

CHAPTER TWO

INCOME TAX

Definition of income

Henry Simon in his personal income entitled book define income as:

“The summation of consumption financed by factor income (labor capital), or transfer income (from gifts, inheritance etc), or accumulated wealth”

Simply consumption + saving

Income definition in Ethiopian

ITP in its art 2 (10) define income:

“Income shall mean 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”

- *Economic benefit*
- *Cash or kind*
- *Credited or received*

Jurisdiction of income taxation

- To tax an income of a person there shall be a connection between that person and a state or country.
- Some of the connectors are residence, domicile, citizenship for major owners, place of effective management for legal persons. individual persons and establishment place, citizenship of

Continued

Accordingly there three principles of jurisdiction of income taxation or taxation as a general:

- Residence principle
- Source principle
- Mix of residence and source principles

Residence principle

A state or country whose citizen (nationality) an individual or where the legal entity registered or incorporated has a jurisdiction.

Source principle

A state or country from where the income gained shall have the jurisdiction.

The mix both principles

Some countries like Ethiopia takes both principles the residence principle for their citizens and source for non- residents.

Who is individual resident in Ethiopia?

- *Has a domicile within Ethiopia;*
- *Has an habitual (183 days) abode in Ethiopia; and/or*
- *Is a citizen of Ethiopia and a consular, diplomatic or similar official of Ethiopia posted abroad.*

Which is resident body in Ethiopia?

- *Has its principal office in Ethiopia;*
- *Has its place of effective management in Ethiopia;*
- *Is registered in the trade register of Ethiopia*
- *Has permanent establishment*

Jurisdiction and issue of Double Taxation

Where the tax authorities of two or more countries concurrently impose taxes having the same bases and incidence, in such a way that a person incurs a heavier tax burden than if he were subject to one tax jurisdiction only, this is what we call double taxation.

Solutions for double taxation

- *Tax Exemption*: whereby all or part of the taxpayer's foreign source income is excluded from the tax base. This is so if that income was subjected to tax in the foreign country.
- *Tax Credit*: whereby foreign tax, paid or payable is credited against the taxpayer's domestic tax amount.
- *Tax Deduction*: whereby foreign tax, paid or payable, is deductible from the domestic tax base, and
- *Reduction in the Rate of Tax*: whereby foreign income or assets are taxed domestically at lower rate.

Categories of tax payers in Ethiopia

Article 18 of the income tax regulation 78/2002 three categories of taxpayers using their annual transaction:

- Category “A” over 500 thousand birr and all legal entity
- Category “B” above 100 thousand up to 500 thousand birr
- Category “C” including 100 thousand and below

Income tax systems/structures

There are three structures of income system:

- Global
- Scheular
- mixed

global

Global: aggregate the income of individuals, regardless of the multiplicity of sources, and permit deductions without regard to the type of income in connection with which they are incurred.

schedular

Schedular: impose separate taxes on different types or sources of income. For each source, there are typically distinct rules of deduction, exemption, and exclusion. For some types of income, no expense incurred in connection with the generation of that income is deductible. Some sources employ withholding methods of collections, while others are based on self-assessment.