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ASSESSMENT OF INCOME TAX UNDER ETHIOPIAN INCOME TAX LAW: CASE ANALYSIS AND PROBLEMS IN PERSPECT

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Declaration

I here by declare that this paper is my original work and I take full responsibility for any failure to observe the conventional rules of citation.

Name ______________________________

Signature ___________________________

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Acronyms

TA – Tax Authority

Art – Article

FDRE - Federal Democratic Republic Ethiopia

Proc –Proclamation

TAC – Tax Authority Commission

TIN - Tax identification number

<u>INTRODUCTION</u>

The beginning of the imposition of tax and the history of taxation can be traced to the date before the birth of Christ. According to the Holy Bible, the first book of Samuel Chapter 8:4-22, greater age persons asked Samuel to appoint a king to rule over them as other countries have. Samuel though not happy with their request, allowed them to have a king of their choice but he explained to them how he would treat them .He told them that

"***The king will make soldiers of your sons to fight wars some to run his war chariots, others to serve in his cavalry. Others will plough his fields, harvest his crops. He went on to say, your daughters will have to make perfumes for him and work as his cooks and his bakers. He will take your best field's vineyards and olive-groves and give them to his officials. He will take a tenth of your corn and of your grapes for his court officers and other officials. He will take your servants, and your best cattle and donkeys and make them work for him. He will take a tenth of your flocks. And you yourselves will become his slaves."***

The people of Israel did not listen to the warnings that Samuel gave them in advance. They totally rejected his advice and teachings relating to the undesirability of king who would impose tax upon them. Thus, they fell under the obligation to pay tax as indicated in the 1st book of Samuel of the Bible. It then became the rule that every citizen of Israel pay tax indifferent form to its rulers. It seems that the idea of taxation spread together with the expansion of sates by the conquest and the spread of religion.

With the advent of our modern era, collection of tax was not a matter of law, but rather that of force. In other words, after victory the conquered nations fell under the burden of paying taxes to the conqueror. It was considered price of victory. In those days collection of taxes were recognized as sign of strength and power. Weak nations were subjected to cruel kind of taxation.

Many years later, the burden of paying taxes and charges was legitimized by use of force of law. This demarcated a shift from collecting of tax that used to be a sign of strength to prerogative of states to impose tax as states are entrusted with the responsibility to supply public goods and services to their citizens with the use of money collected in the form of tax. Tax has become an imposition or an involuntary payment. Rather it is a responsibility of productive and conscious citizens.

Hence, Tax is not deemed to be a payment to get back some kind of service, grant, and work security from the recipient government.

A government may run in to a huge expenditure so as to provide goods and services to its citizens. To cover this expenditure several governments use taxation as a main source of their national income. Besides, governments have the right to compel all citizens to pay taxes within their jurisdictions. Because, paying tax at the right time will benefit greatly any citizen anywhere.

Therefore, governments are entitled to their maximum effort to make aware their citizens to feel full responsibility to pay taxes through considering tax as a voluntary payment made by citizens.

Having said the above important aspects of taxation, I will try to state the ingredient parts of the paper.

In this paper, I will try to deal with the theoretical and practical aspects of continuous income tax assessment, the problem relating to tax imposition and of tax collection in the Ethiopian context and then suggest possible solutions for the particular problems identified.

To this effect, I have consulted different literatures and research findings, internet sources and other materials with the view to analyze the cases and problems.

Here I would like to express the way this paper is organized. The first Chapter deals with the historical back ground of taxation system in our country. It is devoted in explaining income tax in various regimes. In addition, the chapter clearly depicts how tax was levied and collected.

Chapter two, deals with the relevant structures of income tax rates and detail of various views about it.

Chapter three explains categories of tax payers on the basis of assessment of their income.

In chapter four, I have tried to see problems of income tax assessment and what dissatisfied tax payers have to do to remedy the situation. Furthermore; Cases will be presented as evidence to support my stand in connection with these issues.

Finally, recommendations, which the writer suggest will be embodied in the conclusion part.

CHAPTER ONE

1.1 Basic and legal concepts of tax

Different experts and scholars define tax differently. Nevertheless, they all seem to agree that tax is an imposition of payment made by citizens to governments. According to Dr.H.L.Bhatia the term tax, is defined as

"a compulsory levy payable by an economic unit to government without any corresponding entitlement to receive a definite and direct quid pro quio from the government. It is not a price paid by the tax-payer from any definite service rendered or a commodity supplied by the government. The benefits received by tax payers from the government are not related to or based upon their being tax payer. A tax is a generalized exaction, which may be levied on one or more criteria upon individuals, groups of individuals, or other legal entities."[1]

Still another writer defines tax as

"A compulsory contribution of wealth levied upon persons, natural or corporate, to defray the expenses incurred in conferring a common benefit upon the residents of the state."[2]

According to the above definitions we can conclude that it is the responsibility of every citizen to pay tax. Thus the government shall create awareness on why the citizen has to pay tax. Because, people must believe that tax is not paid for the purpose of satisfying individual interest. It is rather for the purpose of public interest. Thus experts can have different personal perceptions about taxes. This has created lack of common understanding. For instance the following opinions Cleary demonstrate that no one expert has identical view about tax:

1. You can have a lord, you can have a king, but the man to fear is the tax assessor.[3]

2. The power of taxing people and their property is essential to the very existence of government.[4]

3. In this world nothing is certain but death and taxes.[5]

4. Death and taxes are inevitable, but they shouldn't be related.[6]

5. What is the difference between a taxidermist and a tax assessor? A taxidermist takes only your skin.[7]

6. The wisdom of man never yet contrived a system of taxation that would operate with perfect equality.[8]

7. Gross inequalities may not be ignored for the sake of ease of tax collection.[9]

8. No government can exist without taxation. This money must necessarily be levied on the people; and the grand art consists of levying so as not to oppress.[10]

Designing an excellent taxation system and following good principle of tax collection is the key to succeed in voluntary tax payment. This must be uniformly applied to all tax payers. Regarding this, scholars express their views in different ways. As N.Kumar and R.Mittal pointed out,

"A good tax system must be based on such principles, which require less energy on the part of the government to accrue it from the tax payer. And for a voluntary system to work successfully, the people must be confident that taxes are levied fairly and that every one pays his share. If the feeling becomes widespread that the tax system is simply a collection of loopholes and evasions, if people see their equally prosperous neighbors paying substantially less or enjoying tax free expense account living, tax payer's morale will decline. The submission of an honest tax return there ceases to be a simple act of morality. In many countries of the world, both rich and poor, ethics concerning taxes and separate from ethics in other spheres."[11]

The tax collection system should be in a manner that is equally applicable to all people. A Government has to organize a good tax collection system in order to collect taxes at the right time and at the right place. Dr.H.L. Bhatia states the following points about good tax system and how to measure it.

"A good tax system, therefore, is one which is designed on the basis of appropriate set of principles, such as equality and certainty. Mostly, however, objectives of taxation conflict with each other and a compromise is needed .Therefore, usually economists select some important objectives and work out the corresponding principles which the tax system should adhere to."[12]

The following is stated by N.Kumar and R.Mittal regarding purpose of taxation.

"Taxation is the greatest technique in the hand of the modern governments to raise money to meet expenditure Incurred for various public services. It may be on their property, income and even it may be required to pay at the time of purchasing a commodity. Tax constitutes the major source of the government's income." [13]

Again another purpose of tax is set as an order to meet public objectives and some reasons are cited by N.Kumar and R.Mittal as

"tax is the share of the income of citizens with which the state appropriates in order to procure for itself the means necessary for the production of general public services."[14] *Furthermore it says,* ***"It is a liability to pay an amount on account of the fact that the tax assessor have income of a minimum amount and from certain specified sources, or that they own certain tangible and intangible properties or that they carry on certain economic activities which have been chosen for taxation. Thus a tax is a generalized exaction."***[15]

The above opinions reflect great importance of tax to the development of a given country.

Next I will try to deal with aspects of a tax system, meaning of income tax and its application in various countries of the world.

Regarding the different aspects of income tax, some scholars give different meaning which varies from country to country N.kumar and R.mittal define the term "income" as

"--- Tax on income are the most important single source of revenue for governments in developed countries, though they at present produce far less revenue in most developing countries than customs duties and taxes on internal transactions. But these taxes are emphasized in all countries, developed as well as developing, because they have the potential for increasing the yield of the tax system and achieving a system of taxation that satisfies the demand for equity and social justice.---By income we mean the net income and not the gross income of an individual. In Income we can include the property in his possession which also earns income. A person can pay a greater amount of taxes due to potential of earning he has in the form of property. "[16]

Sources show that taxation system in the US as a complex system which may involve payment to many different levels of government and many methods of taxation. The lower earning workers especially those with dependants, pay on income taxes as a group and actually get a small subsidy from the federal Government because of child credits and the earned income tax credit. The federal government collects several specific taxes in addition to the general income tax. One unique aspect of federal income tax in the United States is that the U.S uses citizen ship in addition to residency in determining whether a person's income is in subject to US taxation. All U.S citizens, including those who do not live in the United States, are subject to U.S income tax on their world wide income. There are provisions that exist to reduce double-taxation. Most other countries do not impose tax on their citizens who are not resident with in their borders, unless they have income which is sourced in that country (and even then they only tax that specific income.)

From this we can understand countries use this term in their law on the basis of the classification of Federal and unitary state government.

The Ethiopian tax law defines the term "income" under article 2/10 of proclamation no 286/2002 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."[17]

The intention of the legislature is to give the term a wider scope from the point of view of national territory .Any income generated even by a foreigner inside Ethiopia is subjected to taxation. Then, in the above provision 'economic benefit' means to receive revenue from any source. 'Nonrecurring gains in cash or in kind 'means any benefit from money or other non cash materials. 'Paid' means to receive revenue from other sources, 'credited' here indicated the power to obtain goods, on the other hand 'received' may mean to take or an accepted things.

1.2 Tax system

Tax system is a type of system through which the tax liabilities are computed.

Generally speaking there are two types of tax system in the world. These are

a. Global Tax system

b. Schedular Tax system

1.2.1 Global Tax system

The following definition is given to global tax system by Misrak Tesfaye :

"Global tax system is a system whose tax liability is computed on aggregate (the sum) of all incomes and losses derived by a tax payer from different sources in the world. That means, if a tax payer has two or more businesses, the losses incurred in one business can be offset with the income earned in another business and tax is computed on the final balance."[18]

In this Global system, the tax payers declare his /her income collected from different activities. For example he is required to declare total income from the business he/she is currently running.

1.2.2 Schedular Tax system

On the contrary, a

"Scheduler tax system is a system in which tax liability is computed on separate schedules. This means, if a Tax payer has two or more businesses, the losses incurred in one business is not offset with the income in another business unless the same schedule. In schedular system income is classified for income tax purposes according to its nature and source. The classifications in to which the income falls are known as schedules."[19]

Both source and nature have different implication. The Ethiopian tax system follows scheduler tax system and its source refers to different types of activities. These activities that are cited in accordance with proclamation No 286/2002 are like incomes from employment (schedule A), incomes from Rental of Buildings (schedule B), income from Business income (schedule C), and other income (Schedule D). All schedules have different characteristics for tax liability.

1.3 History of income tax in Ethiopia

We can easily recognize that the tax rate for different schedule shows variation /change/.

Therefore, it has brought about an implication that the existing system charges some of the schedule higher amount while the remaining schedule are observed to pay a tax having medium or lower amount.

To this end, I can write few instances taken from some related literatures.

Schedule 'A':-income from employment the first 150 birr of employment income is excluded from taxation.

-employers have an obligation to with hold the tax from each payment to an employee, and to pay to the TA the amount withheld without delay. The tax rate for schedule A is shown below.

Employment income (per month)		Income tax payable	
Over birr	**To birr**	**%**	**deduction**
0	150	exempt	-
151	650	10	15.00
651	1400	15	47.50
1401	2350	20	117.50
2351	3550	25	235.00
3551	5000	30	412.50
Over 5000	-	35	662.50

(Net pay= Income from Employment x % - deduction)

For example: The man who is paid Monthly salary of birr 500.00

$$\frac{500.00 \times 10}{100.00} = 50.00 - 15.00 = 35.00 \text{ (deduction)}$$

$$500.00 - 35.00 = 465.00 \text{ (Net pay)}$$

Schedule 'B':- income from rental of buildings, the first 1800.00 is excluded from taxation. We show it in the following table.

Taxable income from rental (per year)		Income tax payable	
Over birr	**To birr**	**%**	**deduction**
0	1800	-	-
1801	7800	10	180.00
7801	16800	15	570.00
16801	28200	20	1410.00
28201	42600	25	2820.00
42601	60000	30	4950.00
Over 60000	-	35	7950.00

(Tax = Taxable income from rental (per year) x %) – Deduction

For example: The Annual income from rental of residential buildings man is 30000.00, calculated as follows:

$$\text{Tax} = \frac{30000.00 \times 25}{100.00} = 7500.00 - 2820.00 = 4680.00$$

Schedule 'C':- income from Business, the first 1800.00 is excluded from taxation. We show it in the following table.

Taxable income from rental (per year)		**Income tax payable**	
Over birr	**To birr**	**%**	**deduction**
0	1800	-	-
1801	7800	10	180.00
7801	16800	15	570.00
16801	28200	20	1410.00
28201	42600	25	2820.00
42601	60000	30	4950.00
Over 60000	-	35	7950.00

(Tax = Annual Taxable income from Business x %) – Deduction

<u>For example</u>: Annual Taxable income from Business is 7801.00:

$$Tax = \frac{7801.00 \times 15}{100.00} = 1170.15 - 570.00 = 600.15$$

Schedule 'D': Income from other.

1 - Royalty 5%

2 -Income from rendering technical service 10%

3- Income from rental of property 15%

4 - Income from interest 5%

5 -Income from games of chance 15%

6 -Dividends 10%

7-Income from gain or transfer of certain investment property

*building held for business, factory, Office 15%

*shares of companies 30%

Income tax was the back bone of revenue for traditional Ethiopia. In this regard Gebre Worku said, that

"History tells us Ethiopia's tax system dates back to ancient times. For example, in the Axumite kingdom there was a practice of traditional taxation."[20]

In the above statement, early taxation system in Ethiopia shows that there was clear connection of state and religion. In this particular period, tax was paid traditionally in kinds until late 19th century .Tax used to be collected by force. Gebrie says

"…taxation in traditional Ethiopia had been excessively burdensome and arbitrary."[21]

In that period traditional people earns income from farming and the amount of income tax paid is in kind.

"The consolidation of Ethiopian multi-National state in the era of the beginnings of the struggle against imperialism created the material, social basis and conditions for the subsequent rise of irreconcilable class antagonism between the toiling gabar class and the exploiting gultegna class. Thus, the landed and armed ruling class which consists of ecclesiastical, ministerial, mercantilist leaders and members of the feudal aristocracy and nobility of Ethiopia had been known to collect tax unfairly."[22]

"Thus they began to change the Menilik system of maderia, gindebel, and semon possession of land in to the new system of inalienable and inheritable private ownership over and against the toiling gabar class."[23]

Then, in this time, peasants payment was their grain in accordance with obtained form their farm.

Gebrie Worku Further more says

"The most important features of the traditional taxation system continued during the relatively modern administration of emperor Haile selassie I. The elements of the tax system of this era comprise personal

income tax, business income tax, agricultural income tax, land tax, education tax, health tax, road tax, salt tax, tobacco regie tax, the tithe, Alcohol tax, Cattle tax, stamp duties and custom duties."[25]

Coming back to the historical record of income tax in Ethiopia, It can be said the following few statements.

The first income tax law of Ethiopia was enacted in 1944.The personal and business of tax proclamation number 60/1944 reform income taxation in that it provided a modern structural and legal frame work to the disorganized primordial system. Proclamation number 107/49 replaced the first proclamation in 1949 and this proclamation was replaced by income tax Decree number 19, in 1956.The fourth income tax law is enacted by income tax proclamation number 171, in 1961 and then proclamation number 255/1967 has amended it.

"Briefly it can be presented like 1975 brought about the abolition of the feudal land tenure system and the revoke of land taxes and the tithe. The health and education taxes were also cancelled and the remaining types of taxes were extensively amended and restructured by the Derg and used until the Transitional government of Ethiopia amends a new Taxation structure .During this period there was arising in the coverage of tax bases and tax rates owing to tax need to collect more revenue to support the government."[26]

The income tax during Derge regime mainly amended the income tax proclamation number 173/1961 and proclamation number 255/1967.Proclamation number 77/1976 and Proclamation number 152/1978 were aimed at changing the income tax structure levied on agricultural activities. Accordingly, the two proclamations imposed rural land use fee and tax on income from agricultural activity.[27]

Foot Note: 22. http://historyethioia.com/

23. Ibid

When things have been changed both locally and globally the transitional government of Ethiopia pursued the following Taxation system. During this period taxes were designed in the light of fiscal federalism in order to stimulate economic development to overcome vertical and horizontal pecuniary imbalance, economic inefficiencies, inequity and all distortions in the economy in line with the market based economic orientation.

Transitional government of Ethiopia amended the previous personal income tax with proclamation number 30/1992.Accordingly, the first birr 105 monthly personal income was exempted from the payment of income tax.

The Federal and Regional government with proclamation number 33/1992 all collect taxes. Hence the law that has been enacted encourages collection of tax.

CHAPTER TWO

2.1. The structure of income tax Rate

It is quite vivid that there are different structures of tax which are pursued by different countries depending up on their economic climate, environment and suitability as well.

Since income is considered as best measuring parameter of the ability to pay taxes, it becomes the basis for all allocation of taxes among tax payers.

Hence the rate of taxation may be Progressive, Regressive, Proportional and Digressive.

In addition, Misrak Tesfaye says,

"The tax rate is merely the percentage rate applied to the tax base. On the basis of the degree of progression or distribution of tax burden on the tax payers, there are four commonly used tax rate structures, namely, proportional, progressive, regressive, and digressive tax structures."[1]

2.1.1 Progressive Tax rate

A progressive tax rate is a type of tax rate with which the state of taxation increases as the tax base increases. In other words, this type of tax rate can be explained in the following phrase. According to this Misrak Tesfaye said that.

"Progressive tax structure taxes the higher income groups (richer), more amounts of tax; the middle income groups, lower amount of tax; and the lower income groups (poorer) are exempted. This implies that the effective tax rate increases at an increasing or constant rate as the value of tax base increases. Progressive taxation does not provide for a fixed and uniform percentage rate of tax for all the income levels."[2]

In this structure as income increases the liability of tax will increase. The following table illustrates progressive types of tax rate.

Tax Base (In birr)	Tax Rate (In %)	Amount of Tax (in birr)
0-2000	5	100
2000-4000	10	300
4000-6000	12	540
6000-10000	15	1140
12000-15000	25	1890

2.1.2 Regressive Tax rate

In the definition of B.N.Narayan regressive rate is

"...one in which the rate of taxation decreases as the tax base increases. --- As the tax base increases, the tax rate decreases." [3]

According to Misrak Tesfaye

"Regressive tax is the opposite of the progressive tax because according to this system of taxation, the rate of tax diminishes as the tax base increases." [4]

Additionally Misrak Tesfaye says

"…the higher income groups (richer) are taxed at lower rate and the lower income groups pay more amount of tax." [5]

In order to show regressive type of tax rate, I have presented it as follows.

Tax Base (In Birr)	Tax Rate (In %)	Amount of Tax (In Birr)
2-000	25	500
2000-4000	20	900
4000-6000	15	1200
6000-10000	10	1600
12000-15000	5	1850

2.1.3 Proportional Tax rate

Misrak Tesfaye he says

"…every tax payer (higher, middle or lower groups) pays at same flat rate. This implies that the tax rate remains constant as the tax base (eg. Income) increases. In this system, all incomes are taxed at a single uniform rate and it does not matter if the tax payer's income is high or low."[6]

The proportional tax rate is shown in the under mentioned table

Tax Base (In birr)	**Tax Rate (In %)**	**Amount of tax**
1500	10	150
6500	10	650
14000	10	1400
23500	10	2350
35500	10	3550

2.1.4 Digressive Tax rate

When we come to the last type of tax rate, it is defined as one under which the tax may be slowly progressive up to a certain point and limit, and after that point the tax may be charged a flat rate.

The following is stated by Misrak Tesfaye

"Digressive tax structure is similar to progressive tax structure, but in digressive tax the rate of progression is not in the same proportion as the income. In Digressive tax system the marginal tax rate declines with each incremental tax base i.e. the tax rate increases but at a decreasing rate."[7]

The last type i.e. digressive tax system is shown below

Tax Base (In birr)	**Tax Rate (In %)**	**Amount of Tax (In birr)**
0-2000	5	100
2000-4000	10	300
4000-6000	14	580
6000-10000	17	1260
12000-15000	18	1800

Thus, when we come to my case the Ethiopian government is currently pursuing primarily a progressive tax rate system. As it is mentioned in section (2.1.1) of this chapter, a progressive tax rate is the one in which the rate of taxation increases as the tax base increases. In addition, this type of taxation is universally accepted.

CHAPTER THREE

3.1 Assessment of income tax

3.1.1 Meaning of tax assessment

The word 'assessment' has different meaning in the income legislation. Assessment is a kind of collecting method. It is not an easy task to collect information, because it must be followed up every day. For tax assessment first one must know that he/she should have enough knowledge about the case, and then the assessor must be able to use different information collecting technique.

Alfa Gupta commenting on assessment says,

"If the assessing Authority is satisfied that the return submitted is correct and complete, he shall assess the amount of tax due from the dealer on the basis of such return. --- If the Assessing authority is satisfied that a dealer has for a reasonable cause been unable to furnish any return with in the prescribed period, the said authority may extend the period of submission of such return. ---If the assessing authority is not satisfied that a return furnished is correct and complete, he shall serve on the dealer, a notice in the prescribed form requiring him on a date and at a place specified therein, either to attend in person or to produce or cause to be produced any evidence on which such dealer may rely in support of such return.---On the day specified in the notice, the assessing Authority shall, after recording evidence produced by the dealer, assess the amount of tax due from the dealer."[1]

In the Ethiopian context, the tax Authority determines the tax liability of the tax payer by assessment. In this chapter section 3.3 the different types of tax assessment will be discussed.

3.1.2 Methods of tax Assessment in Ethiopia

Ethiopia has three methods of tax assessment. These methods are described by Misrak as follows.

Accrual basis method

"As per article 58/3 of proclamation No. 286/2002, companies (share and private limited) are required for tax purposes to employ accrual basis accounting. If the accounts are kept on accrual basis, revenues are accounted for when they are earned, i.e., when title passes to the buyer for the sale of goods or services is performed to customers irrespective of cash receipts; and expenses are accounted when they are incurred irrespective of cash disbursements."[2]

Cash basis method

"All businesses other than companies can select and employ either cash basis or accrual basis but not both. Based on the cash basis a record is kept of actual receipts and actual payments, entries are made only when money is actually collected or disbursed. If the profit of a business is accounted for in cash basis, the taxable profit is the difference between the receipts (revenues) and the disbursements (expenses) for the period in question."[3]

In other words the net profit is calculated as follows.

Tax profit = R-C, where R = Revenue

C = Total cost

Percentage of completion method

"In reference to article 63 of proclamation No. 286/2002, income relating to a long term contract of business shall be accounted for on the basis of the percentage of the contract completed during any tax year. In determining percentage of completion, cost-to–cost method is used. Cost-to-cost method is the ratio of actual costs incurred to date to the newly estimated total cost to complete the contract." [4]

3.2 Categories of business tax payers

The tax collecting authority, before levying a tax on a tax payer, has to be able to identity the categories of the tax payers. This way it creates a good relation between the two parties / i.e. the tax collecting authority and the tax payer/.our income tax law categories of tax payers in to three categories as category A, category B and category C.

In Accordance with Regulation No 78/2002, they are described in detail as follows.

Category "A" tax payers

It Includes any company incorporated under the laws of Ethiopia or in a foreign country engaged in any business and having an annual turnover of birr 500 000.00(five hundred thousand birr) or more.

This type of tax payer has to pay his/her tax within 4 months starting from the end of tax payer's fiscal year.

Category "B" tax payers

This Includes any business entity having an annual turnover between 100000.000 (one hundred thousand birr) and 500 00.00. (Five hundred thousand birr)

Category "B" tax payers must pay their taxes within 2 months starting from the end of tax payers tax year.

Category "c" tax payers

It Includes any business whose annual turn over is estimated by the Tax authority to be up to birr 100000.000 (one hundred thousand birr).The tax payer shall pay the tax determined in accordance with the standard assessment on the 7th day of July to the 6th day of August in every year, unless, the tax payer requested and is allowed to make installment payments in accordance with Council of Ministers Regulations.

After the tax authority determined the amount of tax, it will commence its duty. The legal system has been enacted to get a good willingness and co-operation from the public and other institutions.

All tax payers have to properly inform the amount of his/her income and the address of the company as well. In addition the tax payer must prepare its own income statement to be examined by TA. In this way, it is quite suitable to determine the amount of tax to be imposed.

3.3 Basis for assessment

The tax law states code of conduct for tax officials and governmental authorities .This is clearly declared in proclamation number 286/2002 of article 40 and 41. From these articles we can infer that tax officials in course of assessing tax ,they have be honest and fair, they should show impartiality and they don't have to abuse their power. Furthermore, the concerned governmental authorities must co-operate with the tax authorities.

The tax collection authority carries its own investigation on the documents after receiving the documents which are filed by the tax payers by his/her own motion to show the amount of his/her income genuinely. The tax payers are expected to use computerized system to keep documents and clear statement of their income.

Tax assessment can be made in four different ways for all categories of tax payers. These are

1. Financial statement method
2. by third party information method
3. by Estimation
4. Presumptive tax Assessment

With regard to the above four types of tax assessment, I have obtained all the information from Kirkos, Gulelle and Bole sub city Revenue office.

1. Financial statement method

In accordance with Art 19 of Regulation number 78/2002, category A and B are mandatory expected to maintain books of account. In addition, the above categories must clearly keep their document in terms of general, administrative expense, depreciation, prvisions and reserves.

On the other hand, Regulation number 78/2002 art. 21/3 states that category C tax payers may maintain books of accounts that are acceptable to the Tax authority and pay the tax on the basis of such books of account. But they are not obliged by the law to do so.

Financial statement is a statement which contains tax declaration legal documents which have the expense amount, commercial commodities in a store their type and amount, and if not sold according to the account it contains the commodities income and expense together.

This document contains the balance sheet, and income statement showing the profit and/or loss of the business .And it will be issued for declaration after it is prepared by the accountant of the agency or by any licensed accountant. Based on the information held by the document, the amount of tax will be declared and paid then after.

The Inland Revenue authority will ask the agency to submit documents and provides all the necessary documents for auditing. Based on the result of the audit report the amount of tax will be decided. If any error or fraud is found, the former document kept by the agency will be disqualified and the amount to be paid will be decided based on information found either from third person or by estimation committee.

Example:

1. If the tax payer is a construction company and the amount paid is believed to be less ,the right amount of payment is decided based on the information found from the design of the building .And the tax authority will also decide monetary penalty for under statements.
2. If the enterprise is a Hotel, estimators will be sent from kebele and the amount of tax will be estimated based on the information obtained from the hotel.

2, **by third party information method**

On the situation that third party information is enough to know the income of the business then the amount of tax will be decided accordingly.

For instance, if the tax payer is an importer any information regarding the amount and kind of goods imported by the agency can be found from the customs authority. Then the true amount of tax can be computed and will be checked if there is any difference with what was paid in advance.

In case of Hotel works the quantity of Meat bought and sold can be found from the Addis Ababa Abattoir. And the volume of drinks is also determined from brewery factories and the tax amount will be decided on the basis of volume work under taken by the hotel.

3. **by Estimation**

Under this title, we will see the tax payers classified in to two types. The first one is, indicated in Article 69/1 of income tax proclamation number 286/2002.The law indicates that the amount of tax by estimation can be assessed in three ways in accordance with Article 69 (1)

" ***If no records and books of accounts are maintained by the tax payer, or if, for any reason, the records and books of accounts are unacceptable to the tax authority, or if the tax payer fails to declare his/her income within the time prescribed by this proclamation, the tax authority may assess the tax by estimation."*** [5]

From the above article we try to identity reasons for the estimation of tax by the tax authority. In the following ways

-If no records and books of account are maintained by the tax payer.

-The records and books of account are made void by the tax authority.

-If the tax payer fails to declare his/her its income within the time prescribed by the law.

3.1 When the tax payer have no records and books of account.

As we discussed above, tax payers are obliged to have account books and records. But if they fail to do so, the authority will use estimation assessment.

So, according to art 89 (1) of the proclamation "the tax payer shall be liable for penalty of 20% of the tax assessed if he/she fails to keep proper book of account, records, and other documents regarding a certain tax year.

This means, what ever the case might be, the person will be liable to pay 20% of the assessed tax as a way of punishment.

Further more, articles 93 says the following in the event that errors that led to incorrect determination and execution of tax obligations, and it has to be corrected independently before commencement of a tax examination. The tax payer shall be released from liability, with the exception of paying the tax and interest.

The tax payer may be relieved from punishment when he/she corrects his/her mistake before the investigation is made on his/her documents by the tax authority.

Of course, it's proper to lay punishment for his/her failure to keep documents on his in come; But as I personally believe, it's better to punish the person after examining and investigating as to why he has failed to do so. The TA has to make sure whether the mistake is committed deliberately or not.

3.2 When the records and books of account is invalidated by TA.

If the way of keeping account books and records are not accepted by the tax authority, for any reason it will be void as prescribed by art.69 /1

Such unclear and ambiguous words should not be stated in the law but if there is ambiguity in the law, the TA can use directive which are regularly updated to execute income tax proclamation.

3.3 When the tax payer fails to declare his or her income with in the time.

Article 69 (1) clearly indicates that failure to indicate or deal his/her income within the time prescribed by law makes the authority to use estimation. But, doesn't provide space to allow the tax payer to be free from punishment the reason for the failure is a just one. The law doesn't give the chance to the tax authority to find out why the tax payer fails to do so and how it evaluates and then it directly enters to estimation tax at the last moment.

Secondly, the tax payer's of this category are those income can be determined directly by daily income estimate. In this case a committee comprising five persons is sent to the business enterprise, and they will collect any information from the owner as well as from the surrounding as to how much this business can earn daily.

They record all the information found in a form designed for the purpose. Based on this information, the amount of tax will be decided by estimation. This decision will be communicated to the owner of the business .The type of business prone to this kind of assessment are the ones like retail sellers, metal works, hotels and soon. Besides, in hotels the tickets given by cash registers is important to determine the amount of tax the business should pay.

4. **Presumptive tax Assessment**

The taxpayers in this category will pay their tax according to the proclamation number 78/2002 decided by the authority. That based on presumptive assessment/Based on standard/ fixed amount is taxable. These tax payers are those who work in businesses like taxi, fruit and Movies.

CHAPTER FOUR

4.1 Problems Relating to Income tax Assessment

Whenever the tax authority levys tax on the tax payer it is desirable that it uses clear measurement and transparent methods to make the tax payer keep proper record and indicate his income truly.

In the time of tax assessment by estimation, it makes difficult for the tax authority in practical terms as the tax payers will have the chance to hide the true amount of their income.

The researcher believes that failure to maintain proper documents results in paying unequal amount of tax among the tax payers having same levels of income. This is common particularly in a situation where tax payers hide most of their merchandise when they know in advance when tax assessment officials come for assessing their daily sales income .The tax payer who is honest will be obliged to pay more than a trader who generates similar income from the same trade fair because he has declared his true income and maintained proper books of account.

The amount of tax assessment by estimation is determined based on the notification of their income by the tax payer, as to the researcher's view these make the assessment difficult and give a chance for corruption.

It is unfortunate tax authorities do not make any investigation when tax payers fail to keep book of account or why they fail to declare their income in the format prepared thereof. This failure would compel the tax authority to fix the tax by estimation which in turn creates dissatisfaction on the part of the tax payer.

4.2 Right left to a dissatisfied tax payer

There is no doubt that establishment of compliant handling is important for tax payers to bring their cases to get them resolve.

This is a right to justice which is granted in article 37/1 of FDRE Constitution ***"Every one has the right to bring a justifiable matter to, and to obtain***

decision or judgment by, a court of law or any other competent body with judicial power." [1]

This granted a right to every body to bring its cases to the eyes of law. Tax appeal commission is established to resolve tax disputes according to income tax proclamation 286/2002, article 107/1"Any tax payer who objects to an assessment may appeal to the tax appeal commission (here in after referred to as the "Appeal Commission") up on the fulfillment of the requirements hereunder." A party has a right to appeal to the competent court of appeal when dissatisfied by the decision of the Tax appeal commission. According to Article 112/1 of proclamation No 286/2002 ***"Any party to dissatisfied with the decision of Appeal commission may appeal to the competent court of appeal on the ground that it is erroneous on any matter of law with in 30 days from the date of receipt of the written decision of the appeal commission"***.[2]

Tax officials may influence tax payers in order to settle their case. The Authority has to establish a committee to get the right information of the business. Tax appeal commission examines the tax with the right to tax payers. Article 114/1/ of proclamation No ***"members of the appeal commission at every level shall be appointed from among persons having good reputation, acceptability, Integrity, general and professional knowledge and from among persons."***[3]

According to this article a tax appeal committee can be appointed on the above specific conditions and criteria's. The committee resolves the disputes between the parties. They have a competitive knowledge in trade. The provision doesn't give a clear meaning to professionals, but it seems to be law professionals and accountant because law professionals have the ability to interpret law and an accountant examines the tax rate and calculation. Any way, the law doesn't give special authority to this body it gives an authority to committees with no professional knowledge relating to tax laws.

4.3 Condition for appeal

In the above section we tried to discuss the right of appeal by the tax payers. The proclamation states conditions for non- acceptance of appeal by tax payers under Article 107/2 (a&b) 🕮No appeal shall be accepted by the appeal commission, unless

a/ a deposit of fifty percent (50%) of the disputed amount is made to the tax authority ;and

b/ The appeal is lodged with the appeal commission within thirty (30) days following the day of receipt of the assessment notice or from the date of decision of review committee"[4]

This means the appeal is not acceptable unless it is logged with in thirty (30) days from the date of the decision or following the day of receipt of the assessment and with out deposit of fifty percent (50%) of the disputed amount.

4.4 Case analysis

Case I

Ato Awad Mohammed is engaged in importing different vehicles both for sale and rental service.

The owner generates two income from two different sources one from the sale of vehicles and the other from giving rental service.

In the event of verification of documents which are submitted by Ato Awad Mohammed, it was found out that the income is treated separately by the business entity based on book of account and presumptive tax assessment instead of being treated in aggregate. Due to this Ato Awad Mohammed's book of account is rejected.

Following this rejection, Ato Awad Mohammed went to Kerkos Sub City tax complain handling committee.

After the committee has carefully examined the case, the committee decided that Ato Awad Mohammed should pay taxed on the basis of presumptive assessment stating that different income should be treated in aggregate. In order to reach to this decision, the committee has taken the following condition into consideration.

1. He doesn't have recruited professional accountant.
2. He has treated the two income separately that should have been treated in aggregate.

Based on income tax proclamation No 286/02 Article 70, even if the income is generated from different source it should be stated in aggregate.

Therefore, from this particular case, we can clearly understand that people treat different income which is generated from different source separately in order to evade the major income of the government. In addition the decision of tax complain handling committee quite acceptable because before making a decision the committee tried to take different aspect in to consideration.

The appeal of tax payer, the opinion of the auditor including the decision of the court is attached in Annex number 1.

Case II

The case at hand started at the Addis Ababa tax appeal commission between Ato Demissie Gebre wedajo (here in after referred as an appellant) and Ledeta sub city tax administration finance and economic development office revenue department (here in after referred as defendant).

The appellant brought his case by stating that, he is an owner of a Hotel business registered in Ledeta sub city kebele 12 house no 263. Disregarding its legal obligation to give a clear notification about tax calculation, the defendant asked me to pay a huge amount of tax from 1997 E.c to 1999 E.c.

The defendant obliged me to pay beyond what is indicated on my book of account. If it gives me a clear notification I am obliged to pay after separating correct and wrong types of calculation by reconciling with ledger. Tax appeal commission order the defendant to give for me a clear tax notification about tax calculation and also the plaintiff adds a Minibus taxi transport service tax with estimation. So tax appeal commission order the defendant to calculate tax based on my book of account. Before this I am applying for the defendant tax complaint handling committee but the committee orders me to pay tax. I am paying all taxes up to 2000 E.c.

The court gives its decision that the commission gave decision based on regulation no 78/02 Art 21(2) this article clearly shows that its applicable for category "C" tax payer so it is not correct that the commission uses article 21 (2) to gave decision. According to its letter the transport tax can be calculated by assessment and also in checklist no 5 transport tax can be aggregate with other tax the lower court decision is reversed.

Tax authority has an obligation to give income tax assessment notice to tax payer in writing. Its contents shall contain gross income and deductions applicable under proclamation of tax law, taxable income, rates applicable or percentages, taxes paid and due, any penalty or interest the tax payers name, address and TIN, and a brief explanation of the assessment and statement of the tax payers rights according to proclamation no 286/2002 Article 72.

The appellant in the commission is category "C" tax payer according to article 68 (1) the authority has a right to determine income tax by assessment method.

The disputed both income derives from business activities because of these, they are under the same schedule but the income is from different sources one is Hotel and the other is Minibus transport service according to article 70 of 286/2002 it can be aggregated. Some business entities don't want to state different incomes in aggregate for the purpose of tax evasion and this in turn reduces government income. The appeal of the two parties including the decision of the court has been presented in the Annexes number 2 to support the agreement.

Conclusion and Recommendation

Taxation is the key and the base of any sort of socio - economic development of any nation.

In order to bring the desired socio - economic development and there by in order to build the capacity of the nation the government will play an immense role.

The government will establish the tax collection system on the basis of the society's respective income level. In addition to this, the government is responsible in formulating procedures rules and regulation of tax collection system.

Tax authority has the power to regulate and collect taxes as per the income level of citizens based on the rules and regulations set by the government. The authorized office can fix the amount of taxes to be paid either by books of account or by estimation. Accordingly based on their income level category A and category B tax payers are forced to pay taxes on books of account where as category C tax payers are obliged to pay on estimation.

Based on the tax payer income level and the amount of tax they are supposed to pay the tax authority must have the tight controlling mechanisms so as to regulate properly tax payers such as category A, category B, and category C.

Tax payers should give correct information about their income level and their address. If the tax payers failed to do all the above things, they will be subject to different legal penalties. In addition, if tax payers have to exercise their rights, they need to discharge their responsibilities.

If taxpayers give reliable information about the amount of income he/she is generating that will be quite useful for tax assessment. Some tax payers will not pay taxes in accordance with the level of income they are generating .When this is going to happen, tax authority should make extensive research and analyses to draw important conclusion which is fully supported by evidence.

Besides, the government is expected to do a lot regarding raising the level of awareness so that tax payers can make their on contribution by paying taxes.

Hence, based on the aforementioned information the following recommendation can be given.

- If the tax payer is using book of account we need to make him to bring his book of account. If there is something ambiguous in the book of account, employees of tax authority who are responsible must be able to make surprise check up when ever the tax payer is totally un prepared. If the desired results is not achieved doing all the necessary things tax authority can resort to other mechanisms. This helps the tax authority not to make tax assessment based on wrong data.
- Proper training should be given for tax officials in order to raise their r level of awareness and in order to make them to be well organized to avoid problem of tax evasion.
- Unclear and ambiguous words should not be stated in the law but if there is ambiguity in the law, the TA can use directive which are regularly updated to execute income tax proclamation.
- During tax Assessment the current marketing situation and other important related aspects have to be properly considered in advance if we need to have the right information about the sources and amount of income earned by the tax payer. In addition to this, there must be regular and strict follow-up concerning this particular aspect

so that tax authority will be able to have a clue about the right income level of tax payer.

- There must be independent external parties that should evaluate the performance of tax assessor.
- The existence of law that can enforce proper tax assessment is very decisive. Beside, tax assessment should be quite understandable, unambiguous & time saving. The law should be legislated in a way that could satisfy both the intention of the tax payer and the tax collector.

Finally, the Government can create public awareness about the objectives of tax through different mechanisms such as using media and like Civics education at school so as to improve the taxation awareness of the public at large. Especially, lessons that teach about the roles of tax playing in the development of the country are included in text books like ethics; they will bring a great influence in the long run.

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