to the local population and can identify their choice and preferences better than the central government. Accordingly, when the decision to provide a bundle of public goods is made by local officials and these officials are directly accountable to the local voters, there is an incentive for the local public officials to provide services that reflect the preferences of

²³ Oates

the local population. Moreover, as long as there is close relation between the benefits from public services and taxes on the local taxpayers, there is additional incentive to utilize resources efficiently and cost effectively. At least by implication, the theory recognizes the need for local authorities to exercise choice in the provision of public services that are of higher local demand instead of resorting to the unitary solution. The decentralization theorem suggests that, under such conditions, decentralization of fiscal decision-making can improve efficiency of the public sector and the welfare of the local population.

Once the allocation of expenditure responsibilities is conducted according to such broad principles, the fiscal system needs to address the issue of assigning taxing power that broadly identifies who should tax, where and what.²⁴ The imposition of taxes, in the absence of lump-sum source of taxation, always involves a certain degree of economic inefficiency. In the context of fiscal federalism, the assignment process needs to identify the comparative efficiency and effectiveness of providing the fiscal instruments to the multi-tier decision-making centers so as to finance public functions and activities in the most efficient manner possible.

What kind of taxes should be assigned to the federal government and which should be assigned to the local governments? The theory and practice in the assignment of taxation power identifies the following main criteria in assignment process: taxes on mobile tax bases, redistributive taxes, taxes that could easily be exported to other jurisdictions, taxes on unevenly distributed tax bases, taxes that have large cyclical fluctuations, and taxes that involve considerable economies of scale in tax administration should be assigned to the national or federal government.²⁵ There are efficiency and equity considerations behind such principle of tax assignment.

The assignment of taxing power between the federal and the regional governments and the provision for concurrent power to share establishes the basic link in which the

²⁴ Ibid

²⁵ Ibid

behavior of one of the parties would influence the decision making power of the other and its effective tax base. There is a possibility for vertical tax externality that might require additional policy instruments to correct their effect on other levels of government. When there are clear cases in which vertical tax externalities are prevalent, the tension between the federal and the state governments would arise. This in turn would require mechanisms for the assignment of taxing power and revenue based on the nature and characteristics of the tax base.

The assignment of taxing power is a thorny issue in fiscal policy and its application is influenced by a number of considerations. First, despite the legislative assignment of taxes, the actual potency of the tax network depends on the nature and development of the national economy, the relative distribution of economic activities across jurisdictions, and the administrative efficiency of the taxation system. Second, the practice of fiscal federalism, especially when citizens across regions with diverse economic and demographic situations are treated unequally, gives rise to the violation of one of the core principles of horizontal fiscal equity. Moreover, fiscal decentralization might also potentially breach the principle of vertical fiscal equity by not treating taxpayers with different capacity to pay differently. Third, despite the monopoly of taxing power resides at the disposal of the government, the reach of the taxation network depends on the economic circumstances of the potential taxpayers.

The fiscal system of Ethiopia has historically been characterized by high centralization and concentration of fiscal decision-making power at the center. Moreover, the structure of the fiscal system shares important features with other underdeveloped economies in terms of reliance on indirect taxes, dependency on international trade taxes, and persistent fiscal deficits. The current fiscal system of Ethiopia features some departures from the previous systems and striking continuities in the structure and essential elements of fiscal performance of the economy. The main features of fiscal aggregates of Ethiopia suggest that either the government is not willing to fundamentally change its fiscal policy stance or the fiscal system is governed by the structural features of the economy that are not easily amenable to change in response to fiscal policy reforms. A closer examination of

the main features of the fiscal system suggests that both factors play a role in the process. The nature and structure of the economy, the resulting tax bases, the excessive dependence on international trade taxes and external grants, and persistent deficits all contribute to the prevailing features of the fiscal sector as do the fiscal policy stance of the government.

For the period 1980/81-2001/02, the government on average extracted about 18 percent of GDP from the public and spent about 28 percent of GDP, of which recurrent spending took more than 19 percent and only 9 percent left for capital spending. This behavior of excessive spending left an average fiscal gap of about 10 percent. Foreigners provided about 3 percent as charity and lent about 4 percent of GDP and the rest was financed mainly from domestic banking system.²⁶ A fiscal system that resorts to borrowing to cover about 36 percent of its spending appetite would sooner or later confront the consequence of its behavior. It is an important predictor of a looming crisis. This behavior of fiscal spending also affected the macroeconomic situation in which aggregate expenditure run in excess of domestic production. The country has become increasingly dependent on foreign aid and borrowing to finance its consumption and investment expenditure.

The fiscal system, nonetheless, witnessed important changes over time. Government revenue increased during the 1980s and reached a peak of 24.8 percent of GDP in 1988/89 before it declined drastically during the subsequent two years of political turmoil in the country.²⁷ The fiscal regime was extremely coercive and led to distortions in resource allocation. The prohibitively high marginal tax rate had driven most activities underground and tax evasion and corruption were on the rise. Such a system was indeed unsustainable and the change in the political regime precipitates a collapse in the fiscal system. The decline in revenue was particularly severe from business profit taxes, export

²⁶ Ministry of Finance and Economic Development, Addis Ababa, Ethiopia and FDRE 2002

²⁷ Ibid

taxes and revenue from government investment income. The collection of government revenue collapsed from about a quarter of GDP to about 10.6 percent by 1991/92.²⁸

The transitional government introduced a number of fiscal and monetary policy reforms that had mixed implications on the revenue collection. The amendment in the tax codes, devaluation and gradual depreciation of the exchange rate, elimination of taxes on exports (except coffee duties), and the privatization process have had important implications on the amount and structure of government revenue. The average domestic revenue to GDP ratio has recovered gradually and for the period 1991/92 to 2001/02 the average reached about 17.2 percent with a gradual and yet increasing trend. The average tax revenue for the period was about 11.7 percent of GDP.²⁹

One typical feature of the tax structure is its narrow base. There is an increasing dependency on foreign trade, especially import, taxes in recent years. The devaluation of the currency and its subsequent depreciation over time somewhat expanded the domestic currency denominated tax base on imports. The tax revenue-to-GDP ratio for developing countries is about 18 percent and for African countries is about 20 percent. The ratio of tax revenue in GDP for advanced countries is significantly higher than developing countries, at about 38 percent, reflecting the state of economic development, the tax base and the efficiency of tax administration. This pattern could broadly be attributable to the structure and performance of the economy, the administration of the taxation system, and the design of the taxation system.

A longer view of the fiscal resource allocation behavior of the government, despite marginal changes in some aspects of the fiscal components, suggests that there has not been enduring and significant shift in policy over the past two or so decades. The current government in power, except some marginal changes, shares important characteristics

²⁸ Ibid

²⁹ Ibid

and behavior in fiscal policy with its predecessor. The current regime spends about 26 percent of GDP and extracts from the public about 17 percent of GDP.³⁰

Foreigners still provide about 3 percent as grants and lend about 3.7 percent of GDP. The remainder of about 2.4 percent of GDP has been financed from domestic borrowing. The relative performance of the current fiscal regime shows some improvement and yet it still covers about 23 percent of its spending by borrowing. The result of such features of government revenue and expenditure has been the emergence of persistent fiscal deficits and the accumulation of public debt. Domestic government revenue apparently has been barely enough to cover recurrent government expenditure let alone to generate resources for financing capital expenditure. The level of deficit has increased so much so that in recent years it has been as much as the total tax revenue collection of the government. Such a stance of fiscal policy is unsustainable and the external grants, even if important to partially narrow the gap, would not and could not resolve the problem. The government has increased its appetite for borrowing from foreign sources to bridge the gap and when external borrowing does not satisfy it resorts quite easily to borrow from the domestic banking sector.

The fiscal performance of the country is reflections of a typical underdeveloped and agrarian based economy in which the majority of the population lives in chronic poverty and a government that devotes its effort to extraction of resources from the economy and failing to allocate these resources to priority areas and sectors of the economy. When this is coupled with a de facto fiscal centralization and stance of inefficient public resource allocation, it fails to address the priorities of the majority of the population and hence becomes increasingly unsustainable. However, both political imperatives and changes in the overall economic policy of the country opened the door for fiscal policy innovation.³¹

As far as the current system of fiscal federalisms and division of revenues in Ethiopia goes, the FDRE Constitution provides that the Federal Government and the States all

³⁰ Ibid

³¹ Abu Girma Moges, An Economic Analysis of Fiscal Federalism in Ethiopia

collect taxes and shall share revenue, taking the federal arrangement into account.³² By taking into consideration principles such as ownership of revenue, regional character of revenues sources, convenience for administration, population, and wealth distribution, sharing of revenue between the Federal Government and the State Governments serves the following purposes: enhancing the efficiency of the central and the regional governments so as to enable them to carry out their respective duties and responsibilities; helping the regional governments to develop their regions on their own initiatives; narrowing the existing gap in development and economic growth between the regions of the country; and encouraging common interest activities of the regions.

In sharing of revenues, taxes are grouped into three: central (that of the Federal Government), regional and joint. As far as collection of the revenues goes, the regional governments collect their own revenues whereas the Federal Government collects not only its own revenues but also the joint revenues, of course with a possibility of delegation whenever deemed necessary.

According to Article 96 of the FDRE Constitution the revenues of the Federal Government include customs duties, taxes and other charges levied on the importation and exportation of goods; income tax collected from employees of the Federal Government and international organizations; income, profit, sales and excise taxes collected from Federal Government owned enterprises; taxes collected from national lotteries and other games of chance; taxes collected from income generated through air, rail, and sea transport services; taxes collected from rent of houses and Federal Government owned properties; charges and fees on licenses issued and services rendered by the Federal Government; taxes on monopolies; and Federal stamp duties.³³

In a similar manner, Article 97 enumerates the revenue sources of the regional governments of the country as comprising of income taxes collected from employees of the States and of private enterprises; fees collected from land usufructuary rights; taxes

³² Article 95, FDRE Constitution.

³³ Article 96, FDRE Constitution

collected from the income of private farmers and farmers incorporated in cooperative associations; profit and sales taxes collected from individual traders operating within state territories; taxes on income from water transportation within state territories; taxes collected from rent of houses and State Government owned properties; profit, sales, excise and income taxes collected from State owned enterprises; taxes on income, royalties, and land rentals from mining operations; charges and fees on licenses issued and services rendered by the State Governments; and royalties for use of forest resources.³⁴

Apart from these, there are certain revenue sources which are shared by the Federal and State governments. The joint revenues are listed in Article 98 of the FDRE Constitution as constituting profit, sales, excise and income taxes on enterprises jointly established by the Federal and State governments; profits of companies and dividends of shareholders; and income and royalties derived from large-scale mining operations and all petroleum and gas operations.³⁵ For those powers of taxation which have not been explicitly stated in the provisions of the FDRE Constitution, such as value added tax, Article 99 clearly stipulates that the exercise of such powers is to be determined by a two-third majority vote in a joint session conducted by the House of Federation and the House of People's Representatives, thus subjecting the exercise of this so-called "undesigned power" to strict requirements.³⁶

The exercise of the taxing powers of both the Federal and Regional governments has to take certain considerations into account. For one, both governments are required to ensure that any tax is related to the source of the revenue taxed and that it was determined per the proper procedures. Secondly, both governments are required to ensure that the relationship amongst themselves is not adversely affected by the tax and that the rate and amount of taxes are commensurate with the services that the taxes help deliver. Finally,

³⁴ Article 97, FDRE Constitution

³⁵ Article 98, FDRE Constitution

³⁶ Article 99, FDRE Constitution

both governments are prohibited from levying and collecting taxes on each other's properties unless it is a profit-making enterprise.³⁷

The FDRE Constitution gives much power to the regional states. Collectively, the regional states are granted the status of a nation. They are given self-determination up to secession. Self-determination is broadly understood to mean as the use and development of one's language, culture, history and administrative structure. Beyond the "unrestricted right to administer itself", self-determination also includes proportional representation at federal organs.³⁸ In order to resolve conflicting claims over representation, territory and resource, the constitution has created the House of Federation whose members are elected by State Councils. The ethnic groups are represented at this institute. This House is composed of "representatives of nations, nationalities and people" at least one for each of them, plus an additional member for nation or nationality for each one million of its population". Ethnic conflicts and boarder disputes are referred to the House of Federation. This body has the role of supreme interpretation of the constitution and resolving key question of the nationalities/ethnic groups.³⁹

The regional states have their respective autonomous governments set up. Accordingly, each regional government includes a State Council (the highest organ of state authority) and a State Administration (highest organ of executive power). The State Council is the highest political authority: it defines the region's policy and has all legislative, executive and judiciary powers regarding the region, except for those under the responsibility of the central government, such as defense, foreign affairs, economic policy etc. The State Council plans, approves, heads and controls economic and social development programs. It drafts, approves and manages the regional budget. The State Administration is the highest executive authority of regional government. It is elected by the State Council and includes 15 Executive Committee members. The State Administration enforces, as appropriate, the policies, proclamations, regulations, plans, guidelines and decisions of the central government and of the State Council. It manages, coordinates and supervises

³⁷ Article 100, FDRE Constitution

³⁸ See generally Article 39, FDRE Constitution

³⁹ See generally Articles 53 and 61 through 64, FDRE Constitution

the activities of regional offices, zone administration offices and Weredas (district) offices. It drafts and submits economic and social projects to the State Council for approval, and manages the projects once they have been approved. It drafts the region's budget, submits it for approval to the State Council and manages the budget once approved.⁴⁰

At the broadest level, the general principle underlying the allocation of authority and legislative responsibility in federal systems has been that matters of common interest and concern to the country as a whole should be assigned to the federal government, and matters of a decidedly regional or local character should be assigned to the regional governments. In actual fact, however, there is a weak federal executive power whose relationship with the regional governments is not yet clearly coordinated. Constitutionally, the federal government is not effectively centralized through presidentialism. The president has a symbolic role. The federal executive power is vested in the Prime Minister and in the Council of Ministers which are politically accountable to the House of Peoples' Representatives in all the decisions it adopts.⁴¹ As enshrined in Article 77 of the Constitution, the Council of Ministers among others, ensures implementation of laws, and decisions adopted by the Federal Parliament, decided organizational structure of Ministries and other Federal Parliament, decided on organizational structures of Ministries and other organs of government responsible to it, coordinates the activities of organs of government, discusses and refers draft proclamations to the Lower House, and decides on the general socio-economic and political strategies the country should pursue.⁴²

State Councils of the regions are also responsible for appointment of the highest executives in charge of the various organs of State. The respective constitution of the various regional states stipulates that the State Councils are entrusted with the power of forming the Executive Committee, which is the highest state-level executive organ. State executive bodies are responsible for the execution of laws, policies and strategies falling

⁴⁰ Article 50, FDRE Constitution

⁴¹ Article 76, FDRE Constitution

⁴² Article 77, FDRE Constitution

within their jurisdiction. These include administering land and other natural resources in keeping with Federal laws, formulating and execution economic, social and development policies, strategies and plans of the state in question.⁴³

Consequently, health, security, and agricultural development and similar other matters seriously demand that the pertinent Federal and State executive organs work in close collaboration. There could be contexts where the common decisions of the two become vital to ensure maximum benefits in a particular area. But there is a weak exchange of information between the two levels. Under such circumstances, it is possible that the regional states can only issue and enforce their own laws not that of the federal government.

The most important factor which underlines the further autonomy of the regional states is the assigning of residual power. The Federal Constitution as stipulated in Article 52(1) states that "All powers not given expressly to the Federal Government alone, or concurrently to the Federal Government and States are reserved to the States"⁴⁴. Accordingly, any residual power unspecified in the constitution is left for the States. It thus allocates residual authority to the constituent units. The significance of the residual power is that the regional states can exercise legislative power over matters not specified in the constitution.

The above three points suggest that the relationship between the federal government and the regional states is asymmetrical, even though they are in principle considered to be equal. Nonetheless, the financial and manpower resources of the regions are very limited. The revenue base of the regions is not that productive and expansive. Currently, they are dependent on federal fund, particularly for capital budget. They are not yet economically strong to claim that their laws supersede that of the federal law. According to the constitution, they are given all the power to develop their region.

⁴³ Article 52, FDRE Constitution

⁴⁴ Article 5(1), FDRE Constitution

As can be inferred from Sub-Article 7 of Article 62 of the FDRE Constitution, which enumerates the powers and functions of the House of Federation, there is a possibility by which the Federal Government may transfer revenue to the regional governments.⁴⁵ Such a system of transfer payments or grants, by which a central government shares its revenues with lower levels of government, is an important aspect of the subject matter of ‘fiscal federalism’. The underlying rationale behind transfer of revenue is the existence of a fiscal gap at the sub-national level emanating from lack of locally generated own revenue to finance own expenditure; differences in the regions’ level of economic development and endowment with natural resources lead to the formation of a fiscal gap.

Federal governments use this power to enforce national rules and standards. Such transfers of revenues usually fall under three categories: conditional, unconditional and equalization grants. A conditional transfer from a federal body to a state, or other territory, involves a certain set of conditions. If the lower level of government is to receive this type of transfer, it must agree to the spending instructions of the federal government. The second type of grant, unconditional, is usually a cash or tax point transfer, with no spending instructions. Unconditional grants are usually general purpose grants aimed at addressing vertical imbalances. The third type of grant, equalization grant, is used to address horizontal imbalances between regional governments through the channeling of resources from the relatively wealthier regions to poorer ones; thereby equalizing the capacity of regional governments to provide a national standard level of goods and services.⁴⁶

1.4. History of Taxation in Ethiopia⁴⁷

The history of taxes reveals that their coercive nature is of comparatively recent development. The original idea of a tax was that payment was not obligatory upon the subject, but consisted rather as a voluntary contribution toward the expenses of

⁴⁵ Article 62(7), FDRE Constitution

⁴⁶ Id. 4

⁴⁷ See generally, Gebrie Worku Mengesha, Tax Accounting in Ethiopian Context, 2nd Ed., pp. 2-12, Alem Printing Press, Ethiopia, 2008

government, as appears from the Medieval Latin term *donum*, and the English "benevolence." This conception of the relation between the subject and government was gradually transformed; payment becoming more and more obligatory, until finally coercive taxation resulted. At the present time payment of taxes is obligatory in all civilized nations; where the rate or imposition is at all dependent upon the taxpayer, the tax takes the form of a fee or payment for contractual services.

Resources were allocated among the various sectors of the economy differently in the imperial and revolutionary periods. Under the emperor, the government dedicated about 36 percent of the annual budget to national defense and maintenance of internal order. Toward the end of the imperial period, the budgets of the various ministries increased steadily while tax yields stagnated. With a majority of the population living at a subsistence level, there was limited opportunity to increase taxes on personal or agricultural income. Consequently, the imperial government relied on indirect taxes (customs, excise, and sales) to generate revenues. For instance, in the early 1970s taxes on foreign trade accounted for close to two fifths of the tax revenues and about one-third of all government revenues, excluding foreign grants. At the same time, direct taxes accounted for less than one-third of tax revenues.

The revolutionary government changed the tax structure in 1976, replacing taxes on agricultural income and rural land with a rural land-use fee and a new tax on income from agricultural activities. The government partially alleviated the tax collection problem that existed during the imperial period by delegating the responsibility for collecting the fee and tax on agriculture to peasant associations, which received a small percentage of revenues as payment. Whereas total revenue increased significantly, to about 24 percent of GDP in 1988/89, tax revenues remained stagnant at around 15 percent of GDP. In 1974/75, total revenue and tax revenue had been 13 and 11 percent of GDP, respectively. Despite the 1976 changes in the tax structure, the government believed that the agricultural income tax was being underpaid, largely because of under assessments by peasant associations.

The government levied taxes on exports and imports. In 1987 Addis Ababa taxed all exports at 2 percent and levied an additional export duty and a sur-tax on coffee. Import taxes included customs duties and a 19 percent general import transaction tax. Because of a policy of encouraging new capital investment, the government exempted capital goods from all import taxes. Among imports, intermediate goods were taxed on a scale ranging from 0 to 35 percent, consumer goods on a scale of 0 to 100 percent, and luxuries at a flat rate of 200 percent. High taxes on certain consumer goods and luxury items contributed to a flourishing underground economy in which the smuggling of some imports, particularly liquor and electronic goods, played an important part.

Although tax collection procedures proved somewhat ineffective, the government maintained close control of current and capital expenditures. The Ministry of Finance oversaw procurements and audited ministries to ensure that expenditures conformed to budget authorizations.

Current expenditures as a proportion of GDP grew from 13.2 percent in 1974/75 to 26.1 percent in 1987/88. This growth was largely the result of the increase in expenditures for defense and general services following the 1974 revolution. During the 1977-78 Ogaden War, for example, when the Somali counteroffensive was under way, defense took close to 60 percent of the budget. That percentage declined after 1979, although it remained relatively higher than the figure for the pre-revolutionary period. Between 1974 and 1988, about 40 to 50 percent of the budget was dedicated to defense and government services. Economic and social services received less than 30 percent of government funds until 1972/73, when a rise in educational outlays pushed them to around 40 percent. Under the Dergue regime, economic and social service expenditures remained at pre-revolutionary levels: agriculture's share was 2 percent, while education and health received an average of 14 and 4 percent, respectively.

1.5. The Ethiopian Tax Reform of 2002

Since 1992/93, the Government of Ethiopia has made a major economic policy shift from Central Planning to market oriented economic system. In line with this change, a series of tariff and tax reform measures have been taken. The reasons to these were: outdated tariff and tax laws; weak customs and tax administration; failure of the tariff and tax regime to attract investment, to facilitate trade and to generate adequate revenue to cover current and capital expenditure, and hence finance development and poverty reducing projects.

The series of tariff and tax reform programs have helped to increase both Federal Government and national revenue. As per the reports of the Ministry of Revenue, the Federal Revenue has increased to Birr 6.7 billion in 2002/2003 from Birr 2.54 billion in 1993/94 as the result of which federal revenue as percentage of the GDP increased from 8.97% in 1993/94 to 11.87% in 2002/03.⁴⁸ The increase in revenue mainly attributes to the modest increase in both direct and indirect taxes, mainly the foreign trade taxes. As well, National tax revenue as percentage of GDP has increased to 15.1% in 2002/03 from 10.9 in 1993/94. Despite, the series of reforms and increase in revenue, the overall budget deficit with and without grant has been increasing. For example, the overall budget deficit without grants as percent of GDP has increased from -5.2% in 1996/97 to -14.5% in 2002/03.⁴⁹ This shows that performance of revenue collection in Ethiopia has been low compared to the rest of Sub-Saharan African countries which is over 23% of the GDP.

Hence, coupled by a series of reduction in the import tariff, excise tax and income tax and widening of the budgetary deficit, introducing a neutral and efficient tax, i.e. the VAT with broad tax base was considered. Value Added Tax (VAT) has become a major tax instrument worldwide. The global trend to introduce VAT in more countries is continuing. VAT has also become an indispensable component of tax reforms in

⁴⁸ Research on Economic Policy Implementation and Management, Northumberland, England, 2004

⁴⁹ National Bank of Ethiopia, Annual Report, 2002/03

developing countries.⁵⁰ Ethiopia's tax reform program has introduced VAT since January, 2003.

VAT revenue performance and its neutrality and efficiency are also the reasons for superiority of this tax in contrast to other common tax instruments such as the turnover tax.⁵¹ The emerging conventional wisdom, based largely on practice and numerous country case studies, suggests that a single rate VAT (with the rate between 10 and 20%), with very few exemptions and, therefore, a broad base is superior to a VAT with multiple rates and many exemptions which reduce its base and complicate administrations. Ethiopia's standard VAT rate of 15% and 10% equalization for services and 2% for goods have to be studied in the medium term whether or not they could broaden the tax base and register high revenue performance. The three major taxes and their respective Tax Reforms are explained below:

A. Taxes on Income and Profits

Tax on employment income used to be guided by Income Tax Proclamation No. 173/1961. In the 1990s, this proclamation was amended with modifications to the legislation regulating income tax on employment: rural land and agricultural income tax; rental income tax; taxes on business and other profits; tax on income from mining activities; capital gains tax, and taxes on other sources of income such as chance winning (which carries a tax rate of 15 per cent), royalties (with a tax rate of 5 per cent) and tax on non-resident persons offering services in Ethiopia (which carries a tax rate of 10 per cent).⁵²

This reform resulted in a schedule for marginal tax rate which is currently being applied to income exceeding Birr 150, the assumed minimum wage rate. Compared to the marginal tax rate of 89 per cent during the military (Dergue) period; the current reform which reduced the maximum marginal tax rate to 35 per cent was quite radical. The 1978

⁵⁰ Goode, Richard (1993) "Tax Advice to Developing Countries:" A Historical Survey, World Development, Vol. 21, No. 1, pp 37 - 53.

⁵¹Zeliko Bogetic and Fareed Hassan, Determinants of Value Added Tax Revenue, October 1995, World Bank WPS

⁵² Id. No. 3

income tax for rural land and agricultural activities was also amended in 1995 and 1997. For land use, farmers are now taxed Birr 10 for the first hectare and Birr 7.5 for each additional half hectare. Moreover, annual income exceeding Birr 1,200 is subject to a progressive tax rate (as outlined in Appendix Table 1). The land use fee for state farms is Birr 15 per hectare. A novel aspect of the latest tax policy concerning the agricultural sector is the fact that an agricultural investor is exempted from income tax for two consecutive five-year periods. A progressive marginal tax rate schedule was also enacted in 2002 for income derived from the rent of houses (including manufacturing plants).⁵³

B. Taxes on Goods and Services

The reform in this category refers to Excise Tax Proclamation (No. 68/193, 77/1997, and No. 149/1999), and the applicable tax rate ranges from a low of 10 per cent on textiles and television sets to 100 per cent for alcohol, perfumes and automobiles. Sales tax on goods constitutes the second category and these ranges from 5 per cent (mainly for agricultural goods) to 15 per cent. Many basic goods are exempt from taxation. The reform also introduced a 5 per cent tax rate for work contracts and financial services, while a 15 per cent rate is applied to the sale of other services. Valued-added tax (VAT) was introduced in January 2003 and may mean a shift from Ethiopia's dependence on foreign to domestic trade, but it is too early to evaluate its impact. It is not, however, difficult to see that its implementation is a challenge, owing to the predominance of small and informal operators in the country, its history of tax evasion and corruption, lack of standard recordkeeping systems as well as the lack of knowledge about VAT and a tax-base for its computation.⁵⁴

C. Taxes on International Trade

The reform of taxes on international trade relates to levies on imports (customs duty, import excise tax, import sales tax) and tax on exports. The custom tariff reform that took place between 1993 and 2002 grouped imports into 97 categories based on the Harmonized System of Tariffs Classification Code. An ad valorem rate ranging from 0 to

⁵³ Ibid

⁵⁴ Ibid

35 per cent was introduced. The same rates were applied for import excise and sales taxes as those established for goods and services (see section above). An important development in the export sector was the abolition of all export taxes, with the exception of coffee. Similarly, to encourage exports, schemes for duty drawback and duty free imports were implemented (see Appendix Table 1 for details).⁵⁵

Other miscellaneous tax-related reforms have been carried out in the last decade. These include the amendment of stamp duties (Proclamation No. 110/1998); the introduction of a 3 per cent withholding tax (Proclamation No. 227/2001), a 2 per cent withholding tax on income (Proclamation No. 227/2001), as well as a 5 per cent withholding tax on interest income (Proclamation No. 227/2001).⁵⁶

1.6. Major Types of Taxes in Ethiopia

The major types of taxes that exist in Ethiopia, their meaning, rates and conditions, as provided by the Federal Inland Revenue Authority, are presented as follows:

1. Value Added Tax (VAT)

This is a sales tax based on the increase in value or price of product at each stage in its manufacture and distribution. The cost of the tax is added to the final price and is eventually paid by the consumer.

The rate and impose of VAT:

- The rate of VAT is 15% of the value for every taxable transaction by a registered person, all imported goods other than an exempt import and an import of services;
- The export of taxable goods or services to the extent provided in regulations for zero tax rate are:
 - The export of goods or services to the extent provided in the regulation;
 - The rendering of transportation or other services directly connected with international transport of goods or passengers, as well as the supply of

⁵⁵ Ibid

⁵⁶ Ibid

lubricants and other consumable technical supplies taken on board for consumption during international flights;

- The supply of gold to the National Bank of Ethiopia; and
- A supply by a registered person to another registered person in a single transaction of substantially all of the assets of a taxable activity or an independent functioning part of a taxable activity as a going concern, provided a notice in writing, signed by the transferor and transferee, is furnished to the authority within 21 days after the supply takes place and such notice includes the details of the supply.

2. Excise Tax

This is imposed and payable on selected goods, such as, luxury goods and basic goods which are demand inelastic. In addition, it is believed that imposing the tax on goods that are hazardous to health and which are cause to social problems will reduce the consumption thereof. Excise tax shall be paid on goods mentioned under the schedule of 'Excise Tax Proclamation No. 307/2002'_(a) when imported and (b) when produced locally at the rate prescribed in the schedule. Computation of excise tax is applied (a) in the case of goods produced locally, production cost and (b) in the case of imported goods, cost, insurance and freight /C.I.F./. Payment of excise tax for locally produced goods is by the producer and for imported goods by the importer. Time of payment of excise tax for imported goods is at the time of clearing the goods from the customs area, and for locally produced goods it is not later than 30 days from the date of production.

3. Turnover Tax

This is an equalisation tax imposed on persons not registered for value-added tax to fulfil their obligations and also to enhance fairness in commercial relations and to complete the coverage of the tax system. Administrative feasibility considerations limit the registration of persons under the value-added tax to those with annual transactions to the total value exceeding 500,000 Birr.

Rate of turnover tax is 2% on goods sold locally and 10% on others; as provided by the 'Excise Tax Proclamation No. 307/2002'

4. Income Tax

Income taxable under the Ethiopian 'Income Tax Proclamation No. 286/2002' shall include, but not be limited to:

- Income from employment;
- Income from business activities;
- Income derived by an entertainer, musician, or sports person from his personal activities;
- Income from entrepreneurial activities carried out by a non-resident through a permanent establishment in Ethiopia;
- Income from movable property attributable to a permanent establishment in Ethiopia;
- Income from immovable property and appurtenances thereto, income from livestock and inventory in agriculture and forestry, and income from usufruct and other rights deriving from immovable property that is situated in Ethiopia;
- Income from the alienation of property referred to in (e);
- Dividends distributed by a resident company;
- Profit shares paid by a resident registered partnership;
- Interest paid by the national, a regional or local Government or a resident of Ethiopia, or paid by a non-resident through a permanent establishment that he maintains in Ethiopia;
- License fees including lease payments, and royalties paid by a resident or paid by a non-resident through a permanent establishment that he maintains in Ethiopia.

5. Business profit tax

- Taxable business income of bodies is taxable at the rate of 30%
- Taxable business income of other taxpayers shall be taxed in accordance with the following expenses:

1.7. Sources of Ethiopian Tax Laws

Tax laws basically emanate from three sources; legislative, administrative and judicial sources. The major sources of Ethiopian tax laws are legislative sources. There are a number of laws that have been adopted by the legislature of the country to deal with the different types of taxes in the country and their administration. The first law that can be taken as a source is the FDRE Constitution which has numerous provisions dealing with the administration of taxes. Then after, there are a number of proclamations and regulations dealing with taxes in the country, the most prominent of which include Income Tax Proclamation No. 286/2002; Council of Ministers Income Tax Regulation No. 78/2002; Value Added Tax Proclamation No. 285/2002; Council of Ministers Value Added Tax Regulation No. 79/2002; Turnover Tax Proclamation No. 308/2002; and Excise Tax Proclamation No. 307/2002.

Summary

Tax is a compulsory contribution of wealth of a person or body of persons for the service of the public powers. As such, it is compulsory; we have to pay it whether we like it or not; it is a definite contribution, a giving up of the individual's wealth that is to say, it is a sacrifice for the use of the public powers, which include, of course, the State and the local authorities. Taxation has a history that goes back to the earliest times; as early as the Axumite period for the case of Ethiopia.

That there are different kinds of taxes is perfectly obvious, but all of them can be placed in one of two large classes. Taxes are either direct or indirect. A direct tax is one which is demanded from the very persons who it is intended or desired from. On the other hand, indirect taxes are those which are demanded from one person in expectation and intention that he/she shall indemnify himself/herself at the expense of another. Obvious examples are the income and inheritance taxes on the one hand, and value added tax and customs duties on the other. Taxation is based on the two major principles of efficiency and equity.

Per the current system of fiscal federalisms and division of revenues in Ethiopia, the FDRE Constitution provides that the Federal Government and the States all collect taxes and shall share revenue, taking the federal arrangement into account. The laws that govern taxation may emanate from the three sources namely legislative, administrative and judicial. Most Ethiopian tax laws however emanate from legislative sources.

Review Questions

- 1) What are the major principles of taxation?
- 2) What are the objectives of taxation?
- 3) What are the basic characteristics of taxation?
- 4) Horizontal equity requires that all persons who earn equal amounts of money should pay equal amount of taxes. How do you see this principle in terms of the different amounts of expenditure that people who earn equal amounts have to spend?
- 5) Compare and contrast horizontal equity and vertical equity in terms of their advantages and disadvantages.
- 6) What sources can you think of that will fall under administrative and judicial sources of Ethiopian tax laws?
- 7) Explain the division of revenues under the Constitution of the Federal Democratic Republic of Ethiopia.
- 8) Compare the traditional tax laws of Ethiopia with the current tax laws.
- 9) What were the major changes in Ethiopian taxation that were brought about by the tax reform of 2002?

Chapter II: Income Tax

2.1. Brief History of Income Taxes in Ethiopia

In traditional Ethiopia, taxation played a pivotal role. The taxation system of traditional Ethiopia provided for the conservation of different entities starting from the central government and extending to lords, clergy, nobles, soldiers and the like. As we have seen in the previous chapter, the taxation of traditional Ethiopia was paid in kind. Though not uniform, through the taxation system employed throughout the country, any productive activity undertaken by any part of the society was charged with taxation. This was evident in the facts that traders were subjected to taxation on the goods they sold; peasants were obliged to pay from what they produced and collected from their lands; craftsmen were obliged to supply their products to their superiors and so on. Another form of taxation in traditional Ethiopia was imposed upon the individual members of society. This was manifested in the imposition of the obligation to render service to superiors.

The concept of income taxation was initially introduced in Ethiopia in the year 1944. The foundational principle of income tax in Ethiopia was laid by Emperor Haileselassie in 1882, when the emperor issued a decree requiring all peasants to pay one-tenth of their agricultural products to tax officials. Accordingly, tax officials would seasonally go to the land of the peasants and collect payment in accordance with the amount obtained from the land.⁵⁷ The decree thus embodied the idea that each individual would be taxed according to the amount he/she earns. Though it was first related to agricultural income, it was modified on a number of occasions resulting in changes. One major change that was introduced was the idea of taxation on income from employment.⁵⁸

⁵⁷ For this purpose, in 1901, tax offices “granary” were set up in each district where the annual tithe had to be deposited.

⁵⁸ Eshetu Chole, *Income Taxation in Pre- and Post- Revolutionary Ethiopia: A Comparative Review*, Ethiopian Journal of Developmental Research, Vol. 9, Number 1, Institute of Development Research, Addis Ababa University, 1987 [Herein after referred to as Eshetu]

The arrangement of income taxation of that period provided a modern structural and legal framework for the collection and levying of income taxation. Income taxation under this arrangement was classified into four schedules based on the sources of the income.⁵⁹ The first schedule, Schedule A, provided for taxation of income from employment; the second schedule, Schedule B, provided for taxation of income from rent of land and buildings used for purposes other than agricultural purposes; the third schedule, Schedule C, provided for taxation of income from business, professional and vocational occupations, the exploitation of woods and forests for lumbering purposes and from interest; finally, the fourth schedule, Schedule D, provided for taxation of income from agricultural activities. By basing on these schedules, income was charged progressively. Employers were required to declare the incomes of employees and employees of more than one organization/institution were required to declare the total amount of their income from their employments.⁶⁰

In administering the collection of these taxes, two methods of collection were employed at that time. Where the taxpayer was in a position to keep accounts, the collection was to be made by the Income Tax Authority. Otherwise, income was to be assessed by a local tax assessment committee and the assessment was to be effective for five consecutive years. As is evident from the fact that most taxpayers of the time were farmers, the latter method of collection was the most employed one.⁶¹

As far as the history of the laws governing income taxation in Ethiopia go, it is said to have started with the Personal and Business Tax Proclamation No. 60/1944 which provided for income taxation in modern form as opposed to the traditional forms of taxation of earlier times. This proclamation was replaced by the Proclamation No. 107 of 1949, which was replaced seven years later by the Income Tax Decree No. 19 of 1956.

⁵⁹ Eshetu

⁶⁰ Gebrie Worku Mengesha, Tax Accounting in Ethiopian Context, 2nd Ed., Alem Printing Press, Ethiopia, 2008

⁶¹ Eshetu

Then after, Income Tax Proclamation No. 173/1961 was enacted followed by Proclamation No. 255/1967.⁶²

During the Dergue period, Proclamation No. 77/1976 and Proclamation No. 152/1978 were adopted as amendments to Proclamations No. 173/1961 and 255/1967. These two amendments changed the income tax structure levied on agricultural activities; and thus introduced rural land use fee and tax on income from agricultural activity (which had been exempted from taxation by the Income Tax Proclamation No. 255/1967). Furthermore, Special Decree No. 18/1990 was passed thereby changing the rate of taxation on business income. During the transitional period of Ethiopia, Proclamation No. 30/1992 was adopted thus amending the previous laws on personal income taxation. This proclamation was further amended by the Income Tax Amendment Proclamation No. 107/1994, which, among other things, amended the tax on income from business and other profits. The currently operating laws with regard to income taxation in Ethiopia are the Income Tax Proclamation No. 286/2002 and the Income Tax Regulation No. 78/2002.

2.2. Income Tax Administration in Ethiopia

Reorganization of the Executive Organs of the Federal Democratic Republic of Ethiopia Proclamation No. 256/2001 establishes the Ministry of Revenue by bestowing it with the powers given to the former Federal Government Revenues Board by Proclamation 5/1995 and other laws and by making it accountable to three executive organs namely the Federal Inland Revenue Authority, the Customs Authority and the National Lottery Administration.⁶³ Accordingly, the Ministry is bestowed with the powers and duties of supervising and following up the efficient collection of government revenues and the supervision of the executive organs established under it, among others.

⁶² Gebrie Worku Mengesha, Tax Accounting in Ethiopian Context, 2nd Ed., Alem Printing Press, Ethiopia, 2008

⁶³ See Articles 4, 5, 16 and 26, Reorganization of the Executive Organs of the Federal Democratic Republic of Ethiopia Proclamation No. 256/2001

The Federal Inland Revenue Authority is given the responsibility, by Proclamation 61/1997, of assessing and collecting legally specified federal tax revenues categorized, by law, for collection by the Federal Government.⁶⁴ The income of both residents and non-residents, whether in cash or in kind, is taxed through the Federal Inland Revenue Authority according to the schedular system provided for by the laws of the country.⁶⁵ The authority collects the taxes from the taxpayers either through its office or through third parties including the Commercial Bank of Ethiopia and the Ethiopian Post Office.⁶⁶

At present, the Authority has started giving Tax Identification Number [hereinafter referred to as TIN] to each taxpayer through a computerized system by way of which the Authority as well as regional administrations can identify and follow up on individual taxpayers thereby enhancing the tax collection system.⁶⁷ TIN has to be provided to every taxpayer free of charge.⁶⁸ In general, the Authority is responsible for the collection of all taxes from income earned in the federal government whereas the regional governments are responsible for the collection of taxes from income earned in the states. The Authority is further bestowed with the duty of implementing and enforcing the laws of the country that deal with income taxation.⁶⁹

2.3. General Definitions and the Notion of Income

Currently, the operative law with regard to income tax in Ethiopia is Proclamation number 286/2002. The discussion in this chapter is dependent mainly on this chapter. Accordingly, the writers believe that it is, first and foremost, necessary to define terms of general applicability throughout the chapter, with this proclamation as a basis for the definitions.

⁶⁴ Article 6, Federal Inland Revenue Authority Establishment Proclamation No. 61/1997

⁶⁵ Gebrie Worku Mengesha, Tax Accounting in Ethiopian Context, 2nd Ed., Alem Printing Press, Ethiopia, 2008

⁶⁶ Ibid

⁶⁷ Ibid

⁶⁸ Article 43, Income Tax Proclamation No. 286/2002

⁶⁹ Refer to Article 38, Income Tax Proclamation No. 286/2002.

As can be evidenced from the above discussions, income tax is a tax levied upon the incomes of an individual. Accordingly, it seems only right to start the discussion in this section with a discussion of what ‘income’ is. Scholars have long debated on the definition of income thereby resulting in the absence of a comprehensive and uniform definition of the term. Different scholars define the term from the perspective of the area on which they are working. Accordingly, the definition of the term depends on the area of specialization for whose purpose it is being defined. This difference is seen in a broad sense, i.e. from profession to profession. However, even when we come to one profession, there might be differences within that profession as well. If we take the legal profession, which is our area of concern, the definition given to ‘income’ might vary from one legal system to another.

In general, in the legal profession, the term ‘income’ is defined in the laws of the legal system. According to the Income Tax Proclamation Number 286/2002, income is defined as “every sort of economic benefit including nonrecurring gains in cash or in kind, from whatever source derived and in whatever form paid credited or received”⁷⁰. Income subject to taxation under Ethiopian law derives from various sources. These sources are listed down in Article 6 of the Income Tax Proclamation as employment; business activity; entertainment, music and personal activities of a sports person; entrepreneurial activities of a non-resident through a permanent establishment in the country; movable property attributable to a permanent establishment in Ethiopia; immovable property and apparatuses thereof, livestock and inventory in agriculture and forestry; alienation of property; dividends of a resident company; profit shares paid by a resident registered partnership; interest; and license fees.⁷¹

The other concepts that need to be defined in dealing with income tax laws are ‘gross income’ and ‘taxable income’. As income is one component of the concept of gross income, the meaning given to the term may vary from profession to profession as well as from one legal system to the other. For the purpose of the legal profession, ‘gross

⁷⁰ Article 2(10), Income Tax Proclamation No. 286/2002

⁷¹ Article 6, Income Tax Proclamation No. 286/2002

income' is taken to mean the total or aggregate income received by an individual. Whatever their sources may be, any types of income that an individual collects constitute his/her gross income. On the other hand, 'taxable income' refers to the amount of income on which actual income is charged, levied and collected after all deductions have been made in accordance with the relevant laws.⁷²

2.4. Income Tax Jurisdiction: Global Jurisdiction on Residents and Source Jurisdiction on non-residents

A look at the Income Tax Proclamation of 2002 reveals that, in Ethiopia, income tax has global jurisdiction on residents whereas it has a source jurisdiction on non-residents. Accordingly, the income tax law is applicable to residents of the Federal Democratic Republic of Ethiopia with respect to their worldwide income.⁷³ Therefore, wherever a resident earns his/her income from, he/she is bound by the provisions of the proclamation. On the other hand, the proclamation has applicability on non-residents of the country to the extent that the source of their income is in Ethiopia.⁷⁴ Therefore, where the source of a portion of a certain non-resident's income is in Ethiopia, he/she will be liable to pay tax according to Ethiopian income tax laws on that portion the source of which is in Ethiopia.

For the purpose of income taxation, residents⁷⁵ are defined as including those individuals who:

- (i) have domiciles within Ethiopia;
- (ii) have habitual abodes in Ethiopia; and/or
- (iii) are citizens of Ethiopia and consular, diplomatic or similar officials of Ethiopia posted abroad.

As far as bodies⁷⁶ are concerned, they will be considered as residents so long as they:

⁷² Refer to Article 2(11), Income Tax Proclamation No. 286/2002

⁷³ Article 3(1), Income Tax Proclamation No. 286/2002

⁷⁴ Article 3(2), Income Tax Proclamation No. 286/2002

⁷⁵ Refer to Article 5 of the Income Tax Proclamation No. 286/2002

- (i) have their principal office in Ethiopia;
- (ii) have their place of effective management in Ethiopia; and/or
- (iii) are registered in the trade register of the Ministry of Trade and Industry or the Trade bureaus of the regional governments as appropriate.

In line with this, the term “resident person” includes a permanent establishment of a non-resident person in Ethiopia.

In addition to this, an individual, who stays in Ethiopia for more than 183 days in a period of 12 calendar months, either continuously or intermittently, will be considered as a resident for that entire tax period.

2.4.1. The Foreign Tax Credit

The concept of foreign tax credit deals with the administration of taxes on income that is derived from a foreign source. Article 7 of the Income Tax Proclamation is devoted to foreign tax credit. Accordingly, if during the tax period a resident derives foreign source income, the Income Tax payable by that resident in respect of that income shall be reduced by the amount of foreign tax payable on such income. The amount of foreign tax payable shall be substantiated by appropriate evidence such as a tax assessment, a withholding certificate or any other similar document accepted by the Tax Authority. However, the reduction of the Income Tax shall not exceed the tax payable in Ethiopia that would otherwise be payable on the foreign source income. In the case of a taxpayer subject to Income Tax on Schedule C income, any such reduction of tax shall be limited to the tax that would otherwise be payable in Ethiopia computed as if Article 28 (loss carry forward) of the Income Tax Proclamation applied separately to each foreign country in respect of profit and losses derived from sources therein. The reduction of tax shall be calculated separately in respect of each foreign country from which income or profit is derived.

⁷⁶ A “body” is defined in Article 2(3) of the Income Tax Proclamation No. 286/2002 as any company, registered partnership, entity formed under foreign law resembling a company or registered partnership or any public enterprise or public financial agency that carries out business activities including body of persons corporate or unincorporated whether created or recognized under a law in force in Ethiopia or elsewhere and any foreign body’s business agent doing business in Ethiopia on behalf of the principal.

2.4.2. Bilateral Double Taxation Relief: Tax Treaties

2.4.3. The Scheduler System of Ethiopian Income Taxation

There are two important systems of income taxation that have been adopted by countries around the world. These are the global and the schedular systems of taxation. The basic feature of the global system of income taxation is that the tax is imposed on the total income of an individual regardless of the types of activities that he/she pursues and regardless of the sources from which he/she obtained his/her income. Accordingly, under the global system of taxation, an individual has to declare his/her aggregate income for the purpose of taxation.⁷⁷

On the other hand, the schedular system of income taxation, which is the system adopted in Ethiopia, takes the different sources of income of an individual into consideration for the purpose of taxation. Accordingly, income is identified by its sources and each source has its own procedures and rates for the determination of income tax; thereby requiring an individual to declare his/her income from each source separately. Under this system, each source of income is considered to have its own identifying unique features for the purposes of taxation. Therefore, before taxation, sources of income have to be properly identified according to the correct schedule set by the system.⁷⁸

2.4.3.1. Major Schedules of the Income Tax

The working law on income taxation in Ethiopia, the Income Tax Proclamation No. 286/2002, has classified sources of income into four schedules. Therefore, income taxation in the country is undertaken based on these schedules, which have been systematically classified as Schedule A, Schedule B, Schedule C and Schedule D.

⁷⁷ Eshetu

⁷⁸ Ibid

2.4.3.2. Schedule A Income

The first schedule of our income tax law, as provided in the Income Tax Proclamation of 2002, i.e. schedule A provides for the tax rate and modality of assessment of income tax collected from employment. Articles 10-13 of the proclamation govern the modalities and rates of taxation on such income.

a. The Definition of ‘Employment’ for Tax Purposes

As we have seen from the above explanation, Schedule A is devoted to employment income tax. Accordingly, a major component of this schedule is the term ‘employment’; and thus it is only fair to start by defining that term before we enter into a detailed discussion of the provisions that deal with this schedule.

As can be inferred from Articles 2(12) and 12 of the Income Tax Proclamation, employment is any arrangement, whether contractual or otherwise, whereby an individual to be called the employee is engaged, whether on a permanent or on a temporary basis, to perform services under the direction and control of another person to be called the employer.⁷⁹ Contractors are excluded from the ambit of employees by way of Article 2(12), which in (b) defines a contractor as an individual who is engaged to perform services under an agreement by which the individual retains substantial authority to direct and control the manner in which the services are to be performed.⁸⁰ Looking to the whole picture, employment income tax is tax that is imposed upon any payments or gains in cash or in kind received from employment by an individual, including income from former employment or otherwise from prospective employment.⁸¹

⁷⁹ Articles 2(12) and 12, Income Tax Proclamation No. 286, 2002

⁸⁰ Article 2(12)(b), Income Tax Proclamation No. 286/2002

⁸¹ Article 12(1), Income Tax Proclamation No. 286/2002

b. Tax Rate and Tax Base

It has been established in the previous chapter that, at present, the rate of taxation is progressive almost all over the world. Ethiopia is no exception to this; and the rate provided by Schedule A of our income tax law is progressive as well. Accordingly, the first 150 Birr that forms part of any taxpayer's income is always not taxable.⁸² Any amount that is above this first 150 Birr will be taxed according to the Schedule, which has a percentage of taxation from 10% to 35%. The Schedule clearly depicts that employment income per month, which is between 151 and 650 Birr will be taxed 10%; between 651 and 1400 Birr will be taxed 15%; between 1401 and 2350 Birr will be taxed 20%; between 2351 and 3350 Birr will be taxed 25%; between 3351 and 5000 Birr will be taxed 30%; and the maximum percentage of income taxation, i.e., 35% will be imposed on employment income that exceeds 5000 Birr.⁸³

c. Exclusions from Gross Income

As of principle, Schedule A applies to tax levied on employment income in the sense that income tax will be levied on any gains in cash or in kind which have been received from employment. However, certain exclusions have been provided by Council of Ministers Income Tax Regulations No. 78/2002. According to Article 3 of the regulation, the following categories of gains have been excluded from the ambit of taxable income and thus will not be subjected to income taxation.

- (a) amounts paid by employers to cover the actual cost of medical treatment of employees;
- (b) allowances in lieu of means of transportation granted to employees under contract of employment;
- (c) hardship allowance;

⁸² The justification behind this exclusion is embedded in the fact that the amount is so small and that the action of the government taking from this small amount would defeat the whole purpose of taxation, which is distribution of wealth. Moreover, if the government opted to collect tax on such small an amount, it would be spending more for the collection of the tax than it would collect from the source.

⁸³ Article 11, Income Tax Proclamation No. 286/2002

- (d) amounts paid to employees in reimbursement of traveling expenses incurred on duty;
- (e) amounts of travelling expense paid to employees recruited from elsewhere than the place of employment on joining and completion of employment or in case of foreigners traveling expenses from or to their country, provided that such payments are made pursuant to specific provisions of the contract;
- (f) allowances paid to members and secretaries of boards of public enterprises and public bodies as well as to members and secretaries of study groups set up by the Federal or Regional Government;
- (g) income of persons employed for domestic duties;

d. Exemptions

In addition to the exclusions provided by the income tax regulation, there are certain exemptions that have been provided by Article 13 of the Income Tax Proclamation. Accordingly, the following categories of income have been exempted from payment of income tax as prescribed by the proclamation:

- (a) income from employment received by casual employees who are not regularly employed provided that they do not work for more than one (1) month for the same employer in any twelve (12) months period;
- (b) pension contribution, provident fund and all forms of retirement benefits contributed by employers in an amount that does not exceed 15% (fifteen percent) of the monthly salary of the employee;
- (c) subject to reciprocity, income from employment, received for services rendered in the exercise of their duties by: (i) diplomatic and consular representatives, and (ii) other persons employed in any Embassy, Legation, Consulate or Mission of a foreign state performing state affairs, who are nationals of that state and bearers of diplomatic passports or who are in accordance with international usage or custom normally and usually exempted from the payment of income tax.

- (d) income specifically exempted from income tax by: (i) any law in Ethiopia, unless specifically amended or deleted by this Proclamation; (ii) international treaty; or (iii) an agreement made or approved by the Minister.
- (e) the Council of Ministers may by regulations exempt any income recognized as such by this Proclamation for economic, administrative or social reasons.
- (f) payments made to a person as compensation or a gratitude in relation to: (i) personal injuries suffered by that person; (ii) the death of another person.

2.4.3.3. Schedule B Income

The second schedule under the Ethiopian Income Tax laws, Schedule B, provides for the taxation of income earned from rental of buildings.⁸⁴ Articles 14 -16 of the Income Tax Proclamation are devoted to the modalities and rates of taxation on income derived from the rental of buildings.

a. The Scope of Schedule B Income

The income to be taxed under Schedule B of the Income Tax Proclamation is provided by Article 14 of the Proclamation, which states that “Income tax shall be imposed on the income from rental of buildings.”⁸⁵ The income from the rental of buildings is to be computed based on the procedures, requirements and modalities set forth by Article 16 of the Proclamation. Accordingly, the principle that tax has to be paid on income from rental of buildings remaining as it is, a taxpayer who leases furnished quarters is liable to pay tax on the income that he/she receives from the lease of the furniture and equipment in the leased quarters.⁸⁶ Furthermore, if a lessee sub leases a building; he/she is liable to pay the tax on the difference between the income from the sub-leasing and the rent paid to the lessor; however, provided that the amount received from the sub-lessor is greater than the amount payable to the lessor.⁸⁷ In the event that the sub-lessor fails to pay, the owner of a

⁸⁴ Article 8(2), Income Tax Proclamation No. 286/2002

⁸⁵ Article 14, Ibid

⁸⁶ Article 16(1)(a), Ibid

⁸⁷ Article 16(1)(b), Ibid

building who has allowed the lessee to sub-lease is liable for the payment of the taxes for which the sub-lessor is liable.⁸⁸

b. Deduction of Expenses under Schedule B

In calculating taxable income under Schedule B, gross income shall include all payments in cash and all benefits in kind received by the lessor from the lessee; all payments made by the lessee on behalf of the lessor according to the contract of lease; as well as the value of any renovation or improvement made under the contract of lease to the land or building, where the cost of such renovation or improvement was borne by the lessee in addition to rent payable to the lessor.⁸⁹

However, the Income Tax Proclamation has provided for some deductions to be made to the taxable income under Schedule B. These deductions include⁹⁰:

- (a) taxes paid with respect to the land and buildings being leased; except income taxes; and
- (b) for taxpayers not maintaining books of account, one fifth (1/5) of "the gross income received as rent for buildings furniture and equipment as an allowance for repairs, maintenance and depreciation of such buildings, furniture and equipment;
- (c) for taxpayers maintaining books of account, the expenses incurred in earning, securing, and maintaining rental income, to the extent that the expenses can be proven by the taxpayer and subject to the limitations specified by this Proclamation; deductible expenses include (but are not limited to) the cost of lease (rent) of land, repairs, maintenance, and depreciation of buildings, furniture and equipment in accordance with Article 23 of this Proclamation as well as interest on bank loans, insurance premiums.

⁸⁸ Article 16(2), Ibid

⁸⁹ Article 5(1), Council of Ministers Income Tax Regulations No. 78/2002

⁹⁰ Article 16 (1)(c), Income Tax Proclamation No. 286/2002

2.4.3.4. Schedule C Income

The third schedule of the Income Tax law of Ethiopia, Schedule C, provides for the taxation of income earned from businesses, i.e. from entrepreneurial activities.⁹¹ Articles 17 – 30 of the Income Tax Proclamation are devoted to the modalities of assessment of taxation under Schedule C.

a. The Scope of Schedule C Income

Business income tax or corporate tax as commonly referred to relates to direct tax levied by various jurisdictions on the profits made by companies or associations.⁹² As Schedule C applies to business income tax, it is only proper to start this discussion by defining what a business is. According to Article 2(6) of the Income Tax Proclamation, business or trade refers to “any industrial, commercial or vocational activity or any other activity recognized as trade by the Commercial Code of Ethiopia and carried on by any person for profit.”⁹³ And when one looks to the Commercial Code for reference, we can find that Article 5 provides for a definition to be referred to. Accordingly, Article 5 of the Commercial Code reads as:

Art. 5. - Persons to be regarded as Traders

Persons who professionally and for gain carry on any of the following activities shall be deemed to be traders:

- (1) Purchase of movables or immovable with a view to re-selling them either as they are or after alteration or adaptation;*
- (2) Purchase of movables with a view to letting them for hire;*
- (3) Warehousing activities as defined in Art. 2806 of the Civil Code;*
- (4) Exploitation of mines, including prospecting for and working of mineral oils;*
- (5) Exploitation of quarries not by handicraftsmen;*

⁹¹ Article 17, Ibid

⁹² Gebrie Worku Mengesha, Tax Accounting in Ethiopian Context, 2nd Ed., Alem Printing Press, Ethiopia, 2008

⁹³ Article 2(6), Income Tax Proclamation No. 286/2002

- (6) Exploitation of salt pans;*
- (7) Conversion and adaptation of chattels, such as foodstuffs, raw materials or semi-finished products not by handicraftsmen;*
- (8) Building, repairing, maintaining, cleaning, painting or dyeing movables not by handicraftsmen;*
- (9) Embanking, leveling, trenching or draining carried out for a third party not by handicraftsmen;*
- (10) Carriage of goods or persons not by handicraftsmen;*
- (11) Printing and engraving and works connected with photography or cinematography not by handicraftsmen;*
- (12) Capturing, distributing and supplying water;*
- (13) Producing, distributing and supplying electricity, gas, compressed air including heating and cooling;*
- (14) Operating places of entertainment or radio or television stations;*
- (15) Operating hotels, restaurants, bars, cafes, inns, hairdressing establishments not operated by handicraftsmen and public baths;*
- (16) Publishing in whatever form, and in particular by means of printing, engraving, photography or recording;*
- (17) Operating news and information services;*
- (18) Operating travels and publicity agencies;*
- (19) Operating business as an agent, broker, stock broker or commercial;*
- (20) Operating a banking and money changing business;*
- (21) Operating an insurance business.⁹⁴*

The taxable income of the income earned by a person according to the above cited provision of the Commercial Code is to be taxed according to Schedule C of the Income Tax Proclamation. And according to Article 18 of the Income Tax Proclamation, taxable business income is to be determined “per tax period on the basis of the profit and loss account or income statement, which shall be drawn in compliance with the Generally

⁹⁴ Article 5, Commercial Code Proclamation, 1960

Accepted Accounting Standards”⁹⁵, subject to the provisions of the Income Tax Proclamation and subsequent directives to be issued by the Tax Authority.

b. The Peculiarities of Schedule C Income

The tax rate of Schedule C income is provided by article 19 of the Income Tax Proclamation. Accordingly, businesses (bodies⁹⁶) are required to pay 30% flat rate of business income tax; and other taxpayers under Schedule C, i.e., unincorporated or individual businesses are required to pay taxes ranging from 10% to 35% according to the following table⁹⁷:

Birr 0 to 1, 800	0%
Birr 1,801 to 7,800	10%
Birr 7,801 to 16,800	15%
Birr 16,801 to 28, 200	20%
Birr 28, 201 to 42, 600	25%
Birr 42, 601 to 60, 000	30%
Over Birr 60, 000	35%

c. Deductions of Schedule C Expenses

Article 20 of the Income Tax Proclamation provides that deductions of Schedule C expenses will be allowed for expenses incurred for the purpose of earning, securing, and maintaining that business income. However, these deductions will be allowed only provided that the taxpayer can prove the expenses and subject to the limitations specified by law.⁹⁸

⁹⁵ Article 18, Income Tax Proclamation No. 286/2002

⁹⁶ Body is defined in Article 2(2) of the Income Tax Proclamation as any company, registered partnership, entity formed under foreign law resembling a company or registered partnership, or any public enterprise or public financial agency that carries out business activities including body of persons corporate or unincorporated whether created or recognized under a law in force in Ethiopia or elsewhere and any foreign body’s business agent doing business in Ethiopia on behalf of the principal.

⁹⁷ Article 19, Income Tax Proclamation No. 286/2002

⁹⁸ Article 20, Income Tax Proclamation No. 286/2002

d. Deductible Expenses⁹⁹

Accordingly the deductible expenses under Schedule C are:

- 1) The direct cost of producing the income. Good examples of such expenses are the expenses incurred in manufacturing, importation, selling, transportations etc
- 2) General and administrative expenses connected with the business activity. These are expenses incurred for the maintaining of the business activity.
- 3) Premiums payable on insurance directly connected with the business activity.
- 4) Expenses incurred in connection with the promotion of the business inside and outside the country subject to the limits set by the directives issued by the Ministry of Revenue.
- 5) Commissions paid for services rendered to the business provided.
- 6) If the tax authority has reason to consider that the total amount of salaries and other personal emoluments payable to the manager or managers of a private limited company is exaggerated, it may reduce the said amount for taxation purposes to the limit which, in view of operations of the company, appears justifiable, either by disallowing the payments made, or in any other way which may be just and appropriate.
- 7) Sums paid as salary, wages or other emoluments to the children of the proprietor or member of the partnership shall only be allowed as deduction if such employees have qualifications required by the post to which they are positioned.
- 8) Interest on loan, provided that the interest charged by the business is paid
 - a) To lending institutions recognized by the National Bank of Ethiopia;
 - b) To foreign banks permitted to lend to enterprises in Ethiopia (note here that interest paid to foreign banks can only be deductible upon fulfilling); and
 - c) In excess of the rate used between the National Bank of Ethiopia and the commercial banks increased by 2 percentage points.

⁹⁹ Refer to Articles 21(1)(e), 21(2), 22, 23, and 27 - 30 of the Income Tax Proclamation No. 286/2002 and Articles 8, 10, 11, 13, 14 of the Council of Ministers Income Tax Regulation No. 78/2002

9) Normally speaking gifts and donations are among non-deductible expenses. However, gifts and donations will be allowed as deductions provided that the following conditions are fulfilled:

- a) The recipient of the donation is registered as welfare organization and where it is certified by registering authority that the organization has record of outstanding achievement and its utilization of resources and accounting system operate with transparency and accountability;
- b) The contribution is made in response to the emergency call carried by government to defend the sovereignty and integrity of the country, to prevent man made or natural catastrophe, epidemic or for any other similar cause; and
- c) The donation is made to non-commercial education or health facilities.

The deductions to be made per the above conditions can only be made where the amount of the donation or grant does not exceed 10% of the taxable income of the taxpayer.

10) Depreciation allowances are deductible, provided that the taxpayers keep satisfactory records showing the date and cost of acquisition of the asset as well as the total amount deducted for depreciation since the date of acquisition. Furthermore, in accordance to transferring government developing organizations depreciation assets to determine taxable income and deductible expense based on specific provisions of the Proclamation, which determine price based on work out. Whereas if the result of the price bid is down, calculations shall be on the purchase price.¹⁰⁰

11) Reinvestment of profit of a resident share company or registered partnership may only be allowed as deduction in an amount not exceeding 5% of the taxable income of each accounting year. With regards to participation deduction, if the taxpayer transfers the share or capital contribution in respect of which deduction was allowed, the amount deducted shall be part of the taxable income of the accounting year in which the transfer was affected and shall be taxed as such. Furthermore, purchase of shares and capital contribution made between related persons shall not be allowed as deduction.

¹⁰⁰ Article 9, Privatization of Public Enterprises Proclamation No. 146/1998

- 12) Bad debts will be deductible for tax purposes on condition that:
- a) An amount corresponding to this debt was previously included in the income;
 - b) The debt is written off in the book of the taxpayer; and
 - c) Any legal action to collect the debt has been taken but the debt is not recoverable.
- 13) In the determination of taxable business income of finance institutions, a deduction shall be allowed for special (technical) reserves in accordance with the directives issued by the National Bank of Ethiopia. The business income, however, shall be increased by the amount drawn from such reserves.
- 14) For the purpose of ascertaining the income of a person for a tax period from a business, there shall be deduction of the cost of trading stock of the business disposed of by that person during that period. The cost of trading stock disposed of during a tax period is determined on the basis of the average cost method, which means the generally accepted accounting principle under which trading stock valuation is based on an average cost of units on hand.
- 15) In addition to the above deductible expenses, certain deductions are allowed to a limited extent as listed below:
- a) Transport allowance in accordance with the Regulation of the Federal Inland Revenue Authority.
 - b) Pension contribution, provident fund and all forms of retirement benefits contributed by employers in an amount that does not exceed 15% of the monthly salary of the employee.
 - c) Representation expenses over and above 10% of the salary of the employee
 - d) Deduction on capital expense for buildings and construction shall be depreciated
 - e) individually on a straight-line basis at 5%
 - f) Intangible assets shall be amortized individually on straight-line basis at 10%
 - g) Computers, information system, software products and data storage equipment at 25%
 - h) All other business assets at 20%
 - i) Indemnity of deduction for financial organization

- j) Losses carry forward, if the determination of taxable business income results in a loss in a tax period, earlier losses being set off before later losses. With regards to loss carry forward, depreciation shall be transferred when the Tax Authority accepts the described book account. If the determination of the taxable income results in a loss in a tax period, that loss may be set off against taxable income in the next 3 periods, earlier losses being set off before later losses. If during a tax period, the direct or indirect ownership of the share capital or the voting rights of a body changes more than 25%, by value or by number, the loss is set off against taxable income in that period and the previous period. A net operating loss may be carried forward and deducted only for two periods of 3 years.
- k) For the purposes of Article 27 of the Income Tax Proclamation, reinvestment of profit by resident share company and registered partnership may only be allowed as deductions in an amount not exceeding 5% of the taxable income of each accounting year.
- l) Interests paid to shareholders on loans and advances shall not be deducted to the extent that the loan or advance in respect of which the interest paid exceeds on average (during the tax period) four times the amount of the share capital. This, however, does not apply to banks and insurance companies.
- m) The amount of deduction shall be allowed for a bad debt after the debt has been taken but the debt is not recoverable.

e. Non-Deductible Expenses¹⁰¹

The non-deductible expenses under Schedule C are provided under Articles 21 and 9 of the Income Tax Proclamation and the Income Tax Regulation respectively are:

1. The cost of acquisition, improvement, renewal and reconstruction of business assets that are depreciated pursuant to Article 23 of the Income Tax Proclamation, which deals with depreciation;

¹⁰¹Refer to Article 21, Income Tax Proclamation No. 286/2002

2. An increase of the share of capital of a company or the basic capital of a registered partnership;
3. Voluntary pension or provident fund contributions over and above 15% of the monthly salary of the employee;
4. Declared dividends and paid out profit shares;
5. Interest in excess of the rate used between the National Bank of Ethiopia and the commercial banks increased by 2 percentage points;
6. Damages covered by insurance policy;
7. Punitive damages and penalties;
8. The creation or increase of Reserves, provisions and other special-purpose funds unless otherwise allowed by the Income Tax Proclamation;
9. Income tax paid on Schedule C income and recoverable Value Added Tax;
10. Representation expenses over and above 10% of the salary of the employee. Here representation allowance refers to hospitality expenses incurred in receiving guest coming from outside the enterprise in connection with the promotion and enhancement of the business;
11. Personal consumption expenses;
12. Expenditures exceeding the limits set forth by the Income Tax Proclamation or subsequent regulations;
13. Entertainment expenses. Here entertainment refers to the direct or indirect provision of food, beverages, tobacco, accommodation, amusement, recreation or hospitality of any kind to any person;
14. Donation or gift are non-deductible to the extent that the recipient of the donation is not registered as a welfare organization and/or the organization does not have a record utilization of resources and accounting system, which operates with transparency and accountability; and the contribution is made in response to emergency call carried by government and the donation or grant exceeds 10% of the taxable income of the taxpayers;
15. Sums paid as salary, wages or other personal emoluments to the proprietor or partner of the enterprise;

16. Expenditure for maintenance or other private purposes in relation to the persons mentioned above; and
17. Losses not connected with or not arising out of the activity of the enterprise.

In addition to the above mentioned non-deductible expenses, Article 30 of the Income Tax Proclamation provides for certain exemptions from payment of business income tax. These exemptions are:

1. Awards for adopted or suggested innovations and cost saving measures, and
2. Public awards for outstanding performance in any field
3. Income specifically exempted from income tax by the law in force in Ethiopia, by international treaty or by an agreement made or approved by the Minister of Finance and Economic Development.

Moreover, the revenue obtained by the Federal, Regional and local Governments of Ethiopia and by the National Bank of Ethiopia from activities that are incidental to their operations shall be exempt from tax under Schedule C.¹⁰²

f. The Treatment of Capital Expenditures

i) Definition of Capital Expenditures

ii) Depreciation, Depreciation Recapture Rules¹⁰³

As time passes, all plant assets with the exception of land lose their capacity to yield services. Accordingly, the cost of such assets should be transferred to the related expense accounts in an orderly manner during their expected useful life. The periodic cost expiration is called depreciation. There are three factors that need to be taken into consideration while calculating an asset's depreciable cost. These are:

- i) Initial cost
- ii) Residual value; and
- iii) Useful life

¹⁰² Article 30, Income Tax Proclamation No. 286/2002

¹⁰³ Refer generally to Article 23, Income Tax Proclamation No. 286/2002

A calendar month is ordinarily the smallest unit of time used to calculate depreciation expense and businesses may recognize partial year depreciation. They may also use the four methods of depreciation namely, straight-line, units of production, declining balance and sum of the year's digits.

For tax purposes in Ethiopia, pooling method is used for computer and information, communication technology related equipments; and straight-line method for buildings and intangibles. Residual value is not taken into consideration in determining the depreciation expenses. Rather, the Tax Authority stated the annual percentage to be used for determination of depreciation expense for each type of plant asset.

In general, fine arts, antiques, jewelry, trading stock and other business assets not subject to wear and tear and obsolescence shall not be depreciated. The acquisition or construction cost, and the cost of improvement, renewal and reconstruction of buildings and constructions shall be depreciated individually on a straight-line basis at 5%. The acquisition or construction cost and the cost of improvement, renewal and reconstruction of intangible assets shall be amortized individually on a straight-line basis at 10%. Computers, information systems, software products and data storage equipments shall be depreciated according to a pooling system at 25%. Similarly, all other business assets shall also depreciate according to a pooling system but at a rate of 20%.

In all the above categories of depreciable assets, the specified rate of depreciation is applied to the depreciation base of the category. The depreciation base shall be the book value of the category as recorded in the opening balance sheet of the tax period:

- a) Increased by the cost of assets acquired or created and the cost of improvement, renewal and reconstruction of assets in the category during the tax period
- b) Decreased by the sales price of assets disposed of and the compensation received for the loss of assets due to natural calamities or other involuntary conversion during the tax period.

If the depreciation base is a negative amount, that amount shall be added to taxable profit and the depreciation base shall become 0. If the depreciation base does not exceed Birr 1, 000, the entire depreciation base shall be a deductible business expense. If a revaluation of business assets takes place, no depreciation shall be allowed for the amount of the revaluation.

CHAPTER THREE: VALUE ADDED TAX

INTRODUCTION

Value added tax (VAT) is a tax on exchange. It is levied on the value added that result from each stage of exchange. It is an indirect tax in that the tax is collected from some one other than the person who actually bears cost of the tax.

VAT has multidimensional advantages to a state. Thus, many states to which Ethiopia is not an exception adopted it. This chapter is basically devoted to introduce VAT, its basic features, exempt transactions, manner of calculation of taxes, enforcement mechanisms and penalties for failure to comply with obligations imposed on persons subjected to VAT and particular emphasis is given to Ethiopian Vat proclamation and Regulation.

Unit objectives:

After successful accomplishment of the contents in this chapter, students will be able to:

- Recognize the brief history of predecessors of VAT in Ethiopia;
- Define what Vat is;
- Differentiate, taxable activities, taxable transaction zero rated transaction and exempt transaction under VAT;
- Understand the different registries under VAT;
- Know imposition on imports;
- Identify, tax payables, tax credits, tax invoices and reverse taxations;
- Prepare VAT records;
- Appreciate procedures in making Appeals; and
- Know the different penalties and criminal offences under VAT proclamation proc NO 1285/2002 and regulation No 79/2002

3.1. Brief Introduction to the Predecessors of VAT in Ethiopia

The concept of VAT was propounded first by American experts by 1920's. But at that time, Americans failed to implement it. The modern concept of VAT was truly introduced in France (1954). It is from France that other countries took lessons about VAT and introduced in their legal systems. In France, it was introduced to satisfy high demand of revenue on the part of the government in order to rebuild France from the civics of WWII .

Owing to its multidimensional advantages to states accepted by many states of the world with in short period of time , to which our country , Ethiopia is not an exception . According to some scholars, in 2003, VAT was exercised, it had been adopted and in more than 123 states of the world .

In Ethiopia, VAT was introduced since January 1, 2003 designed to replace the out dated sales tax, which has served for more than four decades, which was collected at manufacturing level. VAT is taken as dispensable component of tax reforms in developing counties such as Ethiopia by considering it a miracle tax to replace direct and indirect taxes entirely.

In other areas of taxation, where VAT is not regularly governing, turnover tax is introduced. The introduction of VAT under Ethiopian tax system, borrowed from foreign systems, clearly signifies an advancement in the area of taxation. Of course, wholly introduced, truly until the present moment , there happens sever resistance particularly on the part of business entities fearing that they will be imposed with more onerous obligations connected with collection of taxes on behalf of others , final consumers.

Since 1993, the Ethiopian government has made major economic shift from central planning to market oriented economic system. In line with this, changing the then mode of collection of revenue in the form of taxation, and introduction modern tax system (VAT) was considered immediate necessity. The older tax laws were issued in

accordance with the socio-economic situation of the 1960's (When Ethiopia was following unitary structure).

Currently, since Ethiopia adopted federal structure the former tax law can not be properly used and implemented in the presence of federal and state government for both have say on tax laws and enforcements thereof.

Generally the previous tax systems were:

- Out dated tariffs and tax laws;
- Weak customs and tax administrations;
- Poor to attract investments, facilitate trade, and generate adequate revenue to cover current and capital expenditure and hence, cannot finance development and poverty reducing projects.

Of course, taxation plays vital role in raising the substantive revenue to finance the state as the engine of development and to redistribute income and wealth among members of the community residing in a state. This basically necessitates a state to follow modern taxation (VAT) in its legal system.

The major rationales behind introducing VAT in Ethiopia includes, among others, the following:

I. sales tax doesn't allow collection on the added value created wherever sales transaction is conducted but VAT does .

II. VAT allows little room for evasion. Taxes in VAT are collected at multi stages and business entities are allowed to have refund on the tax they paid for inputs (raw materials such as labor, transportation, ware housing, etc). This leaves little room for evasion. But this is not true in sales tax as it is collected only at one stage.

III. VAT enhances saving and investment. VAT is a consumption variety tax. The fact that the final burden lies on consumers raises awareness to have means of reduction of

payment for consumption at any possible incident. This undoubtedly will change the extravagant way of life imposed from the custom, on the part of final consumers.

IV. Out dated sales tax is not capable to generate adequate revenue for the government to cover necessary expenditures.

All in all, Ethiopia adopted VAT proclamation No 285/2002 applied and practiced from January, 1, 2003 onwards. Good TAX administration such as VAT is challenging in all countries especially, developing ones. It takes time, skill and resources all of which are in short supply in many countries including Ethiopia. Therefore, the writers believe that with strong struggle towards its implementation, on the part of general population. Ethiopians can realize the prone consequences of VAT with in near future and hence such shall be encouraged.

3.2. Definition of VAT

In the previous section, we have witnessed that due to acute problems on the application of sales tax, partly it was introduced for unitary state structure and partly it is accompanied by many failures to comply with modern tax administrations, VAT was instead introduced. VAT is thus, inherently a sales tax with its unique features that makes it distinct from other forms of sales tax.

There exists confusion to identify VAT from other sales taxes in its introduction for the first time. VAT appears to be imposed on business entities as it belongs to sales tax family. In reality however, business entities are simple agents to collect tax from individuals, who bear the final burden, final consumers. On the other hand, whereas the income tax proclamation (proc.No286/2002 defines clearly what in -come tax is, the VAT proclamation (Proc. No 285/2002) failed to define VAT.

VAT is a tax on the added value on a good or service .The value added is imposed on the value that the business entity adds to the goods and services that it buys from suppliers or other firms. This value is added partly owing to the fact that processing or handling

purchased materials /items requires additional labor or capital that shall be calculated out from the final product/service and partly because buildings machinery, etc are devoted to preserve the good or provide the service to its destination . Costs of production and preservation shall be borne /deducted from the proceeds of the sale of the good /service (value added) which is serving as tax bases for VAT.

Though the VAT proclamation does not provide flat definition for VAT, for the sake of understanding of the concept of VAT, we can define it by borrowing from other sources. According to Encyclopedia Britanica VAT is:

“A sales tax designed like other sales taxes, to tax private consumption by individuals of the goods or services subjected to tax”

From the given definition, one can understand that VAT is a Variety of sales tax and the tax is imposed on consumer. But the definition provided above failed to list out other features that distinguishes VAT from other kinds of taxes.

Black’s law dictionary on its part provides that *“VAT is a tax assessed at each step in the production of a commodity based on a value added at each step by the difference between the commodities production cost and its selling price”*

Besides, the elements included in the first definition the second definition includes two peculiar features of VAT: tax base and tax imposition at a step the value is added, By combining concepts from the two definitions, one can define VAT as a sales tax imposed on sales transactions which is measured as a percentage of the product or the service rendered.

3.2.1 Types of VAT

Though there is legal and administrative frame work, the administration on VAT refund is still persistent problem. The problems are attributed in one way or another to the existence of widespread of tax abuse and reluctance on the part of tax officials. But, one

feature in VAT, as we discussed earlier, is the prevalence of refund to business entities of the tax they paid in their business against their taxable sales. The treatment for crediting or rebating varies. Accordingly, we have three types of VAT: Gross product type, Income type and Consumption type

i) Gross product type

In this type of VAT, taxes paid on purchases of capital goods fixed capitals and depreciations there to are not allowed to be refunded. If a person registered for VAT purchases equipments, buildings, different machineries, though there exists obvious depreciation value rebut is prohibited this type of VAT is not common as it raises stiff resistance on the part of tax payers.

ii) Income type

Here, again refund ion the purchase value of capital goods is prohibited like in case of goods product type of treatment. But, unlike the previous one, it allows refund on the periodic allowance for the depreciation value of capital goods.

iii) Consumption type

This type of VAT is the most used and widely accepted one. It is almost prevalent in most states of the world. This is basically related with the fact that all business purchases including that of capital goods and related depreciations are allowed to be rebated. Thus, it is accepted easily on the part of the community subject to VAT registration. Stated otherwise in this kind of VAT, there is no discrimination among tax payers

3.2.2 Advantage of VAT

The following are some of the main advantages of using VAT.

a. It avoids cascading effect of a tax (Tax on Tax).

VAT works on the principle that when raw material passes through various manufacturing stages and manufactured product passes through various distribution stages, tax should be levied on the incremental value at each stage and not on the gross sales price. This ensures that same commodity does not get taxed again and again and, thus, there is no cascading effect. Putting the concept in simple terms, in VAT system, each input is taxed only once. However, this is not a condition in sales and excise taxes.

b. It is a more comprehensive and equitable tax system.

Even though the ultimate burden of VAT falls on the final consumer, VAT is collected by the government from all sectors, that is, from import, manufacturing, who sales and retail sectors. Therefore, it is a more comprehensive and equitable tax system. On the contrary, sales tax is normally levied at one stage of the whole marketing.

c. It reduces the possibility of tax evasion

In the case of VAT, the tax is divided in to several parts depending on the number of stages of production and sale. In each stage, every transaction is made using VAT invoice approved by the Tax Authority. In addition, each VAT register person (supplier) has to maintain appropriate records on their sales and purchases transaction those obligations make tax evasion difficult.

d. It has less tax burden

Under VAT system, the tax is collected in small fragment at different stages of production and sales, hence, the VAT payers feel the burden of the tax less.

e. It is neutral

Regardless of the number of stages of production and distribution, VAT is collected in each stage. Therefore, VAT is expected to be perfectly neutral in the allocation of resources in the form of production and commercialization.

f. It improves productivity

In VAT system, a firm has to pay tax even though it runs into loss. The firm cannot claim any exemption for loss because it pays taxes on the value produced and not on profits. So, firm will always try to improve their performance and reduce the cost of production. As a result, the over all productivity of the country will be improved.

g. It promotes capital investment and saving

VAT is a consumption tax since one pays VAT on its expenditure and has the option to save so as not to be taxed. Furthermore, relief from tax on capital goods may encourage investment. Potential investors also consider tax legislation as one of the factors in making investment decision.

h. It enhances exports

Exports of goods and services in most countries that implement VAT are liable to VAT at zero-rate. This may make export internationally competitive and, thus, encourages exports.

3.2.3 Criticisms on VAT

While elaborating points during introductory section to VAT, we have tried to see the rationales behind replacing sales tax with VAT. By then we touched up on some advantages of introducing VAT in certain tax system of state .VAT is not only with advantage scholars raise strong critics against having VAT in a state. Some of the critics are:

a. It is regressive in nature

A straightforward single rate VAT with few exemption would tax lower income groups (the poor) more heavily than the higher income groups (the rich). It is, thus , incongruent with the basic principles of taxation which state that a person should be taxed according to his ability-to-pay. This makes VAT regressive tax system. In order to compensate for its regressive effect, a number of countries have exempted basic goods particularly food items from VAT.

b. It requires advanced economic structure.

The proper implementation of VAT system requires organized and advanced financial and economic structure as it is complicated system. VAT system also requires proper record keeping of invoices at each stage of production and sale by both the seller and buyer. Hence, it becomes difficult to implement the system in all types of economy.

c. It puts additional burden to tax authority

In VAT system, the manufactures, wholesalers and retailers have to fulfill various legal formalities in the form of maintaining various records, accounts, books, etc. the verification of those formalities puts additional burden to the tax enforcing authorities.

d. It is uneconomical

VAT system involves high cost of administration, assessment, verification, collection, etc. hence, it is highly uneconomical.

e. It has ream loopholes for tax evasion

Although VAT system requires proper record keeping of invoices at each stage of production and distribution by both the buyer and seller, it has ream loopholes for tax evasion. This may include the following:

- Taxpayers could over report sales of zero rated goods;
- Taxpayers could use invoices they received for personal purchase to claim tax credit;
- It enables buyers and sellers to strike secret deals with regards the issuance of receipts;
- It could lead to the formation of forged companies receipts to claim tax credit on input VAT, etc.

3.3. Tataxable activity

True, not all supplies of goods and service are taxed. For instance, the income tax proclamation allows exemptions for social, economic or other reasons. The VAT proclamation under Art 6 clearly states what kind of activity or transaction is subject to imposition of VAT. According to the same provision.

‘Taxable activity is an activity which is carried on continuously or regularly by any person.

- (1) *In Ethiopia, or (2) partly in Ethiopia whether or not for pecuniary benefit that involves or is intended to involve in whole or in part , the supply of goods or services to another person for consideration .*

As per the definition, as far as there is regular or continuous (almost the same) supply for consideration whether profit is due or not. The terms regularly and continuously implies the frequency of the transaction. This helps us to exclude occasional /seldom supply of goods or services from the ambit of taxable activity under VAT regime.

Another point of emphasis at this juncture is the mere fact that the activity fulfills the necessary conditions under Art 6 doesn't suffice, the person carrying the taxable activity shall be registered for VAT.

In addition to the above stated supplies there are other kinds which may be liable for VAT. To mention some:

- Sales to the staff (eg. Meals even if supplied free of charge or goods at reduced prices or frees).
- Sales of business assets (eg. Equipment, for nature commercial vehicles)
- Hire or loan of goods to some one else
- Goods which the proprietor or his family have taken from the business for their own use.
- Commission received in return for selling something on behalf of some one else.

3.4. Taxable Transaction

Taxable transaction is a process. It is related with supply of goods or rendition of services. Art 7(3) of the VAT proclamation provides that A “taxable transaction” is” a supply of goods or a rendition of services in Ethiopia in the course or furtherance of a taxable activity other than an exempt supply under. Art 8.

Besides, from cumulative readings of art 7(1)(a) and 7(3) we can appreciate that: Taxable transaction relates to a supply of goods or rendition of services

- The supply of goods or rendition of services is made in the course or furtherance of taxable activity.
- Taxable transaction doesn't relate to exempted supplies under Art 8 and
- The taxable transaction shall be carried out by a registered person..

The points mentioned above require further discussion. We said that taxable transaction is related to supply of goods or rendition of services . The terms “good” and” services “ shall be treated separately. Pursuant to Art 2(2), A” good” is all kind of corporeal movable or immovable property, thermal or electric energy, heat , gas, refrigeration, air conditioning and water energy. From the definition given to goods, the term is used in its broader sense for the term corporeal property, includes capital goods or any other movable property, while immovable ones consist of land and buildings (rights that emanate from such , a concept born from law of property”) we have to notice here that, incorporeal rights which have great implication on the protection and preservations of heritages (culture, tradition, norm. etc) of the public such as copy rights ,patents are excluded from the concept good for the purpose of VAT. Like wise money (be it legal tender of states or negotiable instruments such as bill of exchange, promissory note etc) is excluded from the ambit of good for this sense.

Under Art 2(16) “service “is provided as “work done for others which doesn't result in the transfer of good. When service is rendered the good is not transferred from place to place but the service rendered adds certain value on the good.

The other term that needs attention at this juncture is supply. “Supply” as per Art2 (17) is to mean sale of goods or rendition of services or both. VAT is imposed on supply of goods and services. The transaction is required to add value and the transaction is related to goods or services.

Goods and services, as provided above, are mutually exclusive. Stated other wise, some thing can not be goods and services at time. It is either goods or service.Registration, as can be clearly discussed in separate section ahead, has a lot to do with determination of

VAT. A tax- able transaction (supply of goods or rendition of services) is subject to VAT only if carried out by a person who is registered for VAT.

3.5. Registration for VAT

In the pervious section, we have seen that one basic element in the discussion of VAT is registration. Though VAT can cover substantial part of domestic consumptions, in reality it is limited. Partly because it requires heavy compliance on the part of tax payers and active supervision and monitoring by tax authorities. There fore, delimiting taxpayers by setting certain threshold is inevitable practice prevalent in many counties to which Ethiopia cannot be an exception Registration for VAT under Ethiopian tax laws is of two kinds: obligatory registration and voluntary registration.

A. Obligatory Registration

A person carrying commercial activity may apply to be registered for VAT. Pursuant to Art 16(1) if the total taxable turnover (transaction) over a period of 12 months exceeds 500,000 Ethiopian birr; the person shall be registered for VAT. This requires estimation at the end of each month, the total value of taxable goods and services supplies by a person /business entity/ for the past 12 months. Thus, two periods are to be considered, the past 12 calendar month and the second 12 calendar month, on a month-by month basis.

Where using such method of calculation the total value exceeds 500,000 birr, registration is compulsory. Even at the beginning when there exists reasonable ground to expect that total value of taxable transactions during 12 months period will exceed 500,000 registration is mandatory .(Art 16(2)). One thing to add here is in calculating the total turn over exemptions or transactions subject to other taxes are not included. The calculation is limited to taxable transactions under VAT.

B. Voluntary Registrations

Any body interested may apply for voluntary registration .But Art 17 provided a condition that shall be satisfied. The applicant person /business entity shall supply goods or render services at least 75% of his /its goods and services to a person /business registered for VAT. Of course, as we said earlier, VAT has a lot to do with increment of governmental revenue and hence, voluntary registration shall be fostered forward.

A voluntary registered person is entitled to recover (claim credit or refund) in out put VAT among other certain zero-rated supplies.

3.5.1. Application For Registration

Persons whose total taxable transaction exceeds the minimum threshold and not registered are required to file application for VAT registration by themselves. The application is made on the form called “ *Application for VAT registration*” The authority will issue a VAT registration certificate containing;

- Full name and other details of the registered person;
- Date of issuance;
- Date from which the registration takes effect;
- The registered person’s TIN.

On the other hand, when application is rejected /refused for various grounds the authority has the duty to notify the reasons for such.

3.5.2. Cancellation of Registration

In some situations owing to different reasons the total transaction that the person is running might fall down or be expected to fall down below the threshold (500,000birr)

At this juncture:

- if the person ceases to make taxable transactions ;or
- if the person's total taxable transactions falls below the threshold

application for cancellation is allowed.

The cancellation will be effective:

- at the time the registered person ceased to make taxable transaction
- if the person has not ceased to do so at the end of the accounting period during which the person has applied for cancellation of VAT registration

When registration for VAT is cancelled

- the person's name and details will be removed from registry
- the person shall return the certificate of the authority.

Generally VAT though new introduction in the Ethiopia tax system, opens room for entrance and withdrawal when conditions met and reversed.

3.6 Zero-Rated Transactions

As the name indicates, a zero-rated transaction is a taxable transaction that is taxed at zero-rate of tax. In other words, the transaction by it self is taxable subject to VAT in the sense included under Art 7(3) "taxable transaction" But, the Law has given blessings so that the transaction (supply of goods or rendition of services) are completely free from tax.

In Ethiopia, two rates are recognized on taxable transactions: Standard rate and zero-rate, where the standard rate is 15% and zero rate 0%. It is common, under VAT laws and regulations, to see transactions as; standard rated, zero-rated and exempt transaction. Pursuant to Art 7(2) of the VAT proclamation, the following transactions are zero rated.

- export of goods and services

- the rendition of transportation or other services connected with international goods or passengers, as well as the supply of lubricants, consumption, during international flights.
- the supply of gold to the National bank of Ethiopia.
- transfer of a business from one registered person to another registered person as going concern.

This kind of incentive is allowed basically to encourage export. A close look at with the listings tells us that zero-rated transactions are directly or indirectly connected with export goods or services to make domestic exporters more competent before international arena.

3.7 Exempt Transactions

A supply of goods and rendition of services, import of goods or import of services is an exempt if it is a description included in VAT proc.285/2002. An exempt transaction is a transaction not subject to VAT. Thus the transaction is not considered taxable transaction for social, economic or development reasons.

Art 8⁽²⁾ illustrates supplies (goods) and services) that are example transaction under the proclamation as:

- the sale transfer or lease of immovable
- rendition of financial services
- supply or import of national or foreign currency
- the import of gold to be transferred to the national Bank of Ethiopia
- the rendering The import of gold by religious organizations of religious or church related services
- the import or supply of prescription drugs specified in directives issued by minister of Health,
- rendition of educational services provided by education institutions..

- the supply of goods transferred to state agencies of Ethiopia and public organizations for purposes of rehabilitation after natural disaster, industrial accidents and catastrophes
- the supply of electric and water
- the supply of goods for the official use of diplomatic missions
- post office operations and the provisions of public transport permit and license fees, etc

While having discussions on the above listings of exempt transactions readers are advised to deeply understand the limitations behind each listing to so as to enable identifications of non-exempt transactions.

There might exist confusion on understanding the concepts of zero-rated transactions from exempt transactions of course, in both transactions, persons are free from payment of taxes under VAT. But, there are significant deviations between the two.

Pursuant to Art 23, a registered person making exempt transaction is not entitled to deduct input tax payable on it's acquisition related to the making of exempt supplies and is not entitled to issue covering exempt supplies. A person that purchases goods or services exempt from tax is not entitled to claim an input tax credit for any tax in relation to the prices of those purchases, even if acquired for use in taxable activity, because the item was not purchased in a taxable transaction.

3.8 VAT-on Imports

In our earlier discussions, tax will be imposed on taxable transactions that are not subject to exemption. The rate imposed is a flat of 15% of the value of:

- every taxable transaction by a registered persons
- every import of goods other than exempt import and import of service.

From the readings, one can conclude that whether goods or services are imported for private or public purpose, they are taxed. In discussions on zero rated transactions, exports are encouraged unlike imports.

Here, describing what an import goods is essential to understand VAT on imports. As per Art 2(9) “import of goods” is to mean bringing goods in to Ethiopia, according to customs legislation. To this end Art 14 designates the time when shall we say goods are imported by stating that an import of goods takes place when the goods are interred in to customs declaration. Once a good is imported in this sense, the next step is to calculate its values because it is this value which serve as a base to impose VAT. To this effect Art 15 provides the following.

15 (1) The value of a taxable import is the costumes value of the goods, determined in accordance with the customs legislation of Ethiopia, plus the sum of duties and taxes payable upon the import of the goods in to Ethiopia, excluding VAT and income tax withholding.

2. Where services considered part of import under Art 5 (see the Article), their value without VAT is added to the value as defined order sub-Article (1) of this Article.

The value of imposed good, as per Art 15 (1) cum (2) is the sum of customs value of goods under customs legislation and duty taxes and taxes payable with regard to the import. Notice shall be considered that the value does not include the VAT imposed on the imported good. VAT is also imposed if unregistered and non-resident. person service crevice in Ethiopia for a customer registered for VAT or for any resident legal person or business enterprise (Art 7 (1) (c) cum 23 (1) (2)). Stated in other words, as far as the service is imported, unless it is exempted under Art 8, it is subject to imposition of VAT where rendered to a registered customer or any other business enterprise not to be subject of VAT imposition

3.9. Tax Payable, Tax Credit Taxation and VAT Records

Unless there is strong cooperation between tax payers under VAT, and the tax authority, implementation of the newly introduced VAT in Ethiopia will not be as such attractive so as to play significant role in generating revenue for the government. To this end, the proclamation incorporates rights and duties upon persons registered for VAT. Understanding the following related concepts will facilitate to have proper enforcement of VAT. Tax payable, Tax credits, tax invoice, Reverse taxation and tax records.

One can understand that some of them like tax payment, preparation of tax invoice, tax records and reverse taxation are obligations, they are expected to be discharged on the part of persons registered for VAT. Whereas tax credit (deductible tax) is an incentive that encourages persons to be participant in VAT enforcement.

Now, let us have separate discussion on each of the terms indicated above in the following manner.

3.9.1. Tax Payable and Tax credits

Obviously, in introducing VAT, the government is aspiring to generate better amount of revenue than what was collected during sales tax system which had served for more than four decades but with insignificant place to become basic means of income from taxation in Ethiopian history. In short, tax payable is the amount that is expected to be collected from person registered for VAT in Ethiopia.

Art 20 in this regard runs the amount of tax payable for any accounting period by a person who is registered or is required to register is the difference between the amount of tax charged on taxable transactions creditable tax stated otherwise, under VAT proclamations, though taxable transactions are subject to VAT. There are also deductible/creditable taxes. In this case, the amount required from the person is the simple arithmetic difference obtained by deducting creditable taxes from all taxable

transactions. Instances of creditable/ deductible taxes, indicated under Art 21, includes among others:

- Imported goods that are entered to customs declaration during the current accounting period; and
- Taxable transactions (supply of goods or rendition of services) that are used or to be used for the purpose of the registered persons taxable transactions within the time limit indicated under Art 11 of the proclamation.

Therefore, once creditable items are identified, it is simple to calculate the total amount expected from tax payer.

3.9.2. Reverse Taxation/Reverse Charge)

It is a situation where tax is imposed if a non-resident person who is not registered for VAT renders services to the taxable person who is resident in Ethiopia; In this case, the person who received the service has the duty to withhold VAT payable to the service provider.

In this regard, the cumulative reading of Art 23(1) and (2) tells that. If a non-resident person who is not registered for VAT in Ethiopia renders services in Ethiopia for a person registered in Ethiopia for VAT or any legal business entity, the rendering service is subject to taxation.

Unlike the previous duties which are directly imposed upon the person that supplies goods or services, here, the obligation to withhold and pay tax is imposed on service receiver that is what it is called as reverse taxation.

When the customer, who received the service and withholds the VAT, the withheld tax is payable at the time of filing of the VAT return for the accounting period in which the

transaction takes place. The payment document for payment of the withhold tax is considered to be a VAT invoice and gives the customer the right to VAT credit.

It should be noted that, in reverse transaction if the invoice value doesn't explicitly indicate the amount of VAT, the value would be deemed to have been inclusive of VAT.

3.9.3. Tax Invoice

When ever you supply standard rated goods or services, which are transactions subject to tax, you must give them a document showing certain information about what you have supplied. This document is known as VAT invoice. Tax invoice is imposed on tax payers subject to VAT. But it is also a right conferred upon such personnel, for the fact that a non-registered person cannot issue Tax invoice.

Like other documents, tax invoice for VAT is a document that clearly shows the amount of VAT payable. Issuing this document by the registered person is mandatory imposed so as to have better implementation of VAT.

As per Art 22(2)- the VAT invoice as a document is required to contain the following information's.

- the full name of the registered person and the purchaser and the registered person's trade name if different from the legal name.
- the respective identification numbers of the registered person and the purchaser.
- The number and date of the VAT registration certificate
- The name of the goods shipped or service rendered
- The amount of transaction
- the amount of excise on excisable goods
- sum of the VAT due on the given taxable transaction
- the issue date in the VAT invoice and;
- serial number of the VAT invoice

As can be logically inferred, the corollary obligations behind the particularities indicated above is, the registered recipient who has not received a tax invoice can request from the supplier and the supplier shall comply with the obligation.

3.9.4. VAT Records

Pursuant to Art 37

A registered person for VAT or any other person liable to pay tax is under obligation to maintain for 10 yrs in Ethiopia:

- original tax invoice received by the person,
- a copy of all tax invoices issued by the person
- customs documentation relating to imports and exports by the person
- accounting records; and
- any other records as may be prescribed by the ministry of revenue by directive.

The above mentioned taxpayers are generally duty bound to have purchase book and sales book and maintain them properly.

The purchase books helps to record:

- value of purchases and related VAT
- value of foreign purchases and related VAT
- value of other purchases from non-registered persons and value of VAT exempt or zero rated purchases.

On the other hand sales book clearly shows details of:

- sales value of standard rated supplies and related VAT
- value of zero-rated supplies and
- value of exempt supplies

Besides, the following source documents are required to be filed appropriately:

- VAT collection receipt
- list of items sold
- credit of sales invoices
- receipt for sale of zero rated supplies
- receipt for sale of exempt supplies

3.10. Powers of Levying and Collection Enforcement for VAT

In federal states like Ethiopia, concurrent powers of taxation is given both to federal (central) governments and regional states. As we have seen at the beginning, the FDRE constitution divides powers of taxation between and among the federal and regional governments in the following manner. Powers exclusively given to federal government, powers exclusively given to regional governments, and concurrent powers of taxation. With respect to new taxes, that might be introduced in the future in reaction to societal needs and technological advancements the constitution submits the issue to be decided by the joint session of the house of federation and the house of peoples representatives (art.99 of the FDRE constitution.) When VAT is introduced in 2002 power of taxation was resolved by similar procedure and the joint session decided in favor of the federal government. Thus it is only the federal government that has power to levy VAT in Ethiopia.

One open fact here is persons subject to VAT reside both federal and regional states. Since VAT requires cooperation, regions are given delegations to collect returns from VAT.

Regarding collection enforcement mechanisms, the FIRA (federal Inland Revenue authority) is entrusted with the duty of implementations of the VAT proclamation and regulation issue to supplement the proclamation.

Thus, FIRA is authorized to investigate any statements records, books of accounts submitted by any person at any time. The authority can send duly accredited inspectors to check the statements, records and books of accounts or any vouchers stocks or other material items at the persons place of business, requiring the person, or and employee who has access to produce the same. The person is duly bound to answer questions related with the collection of taxes in VAT. For this purpose any municipalities' body, financial institution, department, or agency of federal or regional governments is required to render full information to the authority.

The power is extended even up to seizure of the properties of the person liable to pay tax and failed to comply with his obligation to pay tax .Here before exercising seizure, the authority has to notify in writing to the who has failed to pay the unpaid tax within thirty days. In default of such, the authority can seize the properties and sell them through public option.

6.2 Appeals

Any body that feels his rights are jeopardize by administrative tribunal or regular courts can bring his case before competent organ. Appeal is a constitutional right as far as made in accordance with law. The VAT system is not exception to this rules. A tax payer under VAT, Who is aggrieved by the decision of tax authorities may lodge his complaint to a body competent to hear and decide on such application. The aggrieved parts has two options: tax appeal commission or regular courts.

The tax payer objecting the assessment by revise committee while taking appeal to Tax Appeal Commission is required to deposit 50% of the additional tax assessed Art 43(1.)

Finally, the proclamation provides that in entertaining value added Tax provisions concerning appeal in income tax proclamation (proc 286 (2002), as discussed in chapter two, will be applied *mutantis mutandis* to VAT proclamation with due regard to appropriate changes regarding VAT.

3.12 Penalties and Criminal Offences

In your course, introduction to Law, one basic feature of law is sanction unless accompanied by punishment/civil or criminal, the enforcement of laws remain at stake. The existence of sanction, from its nature, implies that there exist actually persons that do not respect the law. like wise, under VAT proclamation penalties are imposed and failure to observe the VAT proclamation and regulation is criminal offence as tax law is part of public Law.

The tax authority has the duty to monitor and supervise tax payers, hence administrative penalties are inherent consequences on tax players that fail to comply with tax obligations under VAT.

The failures to comply are related to administrative penalties and criminal offences. Instances of administrative penalties include, among others.

- engaging in taxable transactions with out registration
- issuing incorrect invoice
- issuing invoice with out registration for VAT
- Failure to maintain tax records, file timely etc.

The degree of penalty imposed is directly related to the impact of the fault up on the enforcement of VAT in Ethiopia.

Criminal offences on the other hand are tax offences violations of the criminals Law of Ethiopia and thus are subject to charge, prosecution and appeal in accordance with criminal procedure law. Under the VAT proc 285/2002, the following conducts of tax payers are considered criminal offences.

- tax evasion
- making false or misreading statements
- obstruction of tax administration

- failure to notify changes in business address and business live
- unauthorized VAT collection, improper tax debit and credit notes,
- aiding or abetting
- offences by entities
- offences by tax officers
- offences by receivers

The penalty imposed vary per gravity of the offence. The authority is also given power to publish the list of persons who have been convicted of offense, by notice in the Gazzete, basically to ditte others for them. Coming to the practical assessment, there is poor execution of tax offences. Thus, training, development of staff of the authority and raising the awareness of tax payers shall be given emphasis.

Unit summary

In this chapter we have seen that VAT is one variety of taxes imposed on transactions that result in value addition and it is collected from each stage.

VAT was first introduced in France and distributed to other countries. In our country Ethiopia, thought faced by stiff resistant from the business sector, it was accepted and has replaced the sales tax which has many draw backs. VAT has a lot to do with a tax system of a state. It has also certain demerits late alone in developing countries also in developed ones.

VAT has good product type, income type and consumption type varieties. It is applicable on registered persons, persons importing taxable goods and services and persons importing taxable supplies. There are also zero rated goods where by persons working on such goods can perform with free obligation of taxation.

Review Questions

1. State briefly the historical development of VAT in the world at large and in Ethiopia in particular.
2. What differentiates VAT from sales tax and other kinds of taxes recognized in Ethiopian tax law?
3. What triggers the introduction of VAT in Ethiopia?
4. Explain how VAT operates in Ethiopia.
5. What is the role of regional governments in the enforcement of VAT?
6. Assume that a certain good which is subjected to VAT is imported. Tell out the manner and time of imposition of VAT on such good
7. What relates “taxable transaction” with “taxable activity” in the Ethiopian context?

CHAPTER FOUR: TURNOVER TAX

INTROUDUCTION

Turn over tax ,like others we discussed in chapter two and three, is applicable in Ethiopia tax law. Unlike VAT, where the threshold to identify persons subject to it is 500,000 birr ,turn over tax is applicable for those whose annual transaction is below this amount save voluntary registration for VAT.

Turn over tax is applicable on supply of goods, rendition of services and persons not registered for VAT. Accordingly, there is its own mode of assessment and impositions of obligations expected to be discharged on persons subject to same.

Unit objectives:

After successful accomplishment of this part of the course, students will be able to :

- appreciate the scope of application of turn over tax;
- know the different rates applied to turn over tax; and
- explain obligations imposed on tax payers.

4.1. Scope of Turn -over Tax

In chapter three, we have seen VAT and the scope of coverage of the VAT proclamation. The government considers,for administrative feasibility and other reasons, persons whose annual taxable transaction exceeds 500,000 to be registered for VAT. Similarly, for those persons who are not registered for VAT, it is necessary to impose obligation of taxation. To this end torn over tax is imposed on those not registered for VAT to equalize and enhance fair ness in commercial relations and make complete the coverage of tax system so as to increase government's revenue from taxation.

Therefore, the scope of application of turn over tax proclamation is on :

- i. supply of goods
- ii. rendition of services
- iii. persons not registered for VAT

With the definition of terms under turnover tax, unless otherwise defined in the proclamation, the meanings defined in Value Added Tax proclamation No. 285/2002 shall be used (Art 2(1)).

i Supply of goods

In trying to define supply of goods under turn over tax proc, since it is not clearly touched, as per Art 2(17) of the VAT proc it is to mean the sale of goods and or services or both.

“Goods” is defined under Art 2(7) of proc 308(2002) is to mean any kind of goods or commodity that has exchange value, utility and brings about satisfaction and includes animals. From this wording, we can say that the scope of application turn over tax law is on sale of goods and animals also.

ii. Rendition of services

Services rendered to persons not registered for VAT are under the scope of turn over tax proclamation. Regarding the definition for the term service since the turn over proc fails to deal with it as per Art 2(1) of proc 308/2002 cum Art 2(7) of proc 285(2002) it is to “mean work done for others which doesn’t result in the transfer of goods.”

iii. Persons not registered for VAT

The other term that needs explanation at this juncture is “persons not registered for VAT.” According to Art 2(4) of proc 308/2002” a person not registered” is a person who is not registered for VAT by reason of his annual turnover being bellow 500,000 or threshold set by the minister, by reason of not having applied for voluntary registration.

But, we have to notice also that turnover tax is not applicable to every import of goods and an import of services as provided under Art 23 of the VAT proclamation (they are subject to VAT).

Though turn over tax is applicable to supply of goods, rendition of services and to persons not registered for VAT, no all transactions are taxable. The proclamation recognizes certain exemptions: In this respect as per Art 7 the following are exempt from turn over tax:

- the sale or transfer of a dwelling house used for a minimum of two years or the lease of a dwelling;
- the rendition of financial services;
- the supply of national or foreign currency and securities except for that used for numismatic purposes;
- the rendering by religious organizations of religious or other related services;
- the supply of prescription drugs specified in directives issued by the relevant government agency; and rendering of medical services;
- the rendition of educational services provided by educational institutions as well as child care services for child can at pre-school institutions;
- supply of goods and rendering of services in the form of humanitarian aid
- the supply of electricity, kerosene and water, license fees, etc.

In addition, attention shall be rendered so as to infer that these are not the only listings of exemptions, ministry of finance and economic development by virtue of Art 7(2) of turnover tax proclamation may provide others by its directives.

4.2. Rates of Turnover Tax

The base to compute turn over tax is the goods receipts in respect of goods supplied or service rendered (Art 5). Thus, the person who sells goods and services has the obligation to collect the turnover tax from the buyer and transfer collected tax authority. Art 4

incorporates two kinds of rates: 2% on goods sold locally and for services rendered locally again in two rates: 2% for contractors, grain mills, tractors and combine-harvesters and 10% on others.

4.4. Obligations of Tax Payers under the Turnover Tax Law

In enforcing income tax proclamation and VAT proclamation there are obligations imposed on tax payers and other concerned organs; establishment of organs responsible to enforce the laws; pass decisions and review the decisions in case complaint is lodged by aggrieved party. Likewise, these obligations and organs are recognized under turnover tax proclamation. Some of the obligations on tax payers include:

i. Filing of Turn over Tax Return and payment

Of course, turnover tax is to be declared and paid by tax payer. Therefore, outstanding obligation imposed on them is to file their tax return and pay the tax within the time reasonable in the proclamation. In this regard, Art 10 provides that:

10(1)- Tax payers subject to turnover tax shall:

- a. File a turnover tax return with the tax authority with one month after the end of every accounting period.***
- b. Pay the tax for every accounting period by the deadline for filing the turnover tax return.***

Each tax payer, is thus required to file a turnover tax return to the tax authority before the deadline mentioned above. The tax payers by implication are logically imposed to make correct calculations based on the rates stated under Art 4.

At this juncture, to know the period of time in determining deadline one has to understand what “accounting period” is? Under turnover tax “accounting period” is different for various category of tax payers. Art 10(2) in this respect states in the following manner.

Art 10(2) – for the purpose of this Article “Accounting period” shall mean:

- a. For tax payers classified as category ‘A’ tax payers under the income tax proclamation No. 286/2002, but are not required to register for VAT, the calendar month;***
- b. For category “B” tax payers who are required to keep records under the income tax proc. No. 286/2002, each three month period commencing from the first day of the Ethiopian fiscal year or when approved by the Tax Authority, the first day of the Gorgorian Calendar year;***
- c. For category “C” tax payers, who are not required to keep records under Income Tax proclamation No. 286/2002, the fiscal year?***

ii. Keeping Recodes

This obligation is common in income Tax proclamation and VAT proclamation. Here too, tax payers subject to the record keeping requirement of Art 48 of the Income Tax proclamation No. 286/2002 are required to keep records prescribed there in for use determining Turn over Tax.

From the readings of this provision, it is possible to conclude that tax payers under turnover tax are under obligation to have recodes in similar fashion with income tax payers. The records shall also follow acceptable principles of accounting that can be presented as evidence incase conflict arises between tax payers and tax authority with regard to assessment of taxation.

iii. Notification of changes

It is difficult to know the whereabouts of tax payers incase there is frequent change of address on their part. Therefore, it is right to impose the obligation of notifying one’s address if the tax payer moves from his principal residence to an other abode.

To this end Art 17 runs:

17. Notification of changes:

A registered tax payer shall notify the authority in writing of

- a. any change in the name, address, place of business, constitution or nature of the principal taxable activity the person; and**
- b. any change of address from which, or name in which, a taxable activity is carried on by the registered person.**

with 21 days following such change.

A close reading from Art 17 implies that registered persons have such a duty. But we know that registered persons are subject to VAT proclamation and the scope of turn over tax proclamation is not extended to registered persons.

Thus, the term “registered person” in the English version is not appropriate. On the other side, the Amharic version, the binding in case of discrepancy between English and Amharic version of Ethiopian laws, imposes obligation only on tax payers by saying “መገኛዎቹ ግብር ከፋይ” basically to make all non registered tax payers as the registered one’s are covered under VAT obligation.

With regard to obligations of other entities impositions which have impact on the enforcement and collection of turn over tax are almost similar with that under VAT obligations.

Unit Summary

For the purpose of equalization and fairness that commerce requires, persons that are not registered for VAT are subject to turnover tax, in Ethiopian tax law. The scope of application of this turnover tax is thus: on supply of goods, renditions of services and persons not registered for VAT.

Even if turn over tax is applicable on supply of goods, rendition of services and to persons not registered for VAT, the proclamation allows exemptions since all transactions are not taxable. To this end, Art 7 is devoted to show lists of exempt transactions.

Two kinds of rates are recognized in the computation of taxes under turn over tax. Tax payers under turnover tax proclamation a like others, are imposed with the following obligations:

- filing of turnover tax return and payment to the tax authority;
- Keeping records in a manner acceptable by general principles of accounting; and
- notification of change of address if any that helps the authority to have proper follow up.

Review questions

1. What extinguishes turn over tax from VAT?
2. Are the subjects of turn over tax by far different from that of VAT? Why or why not? If so, what is the yardstick to differentiate them ?
3. Briefly trace out the means of collection and administration of turn over tax in Ethiopia.
4. Do you think that all persons engaging in supply of goods or rendition of services are subject to turn over tax? Why or why not?

CHAPTER FIVE: EXCISE TAX

INTRODUCTION

Excise tax is one variety of sales tax like VAT and turn over tax but unlike turn over tax and VAT, it is applicable not on all kinds of goods rather on selected goods. It is imposed on luxury goods and basic goods which are demand inelastic.

It is also applicable on goods which are hazardous to health and societal problems. In certain goods the tax rate reaches 100% implying that the goods are not encouraged to be imported or produced locally.

Unit objectives:

Up on completion of this unit, students will be able to:

- Understand historical back ground of excise tax in Ethiopia;
- Appreciate products subject to excise tax;
- Identify rates, bases and payments in excise tax; and
- Recognize obligations imposed on tax payers

5.1 Historical Background of Excise Tax in Ethiopia

Excise tax, like VAT and turn over tax, it is one variety of sales tax. It is collected from the sale of certain items. The excise tax, then will be of either specific /per unit or advalorem. Specific excise tax is imposed based on the amount of the item subject to tax. But advalorem is calculated out from the value of the good.

Excise tax in Ethiopia is introduced for many reasons. The preamble of the excise tax proclamation (proc No 307/2003) dictates the rationale in the following manner.

Firstly, it helps to improve government revenue by imposing excise tax payable on selected goods. True, when tax is imposed on certain items that were not subject to tax,

the effect is usually increment of governments revenue to facilitate different projects a head.

Secondly, tax shall be imposed on luxury goods and basic goods which are demand inelastic. The imposition of tax on luxury goods usually has little or no impact on the expenditures of the poor. One basic rational of introducing tax in a certain state is to redistribute income and narrow the gap between rich and poor. Thus, it is logical and acceptable to collect tax from luxury goods that have strong link with capables in certain economy.

Last but not least, imposition of taxation on goods that are hazardous to health and which are cause to social problems, will reduce their consumption. As we will see later on, on some goods hazardous to health the rate is too high and reaches 100%. This undoubtedly will have deterrence purpose so that consumers of such good shift or try to do so to other goods relatively acceptable and imposed with lower rates of taxes. Thus, the excise tax has positive impact on the reduction of consumptions of goods hazardous to health and cause social problems.

5.2 Products subject to Excise tax

Every tax law is applicable on product or services it is designed to cover. The scope of application of excise tax proclamation is determined by the schedule attached to the proclamation. Accordingly, excise tax is applicable to goods which are either produced locally or imported from other countries. To this end, Art 3 clearly states that *:the proclamation applies on goods listed in the schedule attached to the proclamation.*

The attachment at the schedule indicates that the goods or products are related to luxury goods, goods dangerous to health and that cause serious problems to the society, ranging from perfumes to tobacco and tobacco products. The purpose is basically; to reduce the production and distribution of those goods which are dangerous to health and thus, the

rate imposed as we will discuss thereon reaches 100%. The end goal seems to ban their production.

5.3. Tax-rates, Bases and Payment of Excise Tax

These are related concepts but need further discussions.

5.3.1. Tax Rates

The excise tax is imposed on goods imported or produced locally in accordance with the schedule attached with the proclamation proc. No. 307/2002.

Art 4 clearly forwarded rate of taxes as:

The excise tax shall be paid on goods mentioned under the schedule attached to this proclamation.

- a. when imported;*
- b. when produced locally at the rate prescribed in the schedule*

The rate specified above is uniformly applied for goods produced locally and imported from abroad, what matters is the type of product. The rate varies from 10% in textiles and textile products to 100% for other alcohol drinks, perfume and toilet waters; and motor vehicles above 1800 C.C.

5.3.2. Bases of Excise-Tax

The base of the taxation according to the proclamation is a produced thing: whether produced locally or imported from abroad.

Art 5 runs:

Art 5- Base of computation of excise tax

- 1. in respect of goods produced locally, the cost of production*
- 2. in respect of goods imported, cost, insurance and freight (C.I.F)*

Cost of production is taken as base to calculate the amount to be imposed on goods produced locally. Cost of production as per Art 2(8) is to mean direct labor and raw material cost incurred in the production process, cost of indirect inputs and overhead costs, but does not include depreciation costs of machineries.

In respect of goods imported, the base of computation of the tax as mentioned above is cost, insurance and freight.

Here one can conclude that, as we have said early, while discussion in VAT, export rather than import is encouraged. In case of VAT, persons are allowed to deduct costs of productions/ inputs in general. But in excise tax, since attached with luxurious and dangerous product the value of the object imported insurances and freight are not deducted.

5.3.3. Payment of Excise Tax

The excise tax shall be paid with in the time prescribed;

- a. in respect of goods produced locally, by the producer;
- b. in respect of goods imported by the importer.

To implement the obligation of tax payers, the time when the tax is to be paid by tax payers has to be clearly determined.

In connection with this Art 6 provides that:

Art 6. payment of excise tax

- a. time of payment
- b. unless decided otherwise as provided for under sub-article 2(b) of this proclamation, the excise tax on goods specified under the schedule shall be payable.
 1. when imported at the time of clearing the goods from customs area.
 2. when produced locally not later than 30 days from the date of production;

- b. where the tax payer requests for permission to deposit goods produced in a bonded ware house without payment of the tax and if the request is approved by the tax authority the payment of the tax on such goods so deposited shall be effected at the time they are being removed from the bonded ware house.
- c. If the tax authority believes that the activity of the tax payer requires, a bonded warehouse may give him permission to establish such bonded ware house.
- d. where a producer fails to keep proper accounts and records or fails to submit a monthly declaration or pay the tax within the time limit prescribed in this proclamation or submit a declaration which upon investigation is found incorrect the tax authority shall be empowered to forbid the producer to remove any good from the place of production or bonded ware house.

On the other hand, Art 34 provides that the minister may waive in whole or in part, the tax levied under the Excise Tax proclamation; may be for economic, social or administrative reasons.

5.4. Obligation of Tax Payers

Like the tax laws we discussed in the previous chapters, enforcement of excise tax law requires collaboration among the taxpayers and tax authorities. Taxpayers are imposed with the following obligations:

- Maintaining books and accounts and supporting documents in accordance with proper accounting principles and in a manner acceptable by Tax-Authority.
- Submit every 30 days to the tax authority, in a form which would be supplied by the authority, a declaration containing the necessary information for the proper collection of the tax.

- Comply fully with the requirements of inspection of his premises by the delegates of the Tax Authority.
- Immediately communicate to the Tax Authority the type and address as well as the commencement and termination date of his business.
- Pay in full the tax due within 30 days from the date of the termination where such business is terminated.

5.5 Administration of Excise Tax

Administration, among others, requires huge responsibility on the part of tax Authority. To discharge its duties, the authority is vested with the following responsibilities and duties as indicated under Art 9. The powers include:

- the implementation and enforcement of this proclamation
- requiring the person or employee who has access to or custody of any information, records or books of account to produce the same and to attend during normal office hours at any reasonably convenient tax office and answer any question relating there to.
- Enter business premises or stores of the tax payer or to any place suspected to be storage of the products, inspect, collect information and take appropriate measures.
- Notify the tax payer the additional tax to be paid in accordance with the proclamation.
- Requiring any person including a municipality body, financial institution, department or agency of Federal or regional government to disclose particulars of any information or transactions.

Unit Summary

Excise tax, unlike VAT and turn over tax, is collected not on all kinds of goods, rather on some selected goods for different reasons.

True, when tax base increases government treasury shows enhancement and as one variety of taxes, this type of tax generate revenue. Secondly, it is imposed on luxurious and basic goods which are demand inelastic. Thus, this tax as such will not create burden on the majority of the population.

Thirdly, tax imposed here is on goods hazardous to health and which are cause to social problems. Therefore, taxation can beyond, income generation, curtails production as well as consumption of these variety of goods.

Different rates are recognized under excise tax in Ethiopia: The rates are horizontally applicable whether a good is produced locally or imported from abroad. The rate varies from 10% in textiles to 100% in alcohols, perfumes and toilet waters.

Regarding payment enforcement, in goods produced locally, the producer, in goods imported, the importer is duty bound to effect payment.

Taxpayers have the obligation to:

- maintain books and accounts in accordance with accounting principles;
- submit to the authority necessary information for proper collection of the tax;
- comply with inspections by delegates of the tax authority; and
- respect all the obligations mentioned in the proclamations.

Review questions

1. What is the very essence of imposing excise tax on goods imported or produced locally in Ethiopia?
2. What differentiates excise tax from other varieties of tax?
3. Assume that the number of smokers is high rocketed. Do you think that taxation will alleviate the problem? How?
4. State how excise tax operates in Ethiopia.

CHAPTER SIX: CUSTOMS DUTIES

INTRODUCTION

Customs duty is tax like other taxes but imposed on imported goods or exported goods. This type of tax is practiced by all countries to which Ethiopia can not be an exception. Under the federal state of Ethiopia where state have power over taxation [concurrent power of taxation. It is clearly indicated that the FDRE constitution of 1995 has given customs duty as exclusive power the federal government. To this end the federal government has come up with proclamation No 60/1997 to have proper control and follow up power is vested with Ethiopia customs authority.

There are acceptable reasons to have customs duty with in a legal system basically customs duty since imposed on goods imported or exported relatively high amount of tax is collected to strengthen government's financial power to be devoted on poverty reduction and other programmes of development Thus, customs duty raises revenue of the government.

Customs duty is the best instrument to prevent or reduce importation of goods. It serves as trade brevier whenever a state needs to ban or reduce importations to her territory, it can imposed high rate in some good (excise taxation) it might reach a rate of 100%. Thus, such importation will be discouraged. Of course this reduction measure helps to protect infant domestic factories /industries from stiff competitions with the products of competitive and subsidized foreign companies/ importers.

Unit objectives:

Up on Completion of this unit, students will be able to:

- ❖ Identify the powers and objectives of Ethiopian customs authority;
- ❖ Know manner of customs control and administration;
- ❖ Appreciate manner of control, declaration, examination and release of goods ;

- ❖ Recognize handling of goods in transit, temporarily importation, and exportation of goods;
- ❖ Know what warehouse and its importance is; and
- ❖ Understand the valuation, tariff classification and calculation of duties of customs officers and customs police.

6.1. Powers and Objectives of Ethiopian Customs Authority

At the beginning, we have said that though taxation is concurrent power of central and state governments, the constitution resides power of taxation of customs only to the federal government. The organ responsible to supervise and control such is Ethiopian customs authority.

To discharge its duties and responsibilities properly, the objectives and goal of the entity are set out. These include, among others, the following:

- collecting duties and taxes on imported or exported goods
- implementing laws and treaties related with its goal
- Controlling the importation or exportation of prohibited or restricted goods.

Obviously, to achieve such visions it is necessary to vest the Authority with certain powers and imposed duties/ obligations so that the country will become beneficiary from this type of taxation.

In connection with this, Art 6 of the proclamation enumerates powers and duties of customs Authority. This power helps to realize the objectives set above.

The authority supervises and controls imported goods from the time they get at customs port until completion of customs formalities and received by the importer and exporter.

- The authority is under duty to establish customs stations at ports, frontiers and transit routes at each destination: it has the power to check documents of importers and exporters. Today almost at the entrance and exit of big towns there are substations of customs Authority to discharge this obligations.

Importation and exportation of goods require certain procedures. They will be deposited at the place approved by the authority. The goods are to be deposited in a ware house established by the authority or other warehouses established by other individuals licensed by the authority. Thus, the authority shall secure proper deposition of goods. At this juncture, it is simultaneously authorized to control properties /goods which are without master, abandoned, forfeited or contraband goods and take necessary steps upon the goods in relation to this, it can search any good, means of transport entered into and departing from Ethiopia through the ports, frontier posts, and other stations. It can also investigate custom offences, institute proceedings and follow up court trials, through attorney general.

In connection with customs duties, as barrier of importation, the power reduces if a state is a member to WTO, which requires opening of ones door to other members (of course with some privileges to Least Developed Countries (LDCs). It is argued that becoming a member to WTO help to attract investment. It has a lot to do with economic growth of a state. Therefore, currently the more sound arguments is in favor of membership.

A foreign exchange measure which restricts trade in goods is normally considered inconsistent with Art XI of the GATT provisions. Besides, there are most Favored Nation, and standard of National Teatment principles that impose obligation on members not to prohibit importations from other members. All these are commitments that members shall respect save some special and deferential treatments for LDCs.

Ethiopia has applied for membership and the process is undergoing. What will be the prones and cones, if it satisfied all requirements to join as a member? Which one overrides over the other?

6.2 Customs Control and Administration

A. Time of control

We have said that the customs Authority is entrusted with powers and duties to have better implementation of customs duty. Its power is extended, along with supervision and control of import and export of goods, to goods under drawbacks, prohibited goods and restricted goods.

The supervision time begins from the time they reached the customs port through the completion of customs formalities until received by the importer in case of imported goods. Goods under drawback procedure are controlled from the time the draw back claim until exported. With regard to goods in transit, be it without owner, abandoned, forfeited or contraband, the authority supervises and controls until decision is passed and custom procedures are completed. When the thing remains under the control of the authority, the later has to render reasonable preservation and will be liable for every damage happened during the stay of the good.

B. Treatment of Means of Transportation

Means of transportation is also under the control of the authority. Any master of means of transport engaged in the importation or exportation of goods assumes a number of obligations as per Art 16 of proc No 60/97. The means of transport, load or unload goods, embark or disembark passengers only at customs port. But exceptionally, in some circumstances for instance incase of force majeure, the master of the means of transport may land or stop the means of transport in any place other than a customs port. Of course, the master of means of transport is under duty to immediately report the incident to the nearest customs and administration of office of the region.

The master is also under obligation to report the authority and discharge the cargo for customs control, where the time for departure of the means of transport is cancelled or delayed for more than 24 hours after authorized to move.

C. Declaration, Examination and Release of Goods.

As can be easily inferred from the customs duty proclamations strict application of the law is required under Ethiopian case.

Customs declaration is lodged after the arrival of goods at the port. The application for customs declaration helps to clear goods from the authority with in short period of time. The clearing agent, with the application is required to provide all information, fill and sign the declaration. The application also shall involve supporting documents of goods declared. The documents include:

- transportation documents
- bank permit, packing list, price documents, and other necessary documents.

The documents are means of proving for the transportation of goods up to customs port of exit. Documents shall be in Amharic original transaction (proc 60/97) but for adequate reasons, copies are acceptable (amending proc No 368/2003). The authority then will verify documents and examine goods to assure the accuracy of the contents of the document. At this juncture, the owner or his/her legal agent is required to attend the examination in whose default examination will be conducted in the presence of other officials who have direct/ indirect relation with customs duty activities.

If all formalities are satisfied, the good will be cleared from the warehouse; goods not removed will be sold or disposed as abandoned things to the customs authority. This is an indication for discharging duties and responsibilities of the authority.

D. Goods in Transit, Temporary Importation and Exportation of Goods

In the immediate previous section, we have seen that the powers and duties of Ethiopian customs authority is also extended to transit goods. Thus, “what is a transit goods?” is logical question that has to be touched.

As clearly defined under Art 2(15) of the customs duty proclamation, “a transit good” is the movement of goods from one country to another or by crossing the Ethiopian territory, or from one customs station to another by the same or changing the means of transport.

According to the requirements set under Art 24, transit goods are imposed to accomplish transit formalities, before the commencement of transit operation. The customs clearing agent shall report forthwith to the customs destination office as to the arrival of the goods.

As seen in the beginning, custom duties as a matter of fact is imposed on imported or exported goods. But, exceptionally, temporarily imported or exported goods may not be imposed on obligations of customs duty. To this end Art 27 to 29 have devised other procedures for such goods imported or exported. In this regard, the person/ owner who has get chance of importation or exportation is required to submit security /guarantee equivalent to the duties and

Taxes that would have been imposed incase it was not temporary importation or exportation.

E. Ware Houses

As we have seen earlier in the previous subtopics, the Ethiopian customs authority, besides supervision and control of imported and export of goods, can also control contraband, restricted and prohibited goods. To successfully accomplish its duties the significance of ware house operation is invaluable.

As per Art 30 of the proclamation customs warehouse may be established by the authority itself, by business organizations or by individuals to store goods imported or to be exported till accomplishment of all procedures.

Goods are stored in ware house only up to accomplishing all procedural requirements of custom. The ware houses storage rooms, can be established by the customs authority. In this regard since storage, control and supervision are conferred up our the authority as far as the authority needs, it can establish. But where business organizations or individuals need to build ware houses that provide storage services to imported or exported goods through the customs authority securing lisencc is a requirement. Lisences to business organizations or individual persons can be secured through application for license accompanied by necessary documents as required under Art 40. The application for license shall include among other things, the following documents

- License or trade certificate for the activity;
- Certificate for registration (for enterprises);
- Specific activities of the business (person) ;
- The site or building plan (if not built);
- Documentary proof for the paid up capital ;
- Insurance certificate for the ware house and for the goods to be stored; and
- Documentary proof for the fulfillment storage and equipment of the ware house.

Once license is given upon the fulfillment of the above indicated requirements the licensee shall satisfy and discharge the following obligations:

- He/she has to keep registration books for the goods entered in to and cleared form the ware house and report to customs authority officer at any time required;
- He/she has to store good by classifying in their nature and characteristics for cater and convenient condition for control;
- He/she has to be cooperate with investigators sent form the authority; and

- He/she has to surrender to the authorities ware hues good deposited for more than three months

Three period of time seems stringent time limit imposed not only upon private licenses ware house operations but also on customs authority itself. Any good which is not removed within three months is subjected to sale or disposition by the authority. One thing to note here is in both cases, the power of sale or disposition is given exclusively to the authority. That is why licensees are required to transfer the goods stored if last three months to the authority.

F. Valuation, Tariff classification and calculation of Duties and Taxes

The customs duty paying value of any import or export goods which is taken as the base to compute customs duty, is the actual total cost of the goods (Art 47of the proclamation)

G. Duty paying value of imports

The duty paying value of imported goods shall be the sum of the transaction value, flight cost and insurance premium paid to deliver the goods up on the prescribed customer port. Transaction value and other related costs given by supplier who is associated in business with the importer shall be considered genuine unless the given price is influenced by their relation ship. Where documents necessary to determine duty paying value of the goods are not presented or rejected by the customs authority, the transaction value of identical goods imported form the same country at or about the same time shall be taken to determine the value of the goods. However the preceding concept shall be applied if the goods are purchased at the same commercial level and quantity as the goods being valued.

Where no such purchase is found, upon some adjustment the transaction value of identical good sold at different commercial level and in different quantifies shall be taken to determine the value of the goods still, if the preceding concept the transaction value of

similar goods importer from the same country at or about the sometime shall be taken to determine the value of the goods. Where no such purchase is found up on some adjustment, the transaction value of similar goods sold at different commercial level and in different quantities shall be taken to determine the value of the goods.

Where a document which show the correct freight cost up to the first customs port is not produced or the document produced is rejected by the customs Authority, the freight cost identifiable good transported at or about the same time with the same means of transport shall be taken to calculate the cost of freight. For goods imported with out insurance coverage or transported under insurance coverage but the bill is rejected by the customs authority, the insurance cost paid for identical goods transported at or about the same time with the same means of transport shall be considered to calculate insurance in calculating the accurate value of the goods imported, the following additional costs shall also be considered

- The cost of container and cost of packaging the goods be it for labor or material;
- commission and blockage costs incurred by the buyer;
- The value of goods and services supplied by the buyer free of charge or at reduced cost to the extent that such value has not been included in the price of actually paid or payable;
- Royalties and license fees related to the goods that is paid directly or indirectly by the buyer; and
- Loading unloading and handling charges paid up to the port of importation.

On the other hand, we have to note that there are lots which are to be deducted form the duty paying value of imported goods.

Pursuant to Art 49 deductible costs include

- Cost for damages in roots
- cost for damages in customs ware house

H. Value of exported goods

For customer purpose, the base value of exportable goods shall be the transaction value of the goods (invoice value of the supplier) and the cost of transaction up to customs port of exit. The manner of determination is the same with imported goods and the above discussed ways of calculations can be applied alike to export goods.

I. Rates of customs Duty

Duties of custom are levied on goods imported or exported from Ethiopia at a rate specified under the proclamation which lists out grounds for commodity classification and tariff rate.

Any good imported or exported pursuant to Art 52 is subject to

- *Pay duties and taxes according to the tariff harmonized commodity description and coding system*
- *Pay duties and taxes according to the preferential tariff rate where goods are imported from the preferred country*
- *Pay duties and taxes at the rate in force on the day the declaration of the goods are presented to and accepted by the customs office.*

J. Power and Duties of customs officers and customs police

Lots of time, we have said that the Ethiopian customs authority in order to discharge its functions with demands and the needs of Ethiopia, is enthused with different powers and duties under the proclamation. customs officers and the police of customs authentic are similarly given some powers and duties that enables them to carryout what expected from the organ. To this end, Art 58 has given the officer the power and duty to stop and search any means of transport carrying import export or transit goods to seize goods found concealed in the means of transport for the purpose of evading prohibition restriction or duties and if deemed necessary detain the means of transport the master of means of transport or the owner of the goods for investigation.

Besides, the customs office is entitled with enquiring and getting full information from any passenger in relation to importations and exportations. In other circumstances, when there is reasonable suspect, the officer can also examine the luggage's of passengers. Even by authorization of court he can search premises ware house dwellings documents or books records of any person engaged in the business of importation and exportation. Here, the search and investigation shall be considered in accordance with the procedures and requirements indicated under the criminal procedure law of Ethiopia.

In discharging its proper functions the customs officer is assisted by organized regular police force which is in turn given certain powers and duties indicated under (Arts 59-61) the regular police force. Basically, helps in fighting contraband and other illegal activities related with custom laws.

The customs police is empowered to seize goods and persons moving in contravene of customs laws or any other laws that are enforced by the authentic investigate any custom offences and shall forward his report for the necessary legal action in conducting investigation the customs police is under duty to apply provisions of the criminal police is under duty to apply provisions of the criminal procedure code. In case the investigation raises reasonable suspect inclination to wards the commission of a crime, the customs prosecutor will institute charge before a court having jurisdiction to try the matter.

Unit Summary

Customs duty, unlike other taxes, is applicable only on goods imported or exported to and fro-Ethiopia. Exclusive power of control of customs duty is given to the federal government.

Among the reasons to have customs duty, the prominent ones include:

- since it relates with importation and exportation relatively speaking higher amount of revenue is generated.
- it helps a state to prevent and reduce importation of goods by then it serve as best barrier of importation. In connection with these we have seen that there are implications to countries it join WTO, including Ethiopia.

The manner of control and administration of customs activity is touched by giving special emphasis on time of control, treatment of means of transportation, declaration, examination and release of goods, temporary importation and exportation, the role of ware houses and who can construct them, valuation, tariff classification and calculation duties, prevalent rates of customs duty and finally, powers and duties of customs officers and custom police are thoroughly touched.

Review questions

1. What are the powers entrusted with and duties imposed on customs Authority (currently FIRA and customs Authority in enforcing customs duty)?
2. State how customs Authority controls a good imported or exported to effect duty on such good.
3. Currently, Ethiopia has applied to accede to WTO, what will be its impact on customs duty if its application is successful.
4. Discuss the valuation, tariff classification and calculation of duties on goods imported and exported.
5. What powers are given to customs officers and customs police to have effective customs duty in Ethiopia?

CHAPTER SEVEN: STAMP DUTY

INTRODUCTION

Stamp duty is another form of taxation basically imposed on the services given to individuals through affixing seals. Stamp is an official mark or seal placed on a document especially to indicate that a requirement tax has been paid. Thus, stamp duty is a tax raised by requiring stamps sold by the government to be affixed to designed documents, which form one kind of revenue to the governments treasury.

As can be easily understood from the preamble of stamps duty proclamation proc. No. 110/1998, it has become necessary to amend the stamp study levied on documents in a manner which would contribute to the development of art, the activities of financial and the transfer of capital assets; thus it was appropriate to come up with new legislation so as to strengthen the means of raising revenue from different bases of taxes.

Unit objectives:

After successful accomplishment of this part of the course, students will be able to:

- Identify bases of stamp duty;
- Appreciate the rates and modes of valuation of stamp duty;
- Differentiate liability, time, manner of payment stamp duty;
- Differentiate between exemption and non exemptions under stamp duty; and
- Know the penalties imposed for non compliance with the requirements of stamp duty proclamation.

7.1 Bases of the Duty

Identifying the bases upon which tax is to be imposed is the first question that shall be addressed before furthering to other activities. We have said above that, stamp duty is imposed on documents. Art 3 of the stamp duty proclamation exhaustively lists instruments chargeable with stamp duty in the following manner:

1. Memorandum and articles of association of any business organization cooperative or any other form of association.
2. award
3. bonds
4. warehouse bond
5. contractor agreements and memoranda thereof
6. security deeds
7. collective agreement
8. contract of employment
9. Lease, including sub-lease and transfer of similar rights.
10. natural acts
11. power of attorney
12. documents

Before directly addressing the rationales behind each document or instrument, it is appropriate to define what a document (instrument) is. An instrument as per Art 2(5) of stamp duty proclamation is a written document by which any right or obligation is or purports to be created, recorded, transferred, extinguished or by which its scope is limited or extended.

The instruments indicated from Art 3(1-12) implies the existence of indicative qualities under Art 2(5).

Memorandums and articles of association are constitutional documents of any business organization, cooperatives or association. They indicate the powers that such entities can

engage. For instance, in case the memorandum of association is that of business organization, the type of activity be it commercial or non-commercial that helps to earn benefit shall be clearly stipulated.

The existence of articles of association, that governs the internal relationships that should exist among members (common in case of companies) whatever be the case memorandum of association and articles of association, be it for business organizations, cooperatives or associations, can serve as a base up on which stamp duty is to imposed.

An award is similarly subject to stamp duty. An award is defined under Art 2(1) to mean a decision rendered in writing by arbitrator(s) on a reference made otherwise than by order of court in the course of suit by parties to a compromise, conciliation or arbitral submission or other similar matters. Whatever be the award is, as far as made in written form, such document is taken as base of taxation.

In similar fashion bond under Art 2(2) is described as any instrument where by a person obliges himself to pay money to another, on condition that the obligation shall be void if a specific act is performed or is not performed, as the case may be: or any instrument attested by a witness and not payable to order on bearer, where by a person mobilizes himself to pay money to another. Bond, as can be inferred easily is a document showing that the holder is the creditor of the issuer person. It is one means of raising funds, most used in case of companies. The document to have valid effect shall be a tested and this a iteration is the base to impose duty.

Most of the instruments listed under Art 3 of No 110/1998 are given operational definitional under Art 2 of the same proclamation. Thus, leaders are advised have exhausting reading on the given definition and attempting to get concepts from different law concepts covered there in for example, by borrowing concepts from law of property, titles up on properly (Art 3(10) can be understood to mean a certificate bearing the signature of public officials serving, as prima facie evidence that the holder is an owner of the property indicated under the document.

7.2 Rates and Mode of Valuation of stamp Duty.

In the previous discussions, rates and evaluation techniques are touched as integral part of a tax duty rates.

Under stamp duty proclamation too, rates and mode of valuation are treated. Accordingly, As per Art 4 (1) (2) the applicable rates are those specified in the schedule attached to the proclamation which is considered as integral part of the former. In case a document is to be executed subsequently, a flat rate attached as a schedule in the proclamation is applied accordingly.

The rates might be flat or they may depend on the value of the property for which a document is prepared under the schedule for memorandum and articles of associations of business organizations and any association a flat rate of 350. birr (at first execution) and a flat rate of birr 100 (for subsequent exceptional) is imposed. Similar way of flat rating system is extended to memorandum and article of association of cooperatives, contracts and agreements and memoranda there of, collective agreements, natural acts, and power of attestation.

On the other hand, rather than flat rate system proportional taxation is imposed on other kinds of documents. In case of property taxation, the value to be collected that will be due from taxation increases not because the rate grows, but for the fact that the value (the values of the base subject to tax increases) to mention instances of this kind are: Awards, bonds, Warehouse bond, security deeds, leases and registered title to property. (try to have a look at the schedule attached to the proclamation).

As we have addressed above, in assessing the value to be charged up on the document /instrument, some times we apply the value of the right or the obligation and in other times fixed amount will be imposed as indicated in the schedule. But, we might face certain rights or obligations in currencies other than Ethiopian birr. In this case, we have

to compute the value of such right or obligation on the base of the prevailing rate of exchange at that time (Art 5(3)).

Where the amount is advalorem one, average value of the stock and where serial distinct matters are chargeable, the total/aggregate amount of duties payable in respect of each separate instrument will be imposed.

7.3. Liability, Time and Manner of Payment

We have said that stamp duty is imposed on documents (instruments) that are required to bear a physical stamp. Thus, it is logical to impose the tax obligation on the beneficiary of the document. But, since tax administration, as we discussed before, requires collaborative duty, other persons whose work is related are also imposed with the duty of enforcement. From the readings of Art 6, Obviously, unless otherwise determined by the proclamation, the beneficiary of an instrument is liable to pay the stamp duty thereon. The person making (drawing) or issuing an instrument in Ethiopia, is liable for the payment of the stamp duty upon the execution of the instrument. However, when the instrument is made (drawn) outside Ethiopia, the person who is the first executing it in Ethiopia is liable for the payment of the duty.

The lessor and the lessee while entering lease contract can impose this obligation on either of them. In the absence of otherwise stipulation, the lessee is required to cover the stamp duty tax. In the case of lender-borrower relation ship, the borrower is required to pay the charge imposed on security deeds. With regard to documents transferring title to property, the transferee is imposed, on payment of such though in their agreement they can impose same on the transferor.

In contractual documents or agreements, members/parties are jointly and severally liable for the payments of stamp duty there on. In employment contracts, the employer is liable to the payment of the stamp duty tax. In awards, parties to the a ward are Jointly and severally liable to the duty. Like wise in collective agreements, which helps workers to

have some bargaining power towards the employer, both the employer and employees are jointly and severally liable to the stamp duty.

Once we established liability from the contents of Art 6 of the proclamation, what shall proceed is to determine the procedures how payment is effected on the part of the identified personnel's. This lead us to examine the time and manners of payments imposed on individuals involved on the documents be it through issuing them or driving benefits (titles) from same. To this end, Art 7 is devoted to show time and manner of payments regarding stamp duty.

Stamp duty on memorandum and articles of association, shall be paid before or at the time of registration. These documents are registered in respective Justice offices and commercial registries depending on the nature of the activities to be carried out by the associations and business organizations. In case the memorandum and article of association is that of business organizations, it will be registered in respective in commercial registries. Similarly, if it is that of associations, it will be registered in respective Justice offices(at regions in Justice Bureaus and at Federal level in Ministry of Justice).

In similar fashion, in case of awards, the law requires the duty to be paid before or at the time of issuance of the a ward. On contracts or agreements before or at the time of signature. Regarding leases or subleases, payment is required before or at the time of the signature.

On notional acts, at the time of issuance; on security deeds, before or at the time of signature and on documents of title to property before or at the issuance

7.4. Exemptions from Stamp Duty

For economic, Social, or administrative reasons, exemptions are common under tax laws of legal system of different nations. But variations are observed from one state to another. Under Ethiopian stamp duty proclamation Art 7, the following are exempt from the liability of payment of same:

- Public bodies on which the federal government of Ethiopia financial Administration proclamation No. 57/1996 applies.
- Goods imported for sale by traders having import license, when first registered in the name of the trader.
- Documents that are exempted in accordance with international agreements and conventional approved by Ethiopian government.
- Subject to reciprocity embassies, consulates and missions of foreign states may be exempted.
- Share certificates are exempt from stamp duty payable on the register of title of property.

7.5. Penalties

Tax evasion is the major problem in tax administration. This is more severe in developing states, to which Ethiopia is a part, where the awareness of tax payers towards the multidimensional tax returns is very low. Stamp duty also suffers this problem.

Fearing that there might exist poor implementation of stamp duty on those imposed such obligation under Art 5, the proclamation imposes penalty clauses under Art 12 and Art 13 on those who obscures discharging this obligation.

a) Accordingly: Art 12 provides the following:

Art 12 penalty

Any person:

a).Executing or signing, otherwise than as a witness, a document chargeable with stamp duty without the same being stamped.

b) Who, with intent to defraud the appropriate payment of duty, conceals facts bearing on the true nature of any instrument.

Shall be liable on conviction to a fine not less than birr 25,000 and not exceeding Birr 35,000 and to rigorous imprisonment for a term not less than 10 yrs and not more than 15 yrs.

Close reading of the above sub-Articles tells us that the penalty is more sever. But, due notice shall be extended that the penalty (fine and imprisonment is impose disregarding the consequences of the act. Whosoever is found performing the prohibited acts under Art 12(a and b) is liable to the penalties.

Thus, the purpose seems providing warning clause to any body under duty to charge obligations in connection with stamp duty.

The obligations and penalties are also imposed on persons whose activity is related with sale of stamps and on those who engage them selves with the transaction with out due appointment.

In this regard Art 12(2) runs:

Any person who is:

a) appointed to sell stamps or stamp papers, disobeys regulations issued under this proclamation; or

b) not so appointed, sells or offers for sale stamps or stamped papers.

Shall be liable on conviction to a fine not less than 5,000 and not exceeding and to rigorous imprisonment for a term not less than 5 years and not more than 10 yrs.

Unit summary

Stamp duty is one form of tax, but related only with documents. Individuals are imposed for they use stamps affixed to authenticate a document. The base of taxation is thus documents that vary from simple rewards to contractor agreements and memoranda thereof.

The rates applied in stamp duty are either flat that are similar or variable depending on the value of the property for which the document is prepared. In the latter case, proportional taxation is used. Similarly, manner and time of payment are discussed in the chapter.

Not all documents that bear stamp are subject to taxation. Exemption is also one character of stamp duty. Public bodies covered under proc No. 57/96, goods imported for sale, and documents exempted in accordance with international agreements are few to mention.

Like others to have better implementation, the proclamation provides penalties that create obscure, being from inside or outside.

Review questions

1. Define stamp duty, on your way. What are its peculiar features?
2. At what instances exemption to documents work in stamp duty of Ethiopia?
3. What liabilities and penalties imposed on persons that do not comply with the stamp duty proclamation, be it from inside or out side?

CHAPTER EIGHT: SURVEY OF SOME REGIONAL TAXES

INTRODUCTION

In federal structure of government, both central and regional state governments have their own roles for the development of a country. Both governments are entrusted with two very essential functions:

- i. maintenance of law and order which includes police, jails, et c
- ii. social- economic development obviously, with out assist of one another the different strategies and objectives of the countries cannot easily be realized thus, states play role in provision many social amenities like education ,healthy sanitation, utilities and recreation. Economic development incorporates the development of agriculture, industrial and tertiary sectors realization of all these activities will be achieved it great responsibility is shouldered on state government this undoubtedly necessitates the involvement of state in the finance of the country . this kind of financing is common in state following federal state structure in some countries like India, finance of the country is envisaged under three set of government.
 - i. central government
 - ii. state governments and
 - iii. local bodies

Coming to Ethiopia, power of taxation is given to the federal government, state government or concurrently for both central (federal) and state government. But since the focus of attention is on the powers of states on taxation we shall return to this issue. In Ethiopia too, the complexity of the responsibility of the state government require adequate revenues to fulfill their responsibility indicated above to wards the society. This principle in Ethiopia bases it self from the 1995 FDRE constitutions. Pursuant to Art 97 of same, regions are entitled to levy and collect taxes of some species under their territorial boundaries. To mention some income taxes on employees of states private enterprises (97(1))

- land use tax on land usufructuary right (97(2))
- the come taxes on the incomes of private farmers and farmers incorporated in cooperative isolations

Generally, states in Ethiopia can impose taxation on incomes received within their territory but, here, emphasis shall be extended to note that states cannot have say on the powers exclusively given to federal government. For instance, though it is vivid fact that persons registered for VAT or required to be registered for same, derive their incomes both in federal cities (Addiss Ababa and Dire Dawa) and regions, the power of taxation and collection is decided to be given to the federal government. At this juncture, it is expected that certain questions regarding power of taxation on incomes that are not exclusively given to either the federal or regional government nor jointly given both government will be raised.

To this end ,Art 99 of the FDRE constitutions provides that:

The house of federation and the house of people’s representatives shall, in joint session, determine by two third majority Vote on the excurse of powers of taxation which has not been specifically provided in this constitution.

Thus, in powers not exclusively given to either or both governments what matters is the decision to be passed by the sessions of the two federal houses. It seems that if the in come has universal character, there is high possibility that the power being allotted to the federal government and vice versa.

Unit objectives:

After successful accomplishment of this part of the course, students will be able to :

- Appreciate agriculture income taxes
- Analyze property taxes
- Understand other regional taxes

8.1 Agricultural income taxes

This kind of tax is levied on the agricultural incomes of the farmers. Though farmers also exist at federal level, it is obvious that most of the farmer reside on regional territories. Thus , the role of regions in levying and assessing tax on an in come derived from agricultural activities is high but, since we have different regions , the mode of assessment and collection of taxes will differ from region to region.

Coming to the federal government the laws that govern taxation from agricultural income tax laws that govern proc NO 152/1978. According to such proclamation, the amount declared, will be assessed by the tax authority in manner described under the schedule of the proclamation.

8.2 Property Taxes

In law of property, the term property refers to objects up on which patrimonial rights can be exercised and the incorporeal rights that can be expressed in terms of economic value. Also, in defining income, we have said that moral or spiritual benefits are excluded:only benefits that can be evaluated in economic term are considered as income.

Here too, for a thing to be subject to taxation it has to have economic utility to human being. As there are variety kinds of properties, the tax base will be widen accordingly. Under this section we will focus on rural land use tax and urban land use tax (taxes imposed on these immovables).

8.2.1 Rural Land use Tax

The FDRE constitution clearly has given power of determination, levying and collection of taxes on rural land use payment to states (Art 97). As we have different regional states the tax rate, mode of assessment and collection procedures of payment and taxing relating to rural land use very from region to region.

From times immemorial, land revenue has been an important source of income to government of Ethiopia. It can be said that it is one of the oldest taxes. It is a tax on the agriculturalists to for holding land for agricultural purposes. It is a compulsory payment and no agriculturalist is exempted from it of course since we had different land tenure system the land revenue system varied.

During Derg regime we had proc No 77/1976 and proc No152/1978 which were designed to govern issues of rural land use fee and house taxes.

According to these proclamation

- a. Every farmer who is a member of an agricultural producers cooperative shall pay 5 birr
- b. every farmer who is not a member of an agricultural producers cooperative shall pay 10 birr
- c. Every government agricultural organization shall pay a land use fee of 2 birr per factor.

The fee is collected annually between December to April.

8.2.2 Urban Land use Tax

This type of tax is imposed on a piece of land which is used for non- agricultural purposes like constructing a residential building or erecting an industrial plant as the owner of the land gets an unearned increment because of the extra- ordinary increase in the value of land particularly with in or in the vicinity of growing towns and cities.

The assessment of non-agricultural land has assumed special importance with increasing urban development the urban land use and house tax are thus imposed on urban dwellers. Ethiopia had Pro. NO 80/1976 and proc NO 161/1979 according to which families, persons, organization or cooperative societies are required to pay tax to municipalities, or in their absences to town administrations.

Thought, like rural and use tax, it might vary from region to region, lands are classified in to grades . There are three grades:

Grade 1. the highest land

Grade 2:- middle land

Grade 3;-the least land

This grading system helps to determine the rate of taxes imposed, like other taxes, exemptions were allowed under proc No 80/1976. These includes:

- a. public roads, squares, recreation and sport centers, and cemeteries
- b. place of worship , non profit- making private schools, hospitals, charitable institutions
- c. governmental institutions drawing their budgets from the central treasury
- d. dwelling houses whose annual return value is less than 300 birr

8.3 Other Regional Taxes

As can be easily understood from Art 97 of the FDRE constitution, exclusive power of taxation is given to regional states of Ethiopia besides their powers to administer, levy and collect taxes on, agricultural income rural land use and urban land use they have the following powers

- they can levy and collect taxes on employees of the state and private enterprises
- they can levy and collect taxes on incomes from transport services rendered on waters within their territories, taxes on income from private houses and other properties within states.
- They can levy and collect profit, sales, excise and personal income taxes on income of enterprises owned by states
- They are also empowered to determine and collect fees and charges relating to licenses issued and services rendered by state organs and fix and collect royalties for use of forest resources.

Unit Summary

One characteristics of federal government is devolution of power between central and regional governments. Unless properly handled through cooperation, maintenance of law and order as well as socio-economic development will be at stake. Similarly, taxation as one-economic aspect of a nation needs attention.

In Ethiopia, power of taxation is given concurrently to federal and regional governments. Art 97 of the FDRE constitution gives some powers of taxation to states.

Agricultural income taxes, property taxes, rural and urban land use taxes, along with other kinds of taxes are areas of taxation where regions have great role in its administration.

Review questions

1. Under the current land holding system of Ethiopia what is the role of the federal and regional governments in collection of taxation from agricultural income?
2. What is property tax? Is it different from other kinds of taxes? Why or why not?
3. Do you think that the different regional taxes operate in similar fashion? Why or why not?

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- Ethiopian VAT Proclamation No. 285/2002
- Council of Ministers VAT Regulations No. 79/2002
- Turnover Tax Proclamation No. 308/2002
- Excise Tax Proclamation No. 307/2002
- In addition, the following laws not included in the “Compendium” are to be consulted:
 - Customs Duty Proclamation No. 60/1997
 - Re-establishment and Modernization of Customs Authority Amendment Proclamation No. 368/2003
 - Stamp Duty Proclamation No. 110/1998
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