

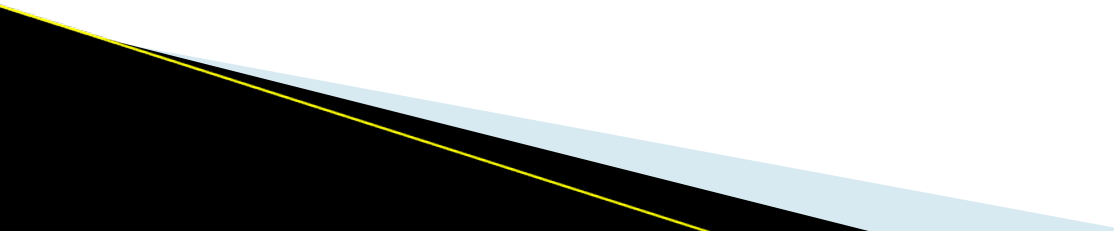
ETHIOPIAN TAX ACCOUNTING METHODS AND ACCOUNTING PERIOD

Objectives of Tax Accounting

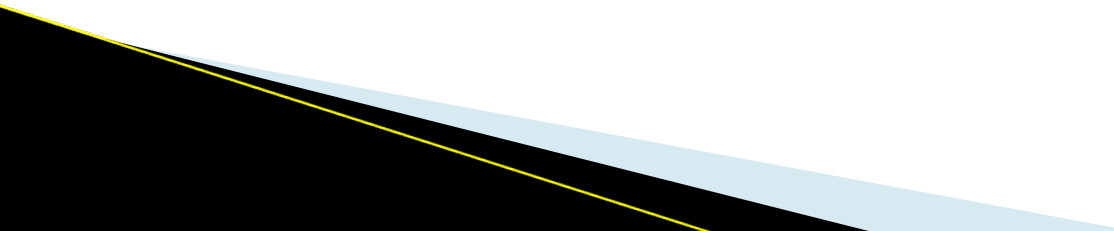
- ▶ The primary objective of tax accounting rules is the allocation of amounts to periods – the allocation of income and deductions to discrete periods.
- ▶ The answers to the timings of income and deductions affect the determination of how much income has been derived and how much will be paid.
- ▶ Tax accounting rules might be misperceived as simple arithmetic juggles – matters for accountants to worry about- but this is a mistake. It is almost inevitable for two taxpayers with the same economic income over the same period to pay different amounts of tax simply because they keep their books in different ways.

General Accounting method

Cash-Basis

- ▶ Recognize income and deductions when cash is received or paid by the taxpayer. See Article 59.
 - ▶ Cash receipt: when income is received in the form of cash or readily convertible negotiable instrument.
 - ▶ Constructive Receipt: when the income is available unreservedly and the only thing preventing cashing it is the will of the taxpayer. For example, interest accruing on deposits.
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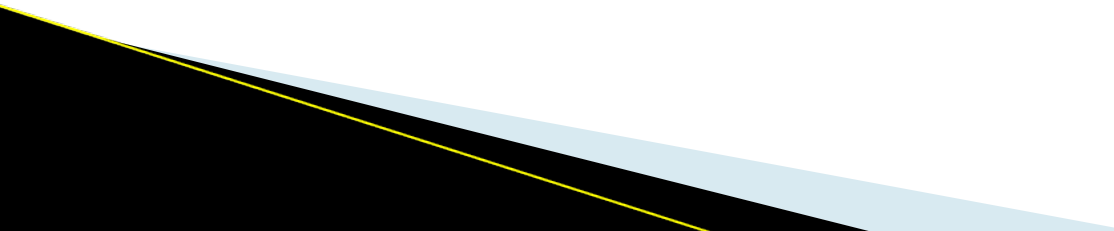
Accrual method

- ▶ Income recognized in the year in which it is earned rather than when it is received. See Article 60.
 - ▶ Expense recognized in the year in which it is payable rather than when it is actually paid.
 - ▶ Accounts receivable are reported as income; and accounts payable are reported as expenses.
 - ▶ A company shall keep this method of accounting
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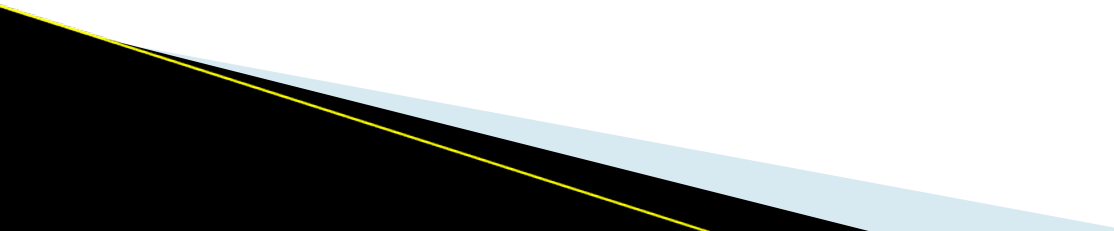
Special Accounting: Prepayments

- ▶ Useful for expenses which cover several years but not in the nature of capital expenditures, for which depreciation is available. These include rental expenses, insurance premium, interest payments for more than a year. See Article 61. See also Article 6 ITR.

Special Accounting: Claim of Right

- ▶ Designed to arrest the uncertainty of reality.
 - ▶ Taxpayers may receive income or incur expenses but uncertainty may remain about whether the income is theirs to keep or the expense is theirs to incur.
 - ▶ Claim of right refers to 'money or property received as income that the recipient holds under a claim of right' but he is required to restore in whole or in part in a later year, to the payer.
 - ▶ Claim of right was originally developed by courts to accord finality to the tax year.
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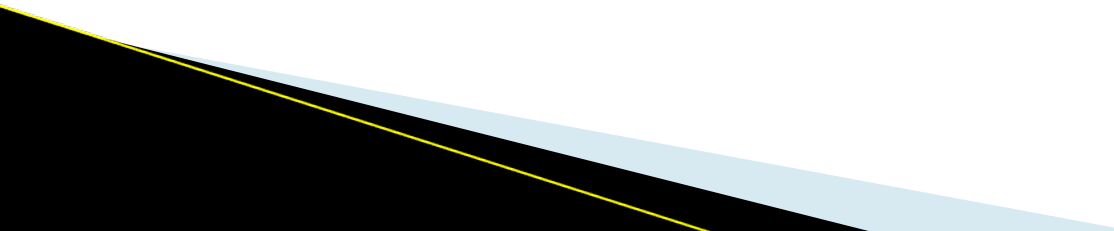
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- ▶ Claim of right applies to both cash and accrual basis taxpayers.
 - ▶ Cash basis taxpayers are required to report as income or expense an item which they claim to be entitled to receive or legally obliged to pay even though they are not legally entitled to receive the amount or liable to incur the expense.
 - ▶ Accrual basis taxpayers are required to report as income any receivable or as expense any outgoing payable if they claim to be legally entitled to receive or to be legally obliged to pay the amount even though they are not legally entitled to receive the amount or liable to make the payment.
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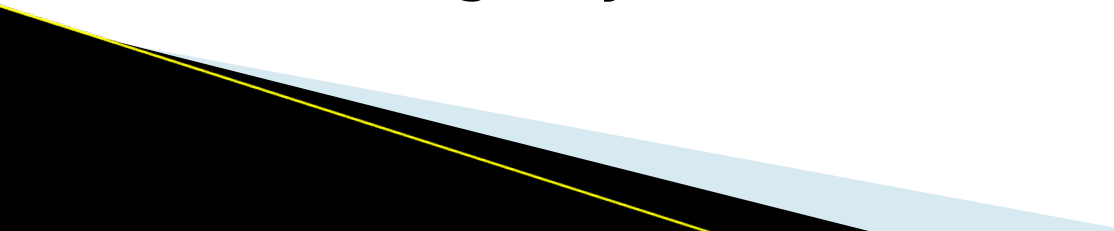
Special Accounting: Long Term Contracts

- ▶ Long term contracts pose special challenge to the annual accounting system of taxation. Taxpayers subject to long term contract may not be paid at the beginning of the contract and may not have the wherewithal to pay the tax. The income as well as the costs of a long term contract may not be ascertained until the end of the contract. Over all, a long term contract is fraught with uncertainties which may keep the tax system guessing until the end of the contract. Like most income tax accounting rules, an accounting convention overrides the reality and imposes rules on an otherwise chaotic situation on the ground.

Cont'd...Definition:

- ▶ Long term contracts are defined as 'contract for manufacture, installation, or construction, or, in relation to each, the performance of related services, which is not completed within the tax period in which work under the contract commenced, other than a contract estimated to be completed within twelve (12) months of the date on which work under the contract commenced'. See Article 63(5).
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Cont'd... Method of Accounting

- ▶ Completed Contract Method: the taxable income on the entire contract is reported in the year when the contract is completed and accepted and expenses allocated to the contract are deductible in the year in which the contract is completed.
 - ▶ Percentage of Completion Method: The method compares the total cost allocated to the contract and incurred before the end of the tax period with the estimated total contract costs including any variations of fluctuations.
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Cont'd...

- ▶ A portion of the total contract price is recognized every tax year in proportion to the costs of the contract. For example, if a construction company agrees to construct a road for one hundred million Birr and estimates that the total cost of construction will be 80 million Birr, the one hundred million Birr is recognized in portions every year in proportion to the costs of construction every year. If during the first year of construction, the company incurs a cost of 40 million Birr, the ratio of the cost to total cost is half, and therefore, half of the total contract price is recognized during the first year.

Cont'd... Adjustment

- ▶ Sometimes, the recognition of income and expenses under the percentage of completion method may lead to a situation where there is no longer income to be recognized – a loss. The long term accounting rules allow the company accounting in this way to carry-back the loss to the earlier years. This is because there is no income in the future from which the extra expenses may be deducted. Incidentally, this is the only situation where Ethiopian tax law allows loss carry-backing, instead of loss carry-forwarding.
- ▶ Should Article 28 of the ITP apply at all to long term contract cases?

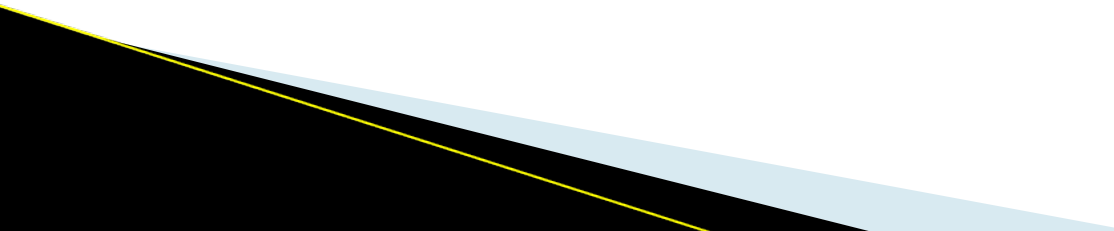
Tax accounting period

- ▶ Accounting period generally describes the time period for computing income and expenses.
- ▶ The accounting period for schedule B and Schedule C in Ethiopia may be the fiscal year (for most taxpayers) or any accounting period a company chooses in permission of tax authority to adopt (some companies may choose the Gregorian calendar – particularly foreign owned or affiliated companies). The Ethiopian fiscal year is the governmental budgetary period- which runs from Hamle 1 (July 8/9) – Sene 30 (July 7/8) every year. See Art. 64.
- ▶ Once a company adopts an accounting year, it cannot change it without the approval of the Authorities (why?)
- ▶ Short tax years (transitional tax years)- identify cases in which short tax years are prescribed.

METHODS OF TAX ASSESSMENT

They can be literary classified
as self-assessment an non-
self-assessment

1. Withholding method

- ▶ It is holding the needed tax at the payment of income or at the earn time of the income.
 - ▶ There two types of withholding:
 - ✓ Final withholding: example schedule A and D income tax
 - ✓ Provisional withholding : it is deducted from the end year tax liability.
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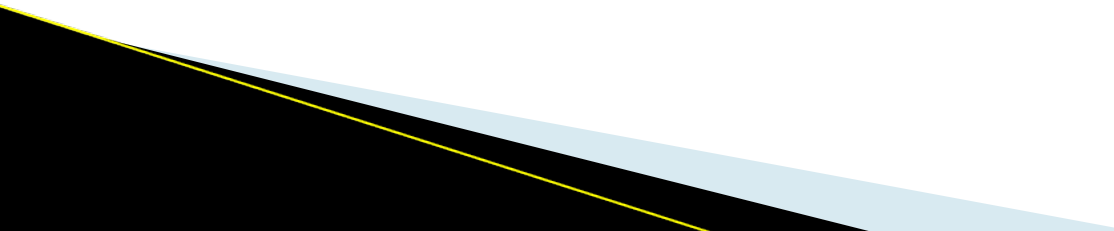
Provisional withholding (art 52 and 53 of ITP nand 24 and 25 of ITR0

- ▶ 3% income tax withholding on imported goods on CIF value
- ▶ 2% at the time of payment when purchasing good or service
- ▶ Any organization having legal personality, governmental agencies, private nonprofit institutions and non-governmental organizations have the duty to withhold income tax when they conduct payment for the purchasing of goods valued more than ten thousand Birr and services

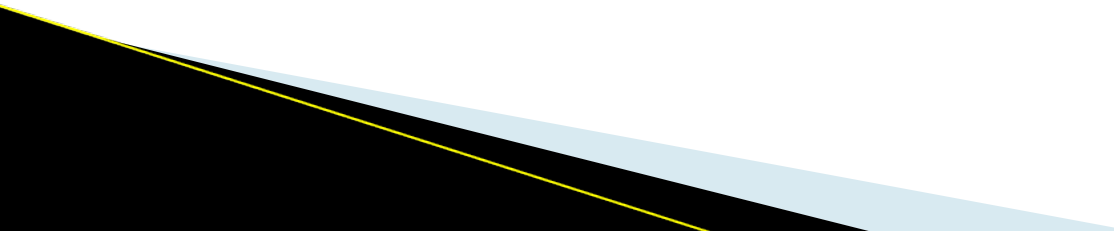
For the following services more than 500 birr

- ▶ Consultancy service;
- ▶ Designs, written materials, lectures and dissemination of information;
- ▶ Lawyers, accountants, auditors and other services of similar nature;
- ▶ Sales persons, arts and sports professionals, and brokers including insurance brokers and other commission agents;
- ▶ Advertisements and entertainment programs for television and radio broadcasts;
- ▶ Construction services;
- ▶ Advertisement services;
- ▶ Patents for scientific and intellectual works;
- ▶ Rent for lease of machineries building and other goods including computers;
- ▶ Maintenance services
- ▶ Tailoring;
- ▶ printing;
- ▶ insurance

2. Records and book based assessment (self-declaration) art 66

- ▶ Taxpayer of category “A” and “B” shall have the duty to prepare books and records
 - ▶ Method of accounting for the prepared records and books shall be based on the generally accepted principles of accounting (GAAP)
 - ▶ The book of account shall show profit and loss statement as well balance sheet (only for category A taxpayer)
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3. Estimation assessment (art 69)

- ▶ The method is used for tax payers who have an obligation to prepare a record and book when they have not maintained books and records or for any reason their account is rejected or they have not submit their book of account at the time prescribed by law.
 - ▶ The rejection of submitted accounting records is taken at the time of review of accounting records
 - ▶ It is always higher tax than the taxpayer who provide book of account.
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4. Standard (presumptive) art 68

- ▶ Tax payers in category “C” can be assessed in standard method of assessment taking in to account the indicators of the business type, size and location
- ▶ Presumptive method can be :
Rebuttable Vs irrebutable
Exclusive Vs minimum
discretionaryVs mechanical

Importance

- ▶ They are simple to administer small businesses
- ▶ They can avoid tax evasion

Time of submission and payment of taxes

No.	Category of taxpayer	Time of payment
1.	Category A	July 1 to October 30
2.	Category B	July 1 to the end of leap year (pagumenn)
3.	Category C	July 1 to July 30

Aggregation and period of limitation

- ▶ Income from similar schedules are aggregated to tax them
- ▶ The authority can reassess the declaration within five years in normal condition
- ▶ No time limitation if there is tax evasion.

Tax administration sequence

- ▶ Identifying taxpayer (TIN) art 43 of ITP
- ▶ Maintenance of books and records art 48 of ITP and art 20 ITR
- ▶ Tax declaration
- ▶ Tax decision and summon
- ▶ Final tax payment
- ▶ Tax return administration
- ▶ Tax interest administration
- ▶ Seizure of property
- ▶ Administrative penalty management
- ▶ Tax crime investigation and prosecution
- ▶ Tax complain and appeal