

TAX & PUBLIC FINANCE : ETHIOPIAN SYSTEM FOR PROMOTIONAL ACTIVITIES

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Abstract

Tax is very important for each and every Government. As we are all know that taxation can be classified into direct and indirect taxes. Every Government need revenue to lead the economic, infrastructure, medical, transport, education, telecom, electricity, staff, research, to concession, subsidies, free facility for the unable sector community in the country. To generate the income Government has a constitution as a law to charge a tax for different sectors of people which brought into different categories of the people. No Tax, No Income; No Income, No Revenue; No Revenue, No Government. Government is a public which is common to the all of the people in the country. Whether the direct or indirect tax, the tax must be charged on the basis of the effort of the people income. Some people earn money with their hard work. Some people earn money easily. The easily earned income must be taxed more than the hard earned money. Ethiopian Taxation system is very important for raising income of the Government.

Key Words: *Tax, Public Finance, Ethiopian Taxation, Direct Tax and Indirect Tax*

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I. INTRODUCTION

Every Government need revenue to lead the economic, infrastructure, medical, transport, education, telecom, electricity, staff, research, to concession, subsidies, free facility for the unable sector community in the country. To generate the income Government has a *constitution* as a law to charge a tax for different sectors of people which brought into different categories of the people. No Tax, No Income; No Income, No Revenue; No Revenue, No Government. Government is a public which is common to the all of the people in the country. Every country has a two types of taxes. They are direct taxes and indirect taxes. Direct tax is that tax where burden in borne by the same person on which it is levied. The ultimate burden of taxation for each and every one of the person on whom the tax is levied. It is based on the ability of the person one who generate the income through his salary, house property, business, capital gains, and other sources. Different country has a different names where they can classify according to the requirement and style of the people behavior to earn income.

Indirect Taxes : An indirect tax is that tax which is initially paid by one individual, but the burden of which is passed over to some other individually who ultimately bear it. The sales tax, Value Added Tax Customs Duty are the best examples of the indirect taxes. Whether the direct or indirect tax, the tax must be charged on the basis of the effort of the people income. Some people earn money with their hard work. Some people earn money easily. The easily earned income must be taxed more than the hard earned money.

Based on the above taxation, it can be classified into different degrees of progression. They are proportional tax, progressive tax, regressive tax and degressive tax. Let us explain one by one of these.

Proportion Tax : A tax is called proportional when the rate of taxation remain constant as the income of the tax payer raises. In this type of tax system all incomes are taxed at a single uniform rate, irrespective of whether tax payer's income is high or low. The tax liability increases in absolute terms, but the proportion of income tax remained the same.

Progressive Tax : It is based on the income raises of the tax payer. If the tax payer income is more than the tax rate is high.

Regressive Taxation: A regressive tax is are in which the rate of taxation decreases as the tax payers income increases. Lower level income is fixed at high income tax rate and vice versa.

Digressive taxation : A tax is called degressive when the rate of progression in taxation down decrease not increase in the same proportion as the income raises of the persons.

II. INCOME TAX EXEMPTION

In every country, circulating the money is important. Unless the money is circulated the revenue is not generated. So some cases the income tax act encourage the tax payers to reduce the tax, so it multiply the money

in another terms. Example, dividends paid by the registered company and mutual fund schemes; insurance proceeds by the insurance companies; maturity proceeds of a provident fund/ pension fund schemes.

Deduction

Any tax payer using the money for other than their constructive purpose of others and in the critical situation premium paid like medical insurance could be deducted from their income. So that their net income will be less so their tax rate also will be less. Different countries having a different sections of the income tax law practice and which mention about the deduction amount for the tax payers.

Income : Taxable income must be calculated after considering the different deduction of the assessee. The each and every income must be calculated appropriately for the income tax purposes.

III. THE ETHIOPIAN TAX SYSTEM

The Ethiopian tax system also public finance- revenue and spending activities. The Transitional Government of Ethiopia issued Proclamation No. 7/1992, providing for the establishment of Regional Governments. Article 1 (constitution) establishment of the FDRE; According to this legislation and the Constitution, the FDRE shall comprise of the federal government and state members (articles 46 and 50(1)); The federal government and the states are legislated to have their respective legislative, executive and judicial powers (Article 50(2)); Regional Governments are accorded **legislative, executive and judicial powers** in respect of all matters within their geographical areas; Exceptions include: defense, foreign affairs, economic policy, conferring of citizenship, declaration of state of emergency, printing of currency, establishment and administration of major development activities.

Powers and duties of federal and regional governments:

i. Federal government: Article 51(10)- it shall levy taxes and collect duties on revenue sources reserved to the Federal government; it shall draw up, approve and administer the federal government's budget;

ii. Regional states: Article 52 (2(e) to levy and collect taxes and duties on revenue sources reserved to the states and to draw up and administer the state budget;

Both regional and federal governments have the right to levy taxes and spend it in financing their own activities; Regional Governments are given **tax and expenditure assignments**; Public finance activities of the Ethiopian government - both the federal and the regional governments are responsible in raising revenue and spending; The Transitional Government of Ethiopia issued Proclamation No. 33/1992 that defined the sharing of revenue between the Central and Regional governments; These provisions later incorporated in the constitution;

Objectives of Revenue Sharing

Enabling the central government and the national/ regional governments efficiently carry out their respective duties and responsibilities; Assist national/ regional governments develop their regions on their own initiatives; Narrow the existing gap in the development and economic growth between regions. Encourage activities that have common interest to regions.

Principles used in the revenue sharing (proc. 33/92)

The important principles are, Ownership of the source of revenue; The national or regional character of the sources of revenue; Convenience of levying and collection of the tax or duty; Population, distribution of wealth, and standard of development of each region; and Other factors that are basis for integrated and balanced economy.

Revenue is categorized as central, regional and joint.

Revenue belonging to the federal government (Article 96- federal power of taxation); Revenues belonging to regional governments (Article 97- state power of taxation); Revenues jointly owned by both (Article 98- concurrent power of taxation); Article 99 –undesignated powers of taxation; Proc33/1992 states that Central Government Revenues and revenues jointly owned by the Central and Regional Governments to be collected by the Central Government revenue collection organs; Federal revenue organs – ERCA along with its branch offices; Regional governments' revenues are collected by regional governments' revenue organs;

The Ethiopian Tax System

Ethiopia is a federal country where there are federal and regional governments; The financial system (tax system in particular) is constituted taking the mode of governance into account; Taxes at federal and regional governments' levels; Taxes account for a significant portion of domestic government revenue;

Income and Value Added Taxation

Income taxation in Ethiopia - It has been in constant revision; The government undertook a significant reform on its income tax system in the year 2002 and issued income tax proclamation No. 286/2002 and

Regulations No. 78/2002; Article 2(11) defines Taxable income: Article 6 states the sources of income subject to tax under proclamation 286/2002; The tax system is scheduler system.

Four schedules of Income

“A” income from employment , “B” income from rental of buildings, “C” income from business, and “D” other income including income from royalty, income paid for services rendered outside of Ethiopia, income from games of chance, dividends, income from casual rental of property, interest income, specified non-business capital gains.

IV. EMPLOYMENT INCOME TAX**Who pays this tax?**

Article 2(12) an employee (definition). Article 12(1)- Employment income includes any payments or gains in cash or in kind received from employment by an individual; Benefits in kind are also considered to be employment income; See Article 12(2) regarding benefits; Check if fringe benefits are being taxed; if so how? If not why? exemption from employment income tax - Articles 12(Proc 286/2002) and 3 (Reg 78/2002); Employment income is taxed at rates ranging from 10 to 35%. Employment income tax is withheld by employers and is a final tax; Hence employees earning income exclusively from employment are not required to declare income (Art. 65(3));

Category “A” shall include the following persons and bodies (Art 18(1)). Any company incorporated under the laws of Ethiopia or in a foreign country; Any other business having an annual turnover of Birr 500,000 or more; Category “B” unless already classified in category “A” any business having an annual turnover of over birr 100,000 (Art 18(2)); Category “C” unless already classified in categories “A” and “B” whose annual turnover is estimated by the Tax Authority as being up to Birr 100,000 (Art 18(3));

Schedule B income/ Income from Rental of Buildings

Article 14 (286/2002) income tax shall be imposed on the income from rental of buildings; Article 5/1/78/2002 gross income shall include: all payments in cash and all benefits in kind received by the lessor from the lessee; all payments made by the lessee on behalf of the lessor according to the contract of lease; the value of any renovation or improvement made under the contract of lease to the land or building, where the cost of such renovation or improvement was borne by the lessee in addition to rent payable to the lessor; Deductions from gross income (Art 16 (1c) Proc 286/2002 and Art 5(2) Reg 78/2002; For taxpayers not maintaining books of account, one fifth (1/5) of the gross income received as rent for buildings furniture and equipment as an allowance for repairs, maintenance and depreciation of such buildings furniture and equipment; For taxpayers maintaining books of account, the expenses incurred in earning, securing, and maintaining rental income;

Schedule “C” Income / Business Income Tax

Art 17/286 /2002 - The scope of schedule “C” income. Art 18/286/2002 Taxable Business Income: determined per tax period on the basis of the income statement, drawn in accordance with the Generally Accepted Accounting Standards, subject to provisions of this proclamation and the directives issued by the Tax Authority.

Tax Rate

Individuals taxed at rates ranging from 10 to 35 per cent; taxable business income of bodies is taxable at the rate of 30% .

Method of Accounting

GAAP, cash or accrual accounting is allowed to be used; a company shall account for tax purposes on an accrual basis, a person may apply, in writing for a change in the method of accounting and the Tax office may, by notice in writing, approve the application but only if satisfied that the change is necessary to clearly reflect that person’s income;

Maintenance of Accounts

All persons who are engaged in a business or trade or who own buildings held all or in part for rental, except for category C taxpayers shall keep books and records; category “A” taxpayers shall at the end of the year submit to the Tax authority a B/S and an I/S and the related details; Category “B” taxpayers shall at the end of the year submit to the Tax authority I/S;

Deductible Expenses

In the determination of business income subject to tax in Ethiopia, deductions shall be allowed for expenses incurred for the purpose of earning, securing, and maintaining that business income to the extent that the expenses can be proved by the taxpayer and subject to the limitations specified by the income tax proclamation; Art 8/78/2002 deductible expenses; Arts 21 (1)/286/2002 and 9/78/2002 non-deductible expenses. Arts 10/78/2002 and 21(3)/286/2002 deductible interest;

Depreciation

Buildings on a straight line basis at 5%; intangible assets on straight line basis at 10%; Two pools of assets: computers, information systems, software products and data storage equipment 25%; All other business assets 20%;

Bad Debts

In the determination of taxable business income, a deduction shall be allowed for a bad debt 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 the taxpayer; and
- any legal action to collect the debt has been taken but the debt is not recoverable.

Withholding tax on payments and imports;

◆ According to Articles 53/286/2002 and 24/78/2002 organizations having legal personality, government agencies, private nonprofit institutions, and non-governmental organizations (NGOs) are required to withhold 2 per cent of income tax on payments for the provision of the following goods and services:

- ◆ Supply of goods involving more than Birr 10,000 in any one transaction or one supply contract;
- ◆ Rendering of the following services involving more than Birr 500 in one transaction or one service contract,
 - ◆ consultancy services; designs, written materials, lectures and dissemination of information etc;
 - ◆ If a person subject to withholding tax fails to provide the TIN to the withholding agent, Article 91 (2)/286/2002 requires the withholding agent to withhold 30 per cent of the payment;

Withholding Income tax on Imports

- ◆ A tax imposed at the time of imports of goods for commercial use;
- ◆ 3% of the CIF value;
- ◆ both withholding taxes on payments and imports are creditable against the total tax due;

Tax Assessment and Declaration

- ◆ Tax assessment is based on the books of accounts for those that are required to keep and properly kept accounts;
- ◆ Estimated assessment for those that are required to keep but fail to keep proper accounts.
- ◆ standard assessment for those that are not required to keep proper accounts.
- ◆ Category A taxpayers declare within 4 months while Category B declare within 2 months from the end of the tax year;

Standard Assessment for Category “C” Taxpayers

◆ Standard assessment amounts intend to reflect variations in the **type of business, business size and business location**; Payment is due on the 7th day of July to the 6th day of August every year; **Loss Carry Forward (Art 28 (1&3)/286/2002)**

Schedule D Income – Other Income

- ◆ Include tax on royalties, dividends, interest, etc , withholding taxes; Some of them are final taxes;

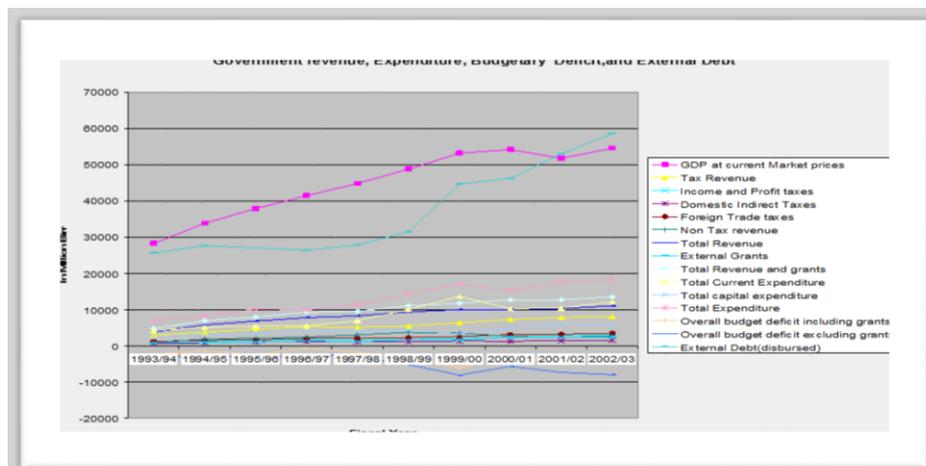


Figure 1: Ethiopian Income by Tax

Source: Ministry of Finance and Economic Development, Ethiopia

V. VALUE ADDED TAX

Value Added Tax mentioned in proclamation 285/2002 and VAT regulations 79/2002. Taxes are inevitable but no one likes paying taxes. However, raising money to pay for a community's government and services has been a feature of organized human existence for thousands of years. The challenge is (as it has always been) how best to structure the tax system so it is considered fair by community members, does not interfere with productivity, and provides sufficient resources for the services that the public demands. In any welfare state, it is the prime responsibility of the Government to fulfill the increasing developmental needs of the country and its people by way of public expenditure. The Government's primary sources of revenue are direct and indirect taxes and VAT (Value Added Tax) is one of the indirect tax used by many countries around the world.

VAT is an indirect tax levied in terms of the VAT Act. VAT must be included in the selling price of every taxable supply of goods or services made by a vendor in the course or furtherance of that vendor's enterprise. A **vendor** is a person who is registered, or required to be registered for VAT. VAT is a destination based tax, which means that only the consumption of goods and services in specified country is taxed. VAT is paid on the supply of goods or services in that specified country as well as on the importation of goods into that country. The scope of this review is to compare and contrast VAT application in Ethiopia based on proclamation No 285/2002 and proclamation No 609/2008 (amended VAT) with that of South Africa.

The date of VAT introduction in Ethiopia

Ethiopia introduced VAT for the first time on January1, 2003 with the standard rate of 15% of which is applied on every taxable transaction by a registered person on; Every import of goods, other than an exempt import; and Import of services and other positive rates of 0%. VAT is levied on an inclusive basis, which means that VAT has to be included in all prices on products, price lists, advertisements and quotations with the exception of some exempts.

Taxable person/ Tax Payer of VAT in Ethiopia

A taxable person can be an individual, firm, company, as long as such a person is required to be registered for VAT and VAT is payable if they are:

- ◆ Supplies made in Ethiopia;
- ◆ Made by a taxable person;
- ◆ Made in the course or furtherance of a business;
- ◆ Are not specifically exempted or zero-rated.

VAT Exemption in Ethiopian Tax System

An exemption implies that the supplier of goods does not levy VAT (output tax) on those exempt supplies but must bear VAT (input tax) on the purchases incurred in making such supplies.

The following types of supplies of goods (other than by way of export) or rendering of services, as well as the following types of imports of goods are exempt from payment of VAT:

- Sale, transfer or the lease of a used dwelling;
- Rendering of financial services;
- Supply/import of national/foreign currency and of securities;
- Import of gold to be transferred to the National Bank;
- Rendering of religious organizations or church services;
- Import or supply of prescription drugs specified in directives issued by Minister of health, rendering of medical services;
 - Educational services provided by educational institutions or child care services for children at pre-school institutions;
 - Supply of goods and rendering of services in the form of humanitarian aid, as well as import of goods transferred to state agencies of Ethiopia and public organizations for the purpose of rehabilitation after natural disasters, industrial accidents, and catastrophes;
 - Supply of electricity, kerosene, and water;
 - Goods imported by the government, organizations, institutions or projects exempted from duties and other import taxes to the extent provided by law or by agreement;
 - Supplies by the post office authorized under the Ethiopian Postal Services Proclamation, other than services rendered for a fee or commission;
 - Provision of transport; Permits and license fees;
 - Supply of goods or services by a workshop employing disabled individuals if more than 60 % of staff are disabled;
 - Import or supply of books and other printed materials.

Taxable Activity (arts 6/285/2002 and 3/609/2008) of VAT

An activity whether or not carried on continuously or regularly by any registered person; in Ethiopia, or partly in Ethiopia.

Taxable Transaction of VAT

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;

Taxpayers of VAT

The following persons are taxpayers:

- a person who is registered or is required to be registered,
- a person carrying out taxable import of goods to Ethiopia with respect to such import;
- a non-resident person who performs services without registration for VAT.

VAT Registration

Obligatory Registration and voluntary registration (Articles 16-19/285/2002); Sector specific registration requirement; *Ethiopia*

a. Obligatory Registration

1. A person who carries on taxable activity and is not registered is required to file an application for VAT registration with the Authority if -

(a) at the end of any period of 12 calendar months the person made, during that period, taxable transactions the total value of which exceeded 500,000 Birr; or

(b) At the beginning of any period of 12 calendar months there are reasonable grounds to expect that the total value of taxable transactions to be made by the person during that period will exceed 500,000 Birr.

Registration procedure can be:

- A person applying to register for VAT is required to do so in such a form as is established by the implementation directives issued by the Ministry of Revenue;
- When a person carrying out taxable transactions files an application to be registered for VAT, the Authority is required to register the person in the VAT register, and to issue a certificate of registration within 30 days of the registration;
- A person registered for VAT is required to use his taxpayer identification number on all VAT invoices, and on all tax returns and official communications with the Authority.
- Registration takes place on the first day of the accounting period following the month in which the obligation to apply for registration arose.

b. Voluntary Registration

- A person, who carried on taxable activity and is not required to be registered for VAT, may voluntarily apply to the Authority for such registration, if he regularly is supplying or rendering at least 75% of his goods and services to registered persons.

- Registration takes place on the first day of the accounting period following the month in which the person applied for registration. On the date selected by the registered person on his application for registration

Refusal for VAT registration, Ethiopia

Any Tax payer who is required to register for VAT commits an offence if found not complying with such obligation and shall, upon conviction, be punished with a fine of not less than Birr 10,000 and not more than Birr 50,000 and imprisonment for a term of not less than one year and not more than two years.

Any Tax payer who is required to register for VAT commits an offence if carries out transactions without VAT invoice and shall, upon conviction, be punished with a fine of not less than Birr 10,000 and not more than Birr 100,000 and imprisonment for a term of not less than two year and not more than five years.

Where the tax payables on the basis of the amount shown on the illegal invoice, subject to transaction carry out without VAT invoice, excess of Birr 100,000 shall be equal to the tax amount.

Obligations of Registered Person

The registered person is required to issue the VAT invoice to the purchaser of goods or services upon the supply or rendering, but not later than 5 days after the transaction.

A registered person or any other person liable for VAT under the Ethiopian proclamation shall maintain Record Keeping Requirement for 10 years such as: Original tax invoices received by the person; Copy of all tax

invoices issued by the person; Customs documentation relating to imports and exports; accounting records; and any other records as may be prescribed by the Minister of Revenue by directive.

Mode of VAT payment

Payment of taxes can be made to Ethiopian Revenue and customs Authority by writing the cheque for not more than Birr 100,000 or payment can be done within the office of authority.

The Right to Appeal

Any person who objects to an additional assessment made by the Authority has the right to appeal within 30 days from the receipt of that assessment notification or from the date of decision of the Review Committee to the Tax Appeal commission by depositing in cash with the Authority an amount equal to 50% of the additional tax assessed but if no appeal is made within the prescribed period the Additional assessment of the tax made by the Authority shall be deemed to be correct and final and shall be immediately payable.

Administrative Penalties

The following penalties are imposed for violations of the VAT Proclamation:

- Where any person engages in taxable transactions without VAT registration where VAT registration is required – 100% of the amount of tax payable for the entire period of operation without VAT registration;
- Where any person issued incorrect tax invoice resulting in a decrease in the amount of tax or increase in accredit or in the event of the failure to issue a tax invoice –100% of the amount of tax for the invoice or the transaction;
- Where a person who is not registered for VAT issues a tax invoice – a penalty of 100% of the tax which is indicated in the tax invoice and is due for transfer to the budget but has not been transferred; and
- Where a person fails to maintain records required – 2,000 Birr for each month or portion thereof that the failure continues.
- Any person commits an offence if uses unauthorized computer generated or printed receipts or provides the service of printing unauthorized receipts and shall, upon conviction, be punished with a fine of not less than Birr 10,000 and not more than Birr 100,000 and Imprisonment for a term of not less than two years and not more than five years.
- A person who fails to file a timely return is liable for a penalty equal to 5% of the amount of tax underpayment for each month (or portion thereof) during which the failure continues, up to 25% of such amount. The penalty is limited to 50,000 Birr for the first month (of portion thereof) in which no return is filed. If any amount of tax is not paid by the due date, the person liable is obliged to pay interest on such amount for the period from the due date to the date the tax is paid. The interest is set at 25% over and above the highest commercial lending interest rate that prevailed during the preceding quarter.

Cancellation of Registration

- A registered person is to apply to have his registration for VAT canceled if he has ceased to make taxable transactions.
- Except in situations provided for the above of this Article, a registered person may apply to have his registration for VAT canceled at any time after a period of three years of the date of his most recent registration for VAT if the registered person's total taxable transactions in the period of 12 months then beginning reasonably are expected to be not more than 500,000 Birr.
- The cancellation of VAT registration takes effect at the time the registered person ceased to make taxable transactions or, if the registered person has "not ceased to do so, at the end of the accounting period during which the person applies to the Authority for cancellation of VAT registration in accordance with Sub-Article (2) of this Article.
- If a person's registration for VAT is canceled, the Authority is required to remove the person's name and all other details from the VAT register and the person is required to return the issued certificate of registration.

Accounting Period : The accounting period is legislated to be one month.

VAT Rates : The value added rate is 15 per cent and zero rate.

Calculation of Tax Payable

The amount of tax payable for any accounting period by a registered person is the difference between the amount of tax charged on taxable transactions and the amount of **tax credit; tax credit means** the amount of VAT that is creditable is the amount of VAT payable (paid) by a registered person in respect of purchase tax invoices or customs declarations;

VI. CONCLUSION

Tax is very important for each and every Government. As we all know that taxation can be classified into direct and indirect taxes. Every Government need revenue to lead the economic, infrastructure, medical, transport, education, telecom, electricity, staff, research, to concession, subsidies, free facility for the unable sector community in the country. To generate the income Government has a constitution as a law to charge a tax for different sectors of people which brought into different categories of the people. No Tax, No Income; No Income, No Revenue; No Revenue, No Government. Government is a public which is common to the all of the people in the country. Whether the direct or indirect tax, the tax must be charged on the basis of the effort of the people income. Some people earn money with their hard work. Some people earn money easily. The easily earned income must be taxed more than the hard earned money. Ethiopian Taxation system is very important for raising income of the Government.

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