TAX LAW

- Is a branch of public law.
- Taxes are important sources of public revenue.
- Public goods are normally supplied by public agencies due to their natures of non-rivalry and non-excludability.
- 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.
- Tax is 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.
- tax is a financial charge or other levy imposed on an individual or a legal entity by government.
- Taxes are contributions from the national dividend; they must ultimately come out of the annual earnings of the nation.
- 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.
- 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.
- The basis of taxation is wealth.
- 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 includes the processes of levying, collecting, and paying tax

Function of taxation

- it is collected for the interest of the whole people.
- Only the sovereign imposes tax:
- Avoids or removes inequalities.
- Accumulation of capital
- Creation of employment opportunities

Basic x-ics of taxation

- Compulsory contribution, it is not optional
- Allocated through the parliament
- 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.

Principles of taxation

1. Fairness justice
2. Efficiency:- the gov't should notice to the tax payer about how much is to be paid.
   - The tax payer collector should take the money and send the tax payer home
   - This can be measured against 3 points
     1. Administrative cost:- 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.
     2. Compliance cost:- are the costs (other than the taxes themselves) of making tax payments to the government. 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.
3. Tax induced:- change in behavior displayed by tax payers.

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

- 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
- 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.
- 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.

- 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 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.
- 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.

History of Taxation in Ethiopia

- 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 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.
- 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.

Sources of Ethiopian Tax Laws

- Three sources; legislative, administrative and judicial sources. The major sources of Ethiopian tax laws are legislative sources.
- The first law that can be taken as a source is the FDRE Constitution

Income Tax

- 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 income of both residents and non-residents, whether in cash or in kind, is taxed through the Federal Inland Revenue Authority according to the scheduler system provided for by the laws of the country. 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.
- 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.
- 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"**
- '**Gross income'** is taken to mean the total or aggregate income received by an individual.
- **'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.
- the income tax law is applicable to residents of the Federal Democratic Republic of Ethiopia with respect to their worldwide income. Therefore, wherever a resident earns his/her income from, he/she is bound by the provisions of the proclamation.
- 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.
- Two jurisdictions global and source Art 3 (1)and (2)
- For the purpose of income taxation, residents are defined as including those individuals who: Art 5
  - **have domiciles within Ethiopia;**
  - **have habitual abodes in Ethiopia; and/or**
  - **Are citizens of Ethiopia and consular, diplomatic or similar officials of Ethiopia posted abroad.**

- As far as bodies are concerned, they will be considered as residents so long as they:
  - have their principal office in Ethiopia:
  - have their place of effective management in Ethiopia; and/or
  - Are registered in the trade register of the Ministry of Trade and Industry or the Trade bureaus of the regional governments as appropriate.
- 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.

The Foreign Tax Credit helps to avoid double taxation

- Deals with the administration of taxes on income that is derived from a foreign source.
- 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 Scheduler System of Ethiopian Income 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.
- Under the global system of taxation, an individual has to declare his/her aggregate income for the purpose of taxation.
- The scheduler 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.

VALUE ADDED TAX

- Is a tax on exchange.
- It is levied on the value added that result from each stage of exchange.
- 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 .
- It is an indirect tax in that the tax is collected from someone other than the person who actually bears cost of the tax.
- 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.
- The major rationales behind introducing VAT in Ethiopia includes, among others, the following:
  - sales tax doesn't allow collection on the added value created wherever sales transaction is conducted but VAT does .
  - 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.
  - 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.
  - 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 .
  - Out dated sales tax is not capable to generate adequate revenue for the government to cover necessary expenditures.
- According to Encyclopedia Britannica VAT is: ***"A sales tax designed like other sales taxes, to tax private consumption by individuals of the goods or services subjected to tax"***
- 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"***

Types of VAT

1. **Gross product type:** 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.
2. **Income type:** refund on the purchase value of capital goods is prohibited but it allows refund on the periodic allowance for the depreciation value of capital goods**.**
3. **Consumption type:** that all business purchases including that of capital goods and related depreciations are allowed to be rebated.

Advantage of VAT

- It avoids cascading effect of a tax (Tax on Tax).
- It is a more comprehensive and equitable tax system
- It reduces the possibility of tax evasion
- It has less tax burden: - 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.
- It is neutral
- It improves productivity
- It promotes capital investment and saving
- It enhances exports

Criticisms on VAT

- it is regressive in nature
- It requires advanced economic structure
- It puts additional burden to tax authority
- It is uneconomical
- It has ream loopholes for tax evasion:
  - 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.

Tataxable activity

- Is an activity which is carried on continuously or regularly by any person.
  Also includes:
- 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 someone 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 someone else.

Taxable Transaction

- 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.
- 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.
- 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.
- "Supply" as per Art2 (17) is to mean sale of goods or rendition of services or both.
- 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.

Registration for VAT

- ***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.
- ***Voluntary Registrations:-*** Anybody 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. A voluntary registered person is entitled to recover (claim credit or refund) in output VAT among other certain zero-rated supplies.

Application for Registration

- Persons whose total taxable transaction exceed 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.

Cancellation of Registration

- 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.

Effect of cancelation

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

Zero-Rated Transactions

- 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.
- 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.

Exempt Transactions

- 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) of the proclamation states exemptions:
  - 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

TURNOVER TAX

- torn over tax is imposed on those not registered for VAT to equalize and enhance fairness in commercial relations and make complete the coverage of tax system so as to increase government's revenue from taxation.
- Turn over tax is applicable for those whose annual transaction is below500, 000 birr save voluntary registration for VAT.
- Turn over tax is applicable on supply of goods, rendition of services and persons not registered for VAT

Scope of Turn -over Tax

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

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).
- 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 mails, tractors and combine-harvesters and 10% on others.

Obligations of Tax Payers under the Turnover Tax Law

- ***Filing of Turn over Tax Return and payment***
- ***Keeping Recodes***
- ***Notification of changes***

EXCISE TAX

- 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. The end goal seems to ban their production.
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- . Excise tax in Ethiopia is introduced for many reasons. The preamble of the excise tax proclamation (proc No 307/2003) dictates the rational in the following manner:
  - it helps to improve government revenue by imposing excise tax payable on selected goods.
  - 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.
  - Imposition of taxation on goods that are hazardous to health and which are cause to social problems, will reduce their consumption. The excise tax has positive impact on the reduction of consumptions of goods hazardous to health and cause social problems.

Products subject to Excise tax

- Excise tax is applicable to goods which are either produced locally or imported from other countries.

Tax Rates

- 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.

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 states that Base of computation of excise tax are:*

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

Payment of Excise Tax

- The excise tax shall be paid within the time prescribed;
  - in respect of goods produced locally, by the producer;
  - in respect of goods imported by the importer.
- Should be paid:
  - When imported at the time of clearing the goods from customs area.
  - when produced locally not later than 30 days from the date of production;

Obligation of Tax Payers

- 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 from 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 with in 30 days from the date of the termination where such business is terminated.

STAMP DUTY

- 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.

Bases of the Duty

Art 3 of the stump duty proclamation exhaustively lists instruments chargeable with stamp duty in the following manner:

- Memorandum and articles of association of any business organization cooperative or any other from of association.
- award
- bonds
- ware house bond
- contractor agreements and memoranda thereof
- security deeds
- collective agreement
- contract of employment
- Lease, including sub-lease and transfer of similar rights.
- natural acts
- power of attorney
- documents

Rates and Mode of Valuation of stamp Duty