

Unit 5: Classification of Taxes

5.1. Direct Taxes

5.1.1. Income from employment (Schedule “A”)

Employment income tax is a tax on the earnings of an employee. Employees who earn birr 601 per month and above are liable to pay employment income tax.

Employer: means a person who engages or remunerates an employee;

Employee: means an individual engaged whether on a permanent or temporary basis, to perform services under the direction and control of another person, other than as an independent contractor, and includes a director or other holder of an office in the management of a body and government appointees and elected persons holding public offices.

Employment Income means the following:

- ✓ Salary, wages, an allowance, bonus, commission, gratuity, or other remuneration received by an employee in respect of a past, current or future employments;
- ✓ An amount received by an employee at termination of employment, whether paid voluntarily, under an agreement, or as a result of legal proceedings; including any compensation for redundancy or loss of employment, or a golden handshake payment.
- ✓ It does not include exempt income

Employment Income Tax Rates

No.	Employment Income (per-month) birr	Employment income tax rates	Deduction in birr
1	0-600	0%	0
2	601-1650	10%	60
3	1,651-3,200	15%	142.50
4	3,201-5,250	20%	302.50
5	5,251-7,800	25%	235
6	7,801-10,900	30%	955
7	Over 10,900	35%	1,500

Example

If the monthly salary of Mr. Abebe is birr 4,500 .In accordance of employment Income Tax it computation would be:

Employment income tax =monthly salary X Tax rate- deduction birr

Employment income tax = 4,500x 20% -302.50

Employment income tax =597.50

Net salary =gross salary- Employment income tax

Net salary = 4,500-597.50

Net salary = birr 3,902.5 (excluding pension deduction)

Exemptions from Employment Income

According to, income tax proclamation no 979/2016 the following categories of income shall be exempt from payment of tax.

- ✓ An amount paid by an employment to cover the actual cost of medical treatment of an employee;
- ✓ An allowance in lieu instead of means of transportation granted under a contract of employment,
- ✓ A hardship allowance
- ✓ Transport expenses and per diem payment to an employee travelling on a tour of duty.
- ✓ Travelling expenses paid to an employee recruited from place other than the place of employment on joining or completion of employment, including in the case of a foreign employee, travel expenses from and to their country of origin, but only if the travel expenses have been paid pursuant to specific provisions of the employee's contract of employment,
- ✓ Food and beverages provided for free to an employee by an employer conducting a mining, manufacturing, or agricultural business.
- ✓ Allowances paid by the government of the federal democratic republic of Ethiopia to employees engaged in public service in foreign country.
- ✓ Allowances paid to members and secretaries of boards of public enterprises, public bodies
- ✓ Study groups established by the federal or state Government or city administration;
- ✓ Contribution by an employer to pension, or other retirement fund for the benefit of an employee provided the monthly total of contributions does not exceed 15% of the monthly employment income of the employee;
- ✓ A pension to the extent exempt from tax under the public servant pension proclamation or the private organization employees pension proclamation;
- ✓ An amount derived by the federal, or a state or local government of Ethiopia, or the national bank of Ethiopia, from activities that are incidental to official operations;
- ✓ An amount exempt from tax to the extent provided for under an international agreement;
- ✓ An amount exempt from tax to the extent provided for under a provision (referred to as an exemption provision") in an Agreement entered into by the government of the federal democratic republic of Ethiopia when the following conditions are satisfied
 - a. The agreement is for the provision of financial, technical, humanitarian, or administrative assistance to the Government: and
 - b. The Minister has concurred, in writing, with the exemption provision;
- ✓ A scholarship or bursary for attendance at an educational institution;
- ✓ Maintenance or child support payments:

- ✓ The income of non-profit organization other than business income that is not directly related to the core function of the organization;
- ✓ A cash indemnity allowance paid by an employer to an employee, but only to the extent that the allowance compensates the employee for shortfalls on money counts
- ✓ An amount that is specifically exempted from income under a law in force in Ethiopia;
- ✓ Salaries paid to domestic servants;
- ✓ Payment made by contractors engaged in petroleum operation to their sub contractors.

5.1.2. Rental Income Tax (Schedule B)

Rental Income Tax is one of the taxes being recently enforced in Ethiopia. Even though it has been a long time since it was included in the income tax proclamation, it was started to be strictly enforced especially on individual home owners who rent out their property not more than 2 years ago. Here one can find rates, applicable deductions and related topics on rental income tax in Ethiopia.

Rental of buildings

Income tax is imposed on the income from rental of buildings and collected at the following rates:

1. On income of bodies (share companies, plc's for example) thirty percent (30%) of taxable income,
2. On income of persons according to Schedule B (shown below) of the Income Tax Proclamation No. 286/2002 and its amendment in July 2016.

No.	Taxable Income from Rental (per year)		Tax Rate (%)	Deduction in Birr
	From Birr	to Birr		
1	0	7200	Exempted	None
2	7,201	19,800	10	720
3	19,801	38,400	15	1,710
4	38,401	63,000	20	3,630
5	63,001	93,600	25	6,780
6	93,601	130800	30	11,460
7	Over 130,800		35	18,000

Income from rental of building is calculated as follows:

- ✓ If the tax payer leased furnished quarters, the amounts received attributable to the lease of furniture and equipment is included in the income.
- ✓ Sub-lessors pay the tax on the difference between income from sub-leasing and the rent paid to the lessor, provided that the amount received from the sub-lessor is greater than the amount payable to the lessor.

Deductions

Deductions apply in computing taxable income:

- ✓ For taxpayers not maintaining books of account; taxes paid (except income taxes) with respect to the land and buildings being leased, and 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.
- ✓ For taxpayers maintaining books of account, the expenses incurred in earning, securing, and maintaining rental income. Deductible expenses include (but are not limited to) the cost of lease (rent) of land, repairs, maintenance, and depreciation of buildings, furniture and equipment as well as interest on bank loans and insurance premiums.

5.1.3. Business Income/Profit Tax (Schedule C)

According to Federal Income Tax Proclamation No. 979/2016, tax is imposed on business income. The Proclamation under Article 21 defines business income as:

1. Subject to this Proclamation, the business income of a taxpayer for a tax year shall include the following:
 - a. the gross amounts derived by the taxpayer during the year from the conduct of a business, including the gross proceeds from the disposal of trading stock and the gross fees for the provision of services (other than employment income);
 - b. the gross amounts derived by the taxpayer during the year from the investment of the capital of a business, including dividends, interest, and royalties;
 - c. a gain on disposal of a business asset (other than trading stock) made by the taxpayer during the tax year;
 - d. any other amount included in business income of the taxpayer for the tax year under this Proclamation.
2. Business income shall not include an amount that is exempt income.
3. Subject to sub-article (4) of this Article, the gain on disposal of a business asset included in business income under sub-article (1)(c) of this Article is the amount by which the consideration for the disposal of the asset exceeds the net book value of the asset at the time of disposal.
4. If a business asset is a taxable asset under Article 59 of this Proclamation:
 - a. the gain on disposal of the asset included in business income under sub-article (1)(c) of this Article is the amount (if any) by which the cost of the asset exceeds the net book value of the asset at the time of disposal; and
 - b. any gain above cost is taxable under Article 59.

As per the Federal Income Tax Proclamation No. 979/2016, the tax rates are as follows:

1. Taxable business income of bodies (eg., PLC, Share Company) is taxable at the rate 30%;

2. Taxable business income of other taxpayers is taxed in accordance with the following Table;

No .	Taxable Business Income /Per Year/		Tax Rate (%)	Deduction in Birr
1	0	7200	Exempted	None
2	7,201	19,800	10	720
3	19,801	38,400	15	1,710
4	38,401	63,000	20	3,630
5	63,001	93,600	25	6,780
6	93,601	130,800	30	11,460
7	Over 130,800		35	18,000

Allowable Deductions (Deductible Expenses)

The general principle regarding deductibility is that deductions will be allowed for expenses incurred for the purpose of *earning, securing and maintaining* the business income to the extent that the expenses can be proven by the tax payer and subject to the *limitations* specified by the proclamation. On the basis of this, the law permits the following lists of expenses as deductible from business income.

1. The direct costs of producing the income, such as the direct cost of manufacturing, purchasing, importations, selling and such other similar costs;
2. General administrative expenses connected with 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 directive issued by the Minister of Revenue.
5. Commissions paid for services rendered to the business, provided that:
 - a. said services were in fact rendered.
 - b. the amount paid corresponds to normal rates paid for similar services. By other persons or bodies similarly situated.
6. In the case of a business located and operating in Ethiopia as the branch, subsidiary or associated company of a business located and operating abroad, no payment of any kind made to the holding or associated company of the business in Ethiopia shall be accepted as deduction unless:
 - a. The payment in question was made for service actually rendered: and
 - b. said service was necessary for the business and could not be performed by the persons or bodies or by the business itself at a lower cost.
7. If the income tax authority has reason to consider that the total amount of salaries and other personal emoluments payable to the manager of a private limited company is exaggerated it may reduce paid amount for taxation purpose to the limit which, in view of operation of the company, appears justifiable, either by disallowing

the payments made to more than one manager or in any other way which may be just and appropriate.

8. 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 the qualifications required by the post.

In computing taxable income, the above listed expenses could be deducted from gross income. If some conditions are met, the proclamation also allows such expenses as depreciation, bad debts, interest expense and donation and gifts, which is covered separately in this section as deductible expenses.

Non-allowable Expenses

All those expenses, which are not wholly or exclusively incurred for the business activity, are not allowable deductions from gross income. Therefore, in computing taxable income the following expenses should be added back.

- a. Capital Expenditure- the cost of acquisition, improvement, renewal and reconstruction of depreciable assets
- b. Additional Investment- an increase of the share capital of a company or the basic capital of a registered partnership
- c. Declared dividends and paid out project shares.
- d. Voluntary pension or provident fund contributions over and above 15% of the monthly salary of the employee.
- e. Damages covered by insurance policy
- f. Interest in excess of the rate used between the National Bank of Ethiopia and the commercial Banks increased by two percentage points.
- g. Punitive damages and penalties
- h. The creation or increase of reserves, provisions and other special purpose funds unless otherwise allowed by the proclamation.
- i. Income tax paid on schedule "C" income and recoverable Value Added Tax (VAT)
- j. Representation expenses over and above 10% of the salary of the employee.
- k. Personal consumption expenses
- l. Expenditures exceeding the limits set forth by the proclamation or regulations
- m. Entertainment expenses "Entertainment" means the provision of food, beverages, tobacco, accommodation, amusement, recreation or hospitality of any kind to any person whether directly or indirectly.
- n. Donation and gift other than those permitted by regulation.
- o. Sum paid as salary, wages or other personal emoluments to the proprietor or partner of the enterprises. Expenditure for maintenance or other private purpose of the proprietor or partner of the enterprise.
- p. Losses that are not connected with or not arising out of the activity of enterprise.

- q. Grants and donations that exceed 10% of the taxable income of the tax payer.

Allowable deductions that need certain conditions to be met

The following expenses need certain conditions to be met before all are allowed to be deducted from gross income:

Interest expense

- a. Interest which is not in excess of the rate used between National Bank of Ethiopia and Commercial banks increased by 2%) is allowable deduction if the lending institution is recognized by NBE or a foreign institution permitted to lend to enterprises in the country. Moreover, for the interest paid to foreign banks to be deductible, the lending bank shall, prior to the granting of any loan to any such person, file a declaration in writing with the Tax Authority wherein it informs said authority concerning all loans granted to any person liable to pay income tax in Ethiopia. In addition, the borrower shall withhold 10% from the gross interest payable and transfer same to the Tax authority within two months of the end of the fiscal year.
- b. Interest paid to share holders on loans and advance can be deducted to the extent that the interest paid is less than the average of four times the amount of share capital in a tax period. This provision doesn't apply to banks and insurance companies.

Representation Allowances

Representation allowance is hospitality expense incurred in receiving guests coming from outside the enterprise in connection with the promotion and enhancement of the business. Such expenses are deductible to the extent of 10% of the salary of the employee.

Gifts and Donations

Gifts and donations are allowable deductions under the following conditions

- a. If they are given to a registered welfare organization and where it is certified by the registering authority that the organization has a record of outstanding achievement and its utilization of resources and accounting system operates transparency, accountability.
- b. If the payment is made in response to emergency call issued by the government to defend the sovereignty and integrity of the country, to prevent man made or natural catastrophe, epidemic or for any other similar cause.
- c. Donation made to non commercial education or health facilities.

Nonetheless, grants and donations made for purpose listed above may only be allowed as deduction where the amount of the donation or grant does not exceed 10% of the taxable income of the taxpayer.

Trading Stock

- ✓ *Trading stock* is a business asset that is either used in the production process or become part of the product, or that is held for resale purpose.

The cost of *trading stock* disposed of during a tax period is allowable deduction for the purposes of ascertaining income.

- ✓ The *cost of trading stock* disposed of during a tax period is determined on the basis of the average cost method, i.e. the generally accepted accounting principle under which trading stock valuation is based on an *average cost of units* on hand.

Depreciation

Any business may acquire assets that have non-current nature to generate profit. In determining periodic income, the cost of these fixed assets should be transferred to expense account in a systematic and rational approach called Depreciation. Generally Accepted Accounting Principles (GAAP) allows different methods of computing annual depreciation charges for preparing general purpose financial statements.

Among these methods, the Ethiopian government adopts the straight line - pooling system method. Generally, except the cost of building, intangible assets and Information Technology Equipments purchased by a business, all other assets become part of a pool of expenditures on which capital allowances may be claimed. Under the pooling system, when addition is made, the pool increases; on disposal the pool is reduced by the sale proceeds.

In accordance with the newly enacted income tax proclamation and regulation, depreciation may be deducted in the determination of taxable business income. Nonetheless, fine arts, antiques, jewelry, trading stock and other similar business assets not subject to wear and tear and obsolescence shall not be depreciated.

Depreciation rate

- a. In determining the amount of depreciation 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 five percent (5%).
- b. The acquisition or construction cost, and the cost of improvement, renewal and reconstruction, of intangible assets shall be depreciated individually on a straight line basis at ten percent (10%).

The above two categories of business assets are depreciated at the given rates based on their cost (gross value).

The following two categories of business assets shall be depreciated according to a pooling system at the following rates:

- c. Computers, Information systems, software products and data storage equipment as a rate of 25%,
- d. All other business assets at the rate of 20%. This category includes motor vehicles, plant and machinery, furniture and equipment, etc.

For assets for which the pooling methods are used, the rate is applied to the depreciation base for the determination of depreciation. The

depreciation base is the book value of the asset as recorded on the opening day of the balance sheet of the tax period increased by the cost of asset acquired or created and the cost of improvement, renewal and reconstruction of the asset during the tax period. The amount can also be decreased by the sales price of assets disposed of during the period. Losses incurred during the period due to natural calamity and other involuntary conversion will also be considered in the computation of depreciation base. Any compensation received for these purposes will be deducted from the book value.

While determining the depreciation base, if the depreciation base becomes negative amount, that amount will be added to taxable income and the depreciation shall become zero. On the other hand, if the depreciation base does not exceed Birr 1,000 the entire depreciation base will be a deductible business expense.

If a revaluation of business assets takes place, no depreciation will be allowed for the amount of the revaluation. In determination of taxable business income a deduction is permitted in respect of each category of business assets for the maintenance and improvement expenses up to a maximum of 20% of the depreciation base of the end of the year. Any actual expense exceeding this 20% will increase the depreciation base of that category (or it is capitalized). Nonetheless, depreciation is not allowed for assets in respect of which all *capitalized costs* have been fully recovered if the transfer of such assets is made between related persons.

- ✓ *The regulation issued by the Council Of Ministers indicates that depreciation will be allowed as deduction only if the taxpayer claiming deductions for depreciation keeps proper records showing the cost of acquisition of the asset and the total amount deducted since the date of acquisition. Moreover, the tax payer must furnish the Tax Authority with satisfactory evidence that the data mentioned in the records are true and correct.*

Bad Debts

In the determination of taxable income, a deduction for a bad debt is allowed if the following conditions are met:

- ✓ *An amount corresponding to this debt was previously included in the income;*
- ✓ *The debt is written off in the books of tax payer; and*
- ✓ *Any legal action to collect the debt has been taken but the debt is not recoverable.*

Computing Taxable Income

Using the income statement, taxable income may be determined as follows;

1. Take the net profit as shown in the income statement which is prepared in accordance with Generally Accepted Accounting Principles (GAAP) or International Accounting Standards (IAS).
2. Add back any item deducted as expense, which is not allowed for tax purposes.

3. Deduct any item included in the income on which income tax has already been withheld by the payer. Examples of such items are income received from royalties, income from games of chance, dividends and interest received, etc. refer schedule 'D' other income in the proclamation.
4. Multiply the figure so arrived (from step 1 through step III) by the income tax rate. For bodies use the progressive tax table for persons (other tax payers) to get the tax payable for the fiscal year.

5.1.4 Other Direct Taxes (Schedule D)

Incomes which are not specifically included under Schedule A, Schedule B and Schedule C is categorized under this schedule. Schedule D income includes;

- ✓ Royalties
- ✓ Income from rendering of technical services
- ✓ Income from games of chance
- ✓ Dividends
- ✓ Income from rental of property
- ✓ Interest Income
- ✓ Gain on transfer of certain investment property.

Income from Royalties

Royalty refers to a payment of any kind received as a consideration for the use of or the right to use any copyright of literary, artistic or scientific work, including cinematography film, and films or tapes for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula, or process, or for the use or for the right to use of any industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.

Royalties is subject to a tax at a flat rate of 5%. The withholding agent who effects royalties payments, withholds the foregoing tax and accounts to the Tax Authority. However, if the payer resides abroad and the recipient is a resident, the recipient must pay the tax on royalty income.

Income from Rendering Technical Services

Income from technical service refers to income from any kind of expert *advice* or *technological* service rendered. All payments made in consideration of any kind of technical services rendered outside Ethiopia to resident persons in this form are subject to a tax rate of 10% which will be withheld and paid to the tax authority by the payer.

Income from Games of Chance

This form of income is derived from winning at games of chance (lotteries, Tom bolas, and other similar activities). This income is subject to tax at the rate of 15%, except for winnings of less than Br. 100 similar to income from rendering technical activities the payer must withhold or collect the tax and account to the Tax Authority.

Income from Dividends

The taxable Income is income received in the form of dividend from a share company or withdrawals of profits from a private limited company. Dividend Income is subject to tax at the rate of 10%. The withholding agent (payer) shall withhold or collect the tax and account to the tax Authority.

Income from Casual Rental Property

The taxable income under this category is income derived from casual rental of property (land, building, or moveable asset) not related to a business activity. This type of income is subject to tax at a flat rate 15% of the annual gross income.

Income Tax on Interest from Deposits

This includes income derived from interest on deposits. Interest Income will be taxed at the rate of 5% and the payer must withhold the tax and account to the Tax Authority.

Gain on Transfer of certain Investment Property

Gains obtained from the transfer (sale or gift) of building held for business, factory, and office and a share of companies is taxable under this category. Such income is taxable at the following rates:

- ✓ Building held for business, factory, and office at the rate of 15%, and
- ✓ Shares of companies at the rate of 30%

Nonetheless, Gains obtained from the transfer of building held for residence is exempted from tax provided that such building is fully used for dwelling for two years prior to the date of transfer.

Computation of Capital Gain Tax

In computing capital gain tax, you should follow the following procedures:

Step 1. Determine the historical cost of the building or the par-value of the Share, as appropriate.

- ✓ When calculating the capital gain realized from the alienation of building, the cost registered with the appropriate government body at the time of issuance of construction permit shall be taken to be the cost of constructing the building. Tax payable on gain realized from alienation of buildings shall be applicable only to buildings in municipal areas.

Step 2. Determine allowable deductions which includes

- ✓ inflation adjustment at a rate to be determined by the appropriate authority
- ✓ taxes paid for the land and the buildings

Step 3. Determine proceeds from the transfer of capital assets

Step 4. Capital gain tax equals tax rate mentioned above times the amount obtained after deducting the sum of step1 and step 2 from step 3.

Example

ABC Co. sold a building, which is held for business for Br. 1,000,000, which is acquired at a cost of Br. 1, 200,000. Depreciation until time of sale amounts Br. 500,000 and property tax paid for the building Birr 50, 000. Calculate the capital gain tax payable by ABC Co.:

Solution:

- Book value of the Building = Cost - Accumulated Depreciation
= 1,200,000 - 500,000
= 700,000
- Property tax on the building is allowable deduction. Br. 50,000
Capital gain tax = (Br. 1000,000 - (Br. 700,000 + Br. 50,000))
15%
= Br. 250,000 X 15%
= Br. 37500

Tax Declaration & Assessment

As already indicated in earlier discussions each tax payer submits a tax return (financial statements) to the income tax authority at the end of each fiscal year. The tax return will, then, be subject to a review by a tax officials. This review by a tax official of the tax declaration and information provided by the tax payer and a verification of the arithmetical and technical accuracy of the declaration tax liability shortly after the **submission** of the declaration is called Tax Assessment.

The tax year of a person is the fiscal year for an individual or association whereas it is the accounting year of the body in the case of a body. The Procedures for the assessment of business income tax takes two forms, assessment by books of account and assessment by estimation.

a. Assessment by Books of Account

Assessment by books will be done for those who maintain books of accounts (Category A&B). The revenue authority makes assessment by estimation when the taxpayers do not maintain the books or when the submitted books are not acceptable. This is also done if the taxpayer fails to declare his/her table within the time required.

b. Assessment by Estimation

If the taxpayers keep no records, or if the income tax authority does not accept the submitted books, or if the taxpayer fails to declare tax within the time specified, the income tax authority estimates tax by the use of certain indicators. Category 'C' should pay tax at fixed rate on the income estimated by the income tax authority.

Tax assessors will be assigned by the tax office to estimate the daily sales of the taxpayers. The estimates will be done using the best of their judgment and objectivity. The estimated daily sales will be converted to annual income using the number of working days. Tax on annual sales is determined on the basis of presumptive value assigned to each activity.

Assessment Notification

Notification regarding the assessment of tax, in writing, is served to taxpayers in the following ways.

1. **To non-residents:** By a registered letter to the agent or by affixing the notice on the residence or place of business.
2. **To Resident individuals:** By registered post or in person. (Incase if the taxpayer is absent, to any adult member of the family). In the

absence of any person to receive the notice, it will be affixed to the door of residence or place of business.

3. **To bodies:** By a registered letter to the body or to any director or employee.

Change of Accounting Year

A body cannot change its accounting year unless it obtains prior approval in writing from the Tax Authority and complies with any condition that may be attached to the approval. However, the Tax Authority may remove the approval granted by notice in writing if the body fails to comply with any conditions set by the tax authority. When the tax year of a person changes, as a result of failure to comply with the tax authority's conditions, the period between the last full year and the date on which the new tax year commences will be treated as a separate tax year to be known as the *"transitional year"*.

Declaration and Assessment of Schedule B and C Income

For the purpose of declaration and payment of income tax, schedule "B" and schedule "C" income tax payers are classified into three categories, known as category "A" category "B" and category "C"

The difference of and the requirements from each category are summarized in the table below:-

Category	Basis of classification	Requirements basis for assessment	Period of payment/ declaration
A	- Any company incorporated under the law of Ethiopia or in a foreign country - Any other business having an annual turnover of Birr 1,000,000 or more	- Balance sheet - Profits and loss statement - Details of gross profit and the manner in which it is computed, general and administrative expense, depreciation, provisions and reserves	Within four months from the end of the tax payers tax year
B	Unless already classified in category "A", any business having an annual turnover of over Birr 500,000.	- Profit and loss statement - Vouchers supporting the above	Within two months from the tax payers tax year (Hamele 1 - Pagume 5/6)
C	Unless already classified in categories "A" and "B" whose annual turnover is estimated by the tax authority as being up to Birr 500,000	- A standard assessment method shall be used to determine the income tax liability.(fixed amount) and - The tax will be paid in accordance with schedule 1 and 2 attached with the regulation or - If the tax payer maintains accountable books of accounts, the tax will be paid based on books	Hamele 1 to Hamele 30 of each year

The tax calculated in accordance with the tax declaration less tax withheld and foreign tax credit must be transferred to the Tax Authority. The tax authority will refund any excess payments resulting from the above within 90 days of becoming satisfied on the tax declaration. The amount of tax due for the year stated in the declaration is the amount assessed by the tax authority although the authority may issue an amended assessment if it discovers an error or omission.

Declaration and Assessment of Schedule “D” Income

Income tax withheld by a payer from Schedule “D” income at source constituting a final tax payable to the tax Authority within 15 days of the end of each calendar month. If, however, a taxpayer who has schedule ‘D’ income, not subjected to withholding at source consulting a final tax, shall prepare a declaration of that income in a form prescribed by tax authority. Taxpayers shall submit this declaration to the tax authority within two months from the end of the Ethiopian fiscal year.

5.2. Indirect Taxes

5.2.1. Value Added Tax (VAT)

The introduction of value Added Tax (VAT) is probably the most important tax development in the world. VAT has been introduced for the first time almost 50 years ago, and its applications remained confined to a handful of countries until the late 1960’s. Today, VAT is applied in over 120 countries. This makes about 4 billion people or 70% of the world’s populations live in countries with a VAT. In these countries VAT raises about \$18 trillion in tax revenue, roughly a quarter of all governments revenue. The Federal Democratic Republic of Ethiopia since January 2003 has joined the over 120 countries of the world that have already adopted VAT into their tax system. VAT is introduced in Ethiopia with the following main objectives.

- ✓ to minimize the damage caused by attempts to avoid and trade the tax and ascertain the profit obtained by tax payables.
- ✓ to enhance economic growth and import the ratio relationship between from Domestic Production and Government Revenue.
- ✓ to enhance saving and investment as it is essentially a consumption tax and does not tax capital.

Value Added Tax (VAT) is levied by the government on the commodities sold and services offered at specified percentage (15% in Ethiopia) on the value of sales or services offered. Sometimes it is also known as Goods & Services Tax (GST).

Definition of Value-Added Tax (VAT)

- ✓ Value Added Tax (VAT) is a general consumption tax assessed on the value added to goods and services.
- ✓ It is a general tax that applies, in principle, to all commercial activities involving the production and distribution of goods and the provision of services.
- ✓ It is a consumption tax because it is borne ultimately by the final consumer.
- ✓ It is charged as a percentage of prices, which means that the actual tax burden is visible at each stage in the production and distribution chain.
- ✓ It is collected fractionally, via a system of deductions whereby taxable persons (i.e., VAT-registered businesses) can deduct from their VAT

liability the amount of tax they have paid to other taxable persons on purchases for their business activities.

Nature of VAT

VAT is characterized by the following features:

- ✓ VAT is “general tax or comprehensive” that applies in principle to all commercial activities in valuing the production and distribution of good and provision of services.
- ✓ VAT is “consumption tax” because it is levied in sales of good and the provision of service rather than income, capitals or saving.
- ✓ VAT is “broad based tax” since the government collects such tax from all sectors that is importer, manufacturing whole sale, and retailer sector.
- ✓ VAT is “percentage of price” which means, the actual tax burdens is visible at each stage in the production and distribution chain.
- ✓ VAT is collected “fractionally” because each time the item is changes hand in the process of production and distribution the VAT is assessed on the incremental value.
- ✓ VAT is “neutral” because regress of how many transactions are involved VAT liability the amount of tax they have paid to other person on purchases for their business activities.
- ✓ VAT is indirect tax because VAT is paid total authority by the seller of the goods, who is the taxable person but it is actually paid by the buyers to the seller as part of the price.

The following are some of the terms that are common in VAT.

- ✓ **Input VAT** - the VAT that the business pays over on the taxable supplies made (VAT paid on purchase) and can be recovered only in so far as the business is VAT registered.
- ✓ **Output VAT** - the VAT that the business collects over taxable supplies (VAT received during sales).
- ✓ **Net VAT** is the difference between Output VAT and Input VAT. The Net VAT can be VAT payable or VAT Refundable (VAT Receivable).
- ✓ **VAT Payable** - is the Net VAT to be paid to Ethiopian Revenue and Custom Authority (ERCA) by a taxable person. It is when Output VAT is greater than Input VAT.
- ✓ **VAT Refundable (VAT Receivable)** - is the Net VAT that is a taxable person expected from ERCA when Input VAT exceeds Output VAT. In Ethiopian case, ERCA does not refund upon declaration date rather taxable person shall carry forward the balance for 5 months until it offset by output VAT. If taxable person doesn't sell taxable supplies within these 5 months, he/she is entitled for refund.
- ✓ **Zero-Rating VAT** - when the supply is charged with VAT at 0%. Zero-Rating: the supply is charged with VAT at 0% but credit can be taken for VAT paid on purchases used to make the supply.
- ✓ **VAT Exemptions** - the supply is exempted from VAT. No VAT is charged on supply and no credit can be taken for VAT paid on purchases used to make the supply. No VAT is charged on the supply and no credit can be taken for VAT paid on purchases used to make the supply.

VAT Exempted Items in Ethiopia

The following are tax exempt items in Ethiopia:

1. The Sale or rent of a dwelling house which has been used for at least 2 years,
2. The rendering of Financial service,
3. Local or Foreign currencies and warranty distribution or importation except for cents and medals research services,
4. The import of Gold for the presentation to the National bank of Ethiopia,
5. Religious or spiritual related services given by religious institutions,
6. Educational services given by educational institutions and child care given by kindergartens,
7. Electricity, kerosene and water supplies (does not include water processed by Factories),
8. Except for different services or commission fees, goods or services presented by postal service institutions as per the authority given by its establishment proclamation,
9. Transportation Services,
10. Permit and license payments,
11. If 60% of the employees are disabled the goods and services supplied by the institution employing these disabled individuals,
12. Supply of Books,
13. Supply of food grains Eg. Teff, Wheat, Maize, Sorghum and other cereal,
14. Goods like sealing plastic bags, sewing materials and fertilizers for making Insecticide-treated bed nets for the prevention of malaria,
15. Transactions of pickles, wet blues and crust made by leather processing factories,
16. The import of chemically processed clothes used for the sewing of Insecticide-treated bed nets for the prevention of Malaria,
17. Government imported wheat,
18. Palm oils used for food,
19. Sale of Milk and bread,
20. Drugs, medical supplies and equipments,
21. Supply and import of agricultural raw materials such as fertilizers, seeds of superior quality, insecticides,
22. Payment of pension fund,
23. The sale of Airplane tickets to customers by travel agencies,
24. "Enjera" (local stable food),
25. Publication and printing of books,
26. Animal skin or hides sold to shoe factories by a leather factory after the tanning process is done,
27. The supply or import of fuel gas.

The Ministry of Finance and Economic Cooperation (MoFEC) increased the threshold amount in excess of which businesses are required to register and pay value added tax (VAT), thus setting it now at one million birr (if the total taxable turnover or transaction over a period of 12 months) from the

previous 500,000 birr. Registration for VAT under Ethiopian tax laws is of two kinds: obligatory registration and voluntary registration.

The following nine trade activities (line) whose annual taxable income is expected to be more than 1,000,000 birr to be registered for VAT and registering all companies having legal entities for VAT without any prerequisite at the current condition.

There are nine trade activities:

- ✓ Jewelry trade
- ✓ Flour factories
- ✓ Electronic trade (like television, refrigerator, deck trade, etc)
- ✓ Shoes producers
- ✓ Leather and leather producers
- ✓ Computer and computer accessories trade
- ✓ Contractors from grade 1 - 9
- ✓ Plastic and plastic product manufactures
- ✓ All permanent importers

Illustration

1. If XYZ company purchase equipments for a cash of Birr 250,000 including VAT and received revenue of Birr 450,000 before VAT. Calculate VAT payable.

Solution

Output VAT = Birr 450,000 x 15% = 450,000 x 0.15 = Birr 67,5000

Input VAT = 250,000 (15/115) = Birr 32,608.70

VAT payable = Output VAT - Input VAT = Birr 67,500 - 32,608.70 = Birr 34,891.30

2. A VAT registered company in Ethiopia purchased taxable goods for Birr 1,150,000 before VAT and sold for Birr 3,500,000 including VAT during a month. Then Calculate a) Input VAT, b) Output VAT and c) VAT payable.

Solution

a) Input VAT = 1,150,000 x 15% = 1,150,000 x 0.15 = Birr 172,500

b) Output VAT = 3,500,000 (15/115) = Birr 456,521.74

c) VAT payable = 456,521.74 - 172,500 = Birr 284,021.74

Zero-Rate Tax

A zero-rated transaction is a taxable transaction that is taxed at a zero rate of tax. The tax on supply (the output tax) is nil, and the registered supplier is entitled to credits for input tax on acquisitions related to the zero-rated transaction. Thus, the transaction is completely free of tax. Where a registered person has applied the rate of zero percent to a supply, the registered person must obtain and retain such documentary proof acceptable to the Authority substantiating the person's entitlement to apply the zero rate to the supply.

Zero-rate tax applies on the following.

a. Export of Goods or Services

A supply of goods where the supplier has entered the goods for export, pursuant to the Customs Proclamation and the goods have been exported from Ethiopia by the supplier;

b. International Transport of Goods or Passengers

Zero rates apply to a wide range of transportation and ancillary services associated with international passenger and freight transport. Zero-rating extends to lubricants and supplies to be consumed international flights.

c. Supply of Gold to National Bank of Ethiopia

Gold to be provided to the National Bank of Ethiopia is free of VAT as it is categorized under zero-rates supply. The law is also considering import of gold for the National Bank as exempt supply (and therefore free of VAT).

5.2.2. Turnover Tax (ToT)

Turnover is a tax levied by the government on the sales which not covered under VAT (Value Added Tax). ToT is a tax imposed on goods supplied and services rendered locally by persons not registered for VAT. The base of computation of the turnover tax is the gross receipts in respect of goods supplied or services rendered.

Turnover tax rate (ToT Rates)

- ✓ 2% Turnover tax rate on goods sold locally
- ✓ For services rendered locally:
 - o 2% on contractors, grain mills, tractors and combine harvesters and
 - o 10% on others.

Obligation to Collect and Transfer the Turnover Tax

A person who sells goods and services has the obligation to collect the Turnover Tax from the buyer and transfer same to the Tax Authority. Hence, the seller is principally accountable for the payment of the tax.

Exemptions

The following shall be exempted from Turnover Tax:

- a. the sale or transfer of a dwelling used for a minimum of two years, or the lease of a dwelling;
- b. the rendering of financial services;
- c. the supply of national or foreign currency (except for the used for numismatic purposes) and of security;
- d. the rendering by religious organizations of religious or other related services;
- e. the supply of prescription drugs specified in directives issued by the relevant government agency, and the rendering of medical services;
- f. the rendering of educational services provided by educational institutions, as well as child care services of children at pre-school institution;
- g. the supply of goods and rendering of services in the form of humanitarian aid;

- h. the supply of electricity, kerosene, and water;
- i. the provision of transport;
- j. permits and license fees;
- k. the supply of goods or services by a workshop employing disabled individuals if more than 60% of the employees are disabled; and
- l. the supply of books.

5.2.3. Excise Tax

Excise taxes are taxes levied on the selected commodities produced locally or imported from foreign countries. Excise taxes are most often levied upon cigarettes, alcohol, luxury items and the like. These are often considered superfluous or unnecessary goods and services. To raise taxes on them is to raise their price and to reduce the amount they are used.

Rate of Excise Tax

The excise tax shall be paid on goods:

- a. When imported;
- b. When produced locally at the rate prescribed in the Schedule

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.);

Payment of Excise Tax

- 1. The Excise tax shall be paid
 - ✓ In respect of goods produced locally, by the producer;
 - ✓ In respect of goods imported, by the importer.
- 2. Time of Payment:
 - a) Unless decide otherwise,
 - i. When imported at the time of clearing the goods from Customs area:
 - ii. 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 warehouse without payment of 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 Bounded warehouse:
 - c) If the Tax Authority believes that the activity of the taxpayer requires a Bonded Warehouse may give him permission to establish such Bonded Warehouse. The conditions under which the Bonded Warehouse operates shall also be laid down by directive to be issued by the Tax Authority. No goods shall therefore be deposited in or removed from a Bonded Warehouse except in the presence and under the control of a representative of the Authority;
 - 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 or submits declaration which upon investigation is

found incorrect the Tax Authority shall be empowered to forbid the produce to remove any good from the place of production or Bounded Warehouse.

Assessment of the Excise Tax

1. If the Tax Authority accepts that the books and records maintained by the producer are properly kept and that the monthly declaration submitted by him/her, is correct the tax paid in accordance with the monthly declaration shall be considered accurate.
2. If, after review by the Tax Authority, it appears that a person has understated his tax obligation, the Authority shall issue an additional assessment.
3. The assessment made shall be prepared in an assessment notification and be delivered to the taxpayer. Delivery of the assessment notification shall be made in accordance with the provisions of Income Tax Proclamation.

Obligations of the Tax Payer

1. maintain books of accounts and supporting documents in accordance with proper accounting principles and in a manner acceptable to the Tax Authority:
2. submit every 30 days to the Tax Authority, in a form which shall be supplied by said Authority, a declaration containing such information as may be necessary for proper collection of tax.
3. pay in full the tax due with 30 days from the date of termination where such business is termination.

List of goods that shall be liable to excise tax when either produced locally or imported:

S.N.	Type of Product	Excise Tax Rate (%)
1	Any type of sugar/In solid form excluding Molasses	33
2	Drinks:	
2.1	All types of soft drinks/except Fruit/ Juices	40
2.2	Powder soft drinks	40
2.3	Water bottled or canned in a factor	30
2.4	Alcoholic drinks	
2.4.1	All types of beer & stout	50
2.4.2	All types of wine	50
2.4.3	Whisky	50
2.4.4	Others alcoholic drinks	100
3	All types of pure Alcohol	75
4	Tobacco & Tobacco products:	
4.1	Tobacco leaf	20
4.2	Cigarettes, Cigar, Cigarillos, pipe Tobacco snuffs and other tobacco products	75
5	Salt	30
6	Fuel-Super Benzene, Regular Benzene, Petrol, Gas-online and other motor spirits	30
7	Perfumes and toilet waters	100
8	Textile and Textile products:	
8.1	Textile fabrics, knitted or woven of natural silk, Rayon, nylon wool or other similar material	10
8.2	Textile of any type partly or wholly made from cotton which is gray, white, dyed or printed, in pieces of any length or width /except mosquito net and "Abudgedi"/ and including blankets, bed sheets, counterpanes, towels, table clothes and similar articles	10
8.3	Garments	10

S.N.	Type of Product	Excise Tax Rate (%)
9	Disk washing machines of a kind for domestic use	80
10	Washing machines of a kind for domestic purpose	30
11	Video decks	40
12	Television and video cameras	40
13	Television broadcast receivers whether or not combined with gramophone, radio, or sound receivers and reproducers	10
14	Motor passenger cars, station wagons, utility cars, and land rovers, tips pickups, similar vehicles/including motorized caravans/ whether assembled, tighter watt gaur appropriate initial equipment:	
14.1	Up to 1,300 C.C	30
14.2	From 1,301 C.C up to 1800 C.C	60
14.3	Above 1,800 C.C	100
15	Carpets	30
16	Asbestos and Asbestos products	20
17	Clocks and watches	20
18	Dolls and toys	20

5.2.4. Custom Duty

Customs Duties are a tax that the government places on the importation of goods once they reach and clear the border. A tax levied on imports (and, sometimes, on exports) by the customs authorities of a country to raise state revenue, and/or to protect domestic industries from more efficient or predatory competitors from abroad.

Customs duty is based generally on the value of goods or upon the weight, dimensions, or some other criteria of the item (such as the size of the engine, in case of automobiles).

Customs Import Duty

One hundred percent (100%) exemption from the payment of import customs duties and other taxes levied on imports is granted to an investor to import all investment capital goods such as plant machinery and equipment, construction materials as well as spare parts worth up to 15% of the value of the imported investment of capital goods provided that goods are not produced locally in comparable quantity, quality and price. Exemptions from customs duties or other taxes levied on imports are granted for raw materials necessary for the production of export goods.

Export Customs Duties

Ethiopian products and services destined for export are exempted from the payment of any export tax and other taxes levied on exports.

5.3. Stamp Duty

Stamp duty is a duty levied on the legal recognition of certain documents. Enforcement of stamp duty is required to have strong system of law enforcement to prevent the increasing incidence, from time to time, of contraband and other commercial fraud crimes which are resulting negative impact to legitimate trade, public security, government revenue and other social and economic development.

Instruments Chargeable with Stamp Duty

The Following instruments shall be chargeable with stamp duty:

- ✓ memorandum and articles of association of any business organization, cooperative or any other form of association;
- ✓ contract and agreements and memoranda thereof;
- ✓ lease, including sub-lease and transfer of similar rights;

- ✓ award;
- ✓ bonds;
- ✓ warehouse bond;
- ✓ security deeds;
- ✓ collective agreement;

- ✓ contract of employment;
- ✓ notarial acts;
- ✓ power of attorney;
- ✓ documents of title to property.

Time Stamp Duty Payment

The stamp duty shall be paid:

- ✓ on memorandum and articles of association, before or at the time of registration;
- ✓ on awards, before or at the time of issuance of the award;
- ✓ on contracts or agreements, before or at the time of signature;
- ✓ on leases or sub-leases, before or at the time of signature;
- ✓ on notarial acts, at the time of issuance;
- ✓ on security deeds, before or at the time of signature;
- ✓ on documents of title to property, before or at the time issuance is effected.