ETHIOPIAN TAX LAW

A Textbook

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Addis Ababa, Ethiopia
June 2022

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Preface

Although taxation has firm importance in the long history of statehood in Ethiopia, the 'modern' system of taxation is only a product of post-1940s reforms in policy, laws, and institutions. Various changes have been made in the tax base, rate and administration of the existing taxes. New categories of taxes were also introduced into the system. Currently, Ethiopia is a federal state composed of eleven regional states and two chartered cities, and the power to levy and collect these taxes has been shared accordingly. However, just to borrow the sensational but not altogether exaggerated expression of the renowned tax lawyer Taddesse Lencho (Ph.D.), the Ethiopian tax system, whose existence is even questionable from the eyes of strict standards, 'is still random, disorganized, and incoherent in policy, law and practice'. The tax law-making and practicing (more generally the jurisprudence) is in its infancy, if not embryonic. The tax policy of the country can only be found sprinkled in the economic and other policies of the country. In the face of the recent government's commitment to modernize the system, grand tax issues in taxpayer-tax authority relationships such as tax culture, voluntary tax compliance, tax evasion and avoidance, and tax justice have remained contentious. With a tax-to-GDP ratio of 10.7%, Ethiopia's tax revenue is one of the lowest in the world compared to sub-Saharan Africa (18.6%), middle-income countries (25%) and higher-income countries (40%) standards. With all these inadequacies and incongruities, however, there is a system apparently operating with respect to the different forms of taxation in Ethiopia. There are, in particular, various federal and regional tax legislation and institutions organized to enforce the laws. There is a growing body of tax disputes that call tax authorities, public prosecution offices, private lawyers, tax appeal commissions, courts and others to work and speedily deliver solutions.

Unfortunately, the Ethiopian tax law regime is the most complex, ignored and feared area of legal discourse by academics. One of the reasons can be that tax law and administrations often replete with technical concepts and rules borrowed from other disciplines such as constitutional and administrative laws as well as accounting and economics. One more thing to add, studying Ethiopian tax laws requires extensive analysis of a wide array of laws (proclamations, regulations, directives or others) and the institutions (private and public) involved in the administration of taxation. There is no organized

and comprehensive academic work in the area of tax law so far. There are only very few journal articles and thesis works. This work is an attempt to fill this gap. Its main objective is to develop a new textbook for tax law in a way it best guides course instructors and students in the undergraduate and graduate legal education programs in Ethiopia.

This textbook has come about with the participation of four academicians that teach and conduct research on tax laws at different universities in Ethiopia. It is organized into twelve chapters. Chapters one, five and six are written by Mr. Mulugeta Akalu (Assistant Professor at Bahir Dar University). Chapters two, nine and ten are written by Mr. Misganaw Gashaw (Assistant Professor and Ph.D. Candidate at Bahir Dar University). Chapters three, four and seven are written by Mr. Zerihun Asegid (Lecturer and Ph.D. student at Debre Berhan and Bahir Dar Universities respectively). Chapters eleven and twelve are written by Mr. Aschalew Ashagre (Assistant Professor and a Ph.D. Candidate at Addis Ababa University). Chapter 8 is a joint work. It is developed by a guest author, Muluken Bekele, who has been working in the Ethiopian Customs Commission (formerly Ethiopian Revenues and Customs Authority) for nearly 13 years, and Misganaw Gashaw. General administrative responsibilities such as coordinating the authors, ensuring scientific and ethical protocols, budget administration, and communication with funders were carried out by Misganaw Gashaw, team leader of this textbook project.

Chapter one in general covers introductory concepts on taxation and tax law. It mainly deals with the role of the government in a free economy and the need for revenue for governments, the importance of tax as government revenue, the meaning, nature, purpose, principles and theories of taxation. Chapter two of the book focused on the Ethiopian tax system, which tries to introduce students to the Ethiopian tax system centering on policies, operating laws, administrative institutions and the structure and limitations of taxation power. Chapters three and four deal with the income tax laws of Ethiopia. In these chapters, the concept of income, income tax and its justifications, the jurisdiction issues on taxing cross-border income, the alternative income tax systems, the features of the Ethiopian income tax system and the schedules, tax rates, assessment, tax brackets, taxable units, tax computation and declaration and payment procedures are explored thoroughly. Chapter five looks at the Value Added Tax in general and the Ethiopian Value Added Tax in particular. It discusses the concept of consumption taxes, the meaning of VAT and its difference from

other consumption taxes, its history and how it became popular its disadvantages, the methods of calculating it, the features of Ethiopian VAT, the scope of VAT under Ethiopian law, the exemptions and zero ratings, the VAT rate and their application, taxpayer control mechanisms, VAT assessment, payment, refund and carry forward rules.

Chapter six of the book explores turnover tax, another consumption tax whose relevance is declining due to the popularity of the VAT. In this chapter, the meaning and nature of the turnover tax, its similarity and difference with other indirect/consumption taxes, exempt transactions, businesses that must register for turnover tax and its scope and the method of assessing it are addressed. Chapter Seven of the book explains the concept of excise taxes, their meaning, nature, purpose, tax base, rate, assessment, payment and controlling mechanisms under the Ethiopian excise tax laws. Chapter eight which focused on customs duties begins with an explanation of the concept and development of laws on customs and customs duties. It also discusses various procedures, restrictions, prohibitions and operational activities in customs administration. The chapter emphasizes customs declarations, transit, warehousing, clearance, valuation, tariff classifications, rules of origin and related issues. finally, issues of enforcement, offences and appeal procedures are discussed. Chapter nine deals with stamp duties that will mainly focus on the concept of stamp duty, its development in and outside Ethiopia, the governing legal regime, the power to levy and collect stamp duty, chargeable instruments, applicable rates, modes of valuation, time and manner of payment, exemptions, consequences of delinquency, and the need to rethink e-stamping. Chapter ten is devoted to property tax and it discusses the concept, justifications and theories of property taxation. It explores the historical developments of property taxes in Ethiopia and the world, issues in allocation of the power to impose, collect and use property tax; and explanation of issues in designing property tax law and property tax administration. This chapter is prepared in a way it better informs the ongoing property tax reform in the country. Chapter eleven addresses the rules of Ethiopia on tax administration including the fundamentals of tax administration, the rights and duties of the taxpayers and officers, institutional aspects of tax administration, taxpayer's identification and registration, tax representatives and agents, tax declarations, tax assessments and advance rulings. Chapter twelve, which is the last chapter of the book, deals with the issues of international taxation. The topics covered under this chapter include;

international tax meaning and development, sources of international tax law, jurisdiction issues, double taxation, treaties, tax planning, transfer pricing, the tax aspects related to the WTO and taxation in the digital age.

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The book is highly desk research and much of the discussions are derived from the different published and unpublished works, texts of laws, and court cases. Yet, we are solely responsible for any errors and opinions in the texts.

Chapter One

An Introduction to Taxation and Tax Law

Introduction

It's only after one gets a clear idea of taxation and tax law that he/she can easily follow and understand the subsequent chapters. This chapter thus explains what tax is, what makes it different from other levies, what justifies taxes, and the various types of taxes? In order to let readers understand the general context, the chapter will start by introducing what public finance is, why the government needs to intervene in the economy, why the government needs revenue and how tax is the main source of government revenue. Section two will cover the concept of taxation and tax revenue, the history of taxes, theories justifying taxation, the principles of a good tax, the classifications of taxes, the purposes of taxation and the concept of tax law.

1.1. The Meaning of Public Finance

Public finance is the branch of economics that deals with the role of the government in the economy. It is the systematic study of the revenue and expenditure of the government or public authorities and the adjustment of one or the other to achieve desirable effects and avoid undesirable ones.[1]Generally, the effects of government expenditure, public borrowing, the impact of taxation and deficit financing on the economy comprises the subject matters studied by public finance. Further, it also deals with fiscal policies which ought to be adopted to achieve certain objectives such as price stability, economic growth, and more equal distribution of income.

1.2 The Economic Role of the Government

The extent of the economic role of the government has been and will always be contentious. Over the years and in different countries there have been different views on the role that governments should play in the economy. Some people believe that governments are involving excessively in the economy of the society while others expect them to do more.[2] Many others expect governments to solve problems they believe to be important to them but would rather not

[1]Ishwor Thapa, Public Finance, Concept, Definition, and Importance for a Country's Development, research gate, 2020, pp.1-8

[2]David N. Hyman, Public Finance, A contemporary Application of Theory to Policy, Cengage Learning, 10th Edition, 2011, P.3

have them engage in activities that benefit others. No matter what our view of government, it is clear that its functions and scope have grown considerably from a small share of the economy in the past to a large share of the economy in modern times. Individuals are sacrificing substantial amounts of their income each year to pay the taxes necessary to finance government expenditures. Governments do not have a uniform role in the economy in all jurisdictions too. Though in our past and current world there existed different types of governments, none of them are the exact matches of the government structures discussed in the literature though they share substantial similarities either of them. Some of the major views on the economic role of governments are discussed below.

I. Individualistic (mechanistic) View of the State

The individualistic view is also known as the mechanistic view. According to this view, the government or the state is created by a collective of individuals to serve the interest of the individuals. Rosen claims that Government is a trust, and the officers of the government are the trustees, and both the trust and the trustees are created for the benefit of the people.[3]He argues that individuals are at the center stage whereas the government can be demolished or changed if it fails to serve the interest of individuals.[4] According to this view, groups including democratic majorities cannot impose their rules on individuals or minority groups.[5]

II. Organic View of the state

This view was the dominant view in societies that have strong national links and common history and traditions.[6]Pluto was the earliest thinker who introduced this theory by comparing the state to "A" and an individual to "a" and called the state a magnified individual. Aristotle also held the same view with Plato as he drew an analogy between a human body and a state. The theory was further developed by Cisero and later on by Thomas Hobbs.[7] Nevertheless, the organic theory is severely criticized for several reasons. Among the

[3] Rosen, Harvey S., Public Finance, 7th edn (New York: McGraw-Hill/Irwin). 2005.
[4] Ibid
[5] Vito Tanzi, Advanced Introduction to Public Finance, Edward Elgar Publisher, 2020, P. 34
[6] Ibid, P. 36
[7] Thomas Hobbes, Leviathan, Edited with an introduction and Notes by J.C.A. Gaskin. Oxford's World Classics, Oxford University Press, 1996

criticisms is the theory makes individuals completely subordinate to the state as if they can't have separate existence; it contradicts the rule of democracy and liberty; is against the social contract theory and makes the state a totalitarian state.[8] According to this view, society is similar to an organism. The country is treated as an organic whole similar to the human body.[9] In this case, an individual can play a role only as part of society. This view does not recognize an individual as a separate entity from society.[10] This view does not allow individuals to have separate goals.[11] Rather only the state can decide what is best for members of the society and individuals as members of the society are expected to act according to what they are ordered by the state. Hence, there is nothing the individual keeps for themselves away from the state as the state can take whatever it wishes from its members. This view considers national goals more important than the goals of individual citizens.[12]

III. Paternalistic View of the State

The Paternalistic view is an Italian version of the organic view. The concept originated in the late nineteen century as an implied critique predicated on the inherent value of personal liberty and autonomy positions elegantly outlined by Emanuel Khant in 1785 and John Stuart Mill in 1859., The theory become a topic of extensive philosophical debate with the publication of Gerald Dworkin's article in the context of criminal law in 1971.[13] According to this view, the state has the mandate to make some important decisions, even if the decisions may go beyond the wishes of the majority of current voters.[14] Under this view, it is believed that the policymakers sometimes know what is good for the country and the society better than the average citizen just like what the father knows best for his children.[15]The paternalistic view enables governments to implement policies that restrict the choice of individuals in their own interest and without their consent. In state paternalism, governments are allowed to

[8] W.H Manwaring, Organic View of the State, The Scientific Monthly, Vol. 47, No. 1, 1938, pp. 48-50
[9] Rosen Harvey S. and Ted Gayer, public Finance, 8th edition, Macgrew Hill education Publishing, 2008, P. 2
[10]Johansen Leif, The Theory of Public Goods, Misplaced emphasis, Journal of Public Economics, Vol. 7, No. 1, 1977, 147-152
[11]Ibid
[12] Veblen, The Dynastic State: The Case of Germany, 1948, PP. 547–72
[13] Ronald Dworkin, Taking Rights Seriously, Harvard Law Review, 1971.
[14] Vito Tanzi, Supra Note 5, P. 36
[15] Ibid, p. 36

intervene in citizen activity within their jurisdictions to promote, modify, hinder and/or eliminate that activity with the justification that such intervention is for the benefit of the individuals, groups and the whole society.[16]Dworkin in his article explained paternalism as "the interference with a person's liberty of action justified by reasons referring exclusively to the welfare, good, happiness, needs, interests or values of the person being coerced.[17] This theory is criticized for denying the humanity of individuals and for failing to recognize the capabilities of individuals of acting in their own best interest and restricting personal freedom.[18]

IV.The Practice

Whatever the view or type of government is in place, however, there is a growing consensus that governments must play a key role in any economic system. Even in the most liberal and individualistic states, the involvement of the government in the economy has been unavoidable.[19] People tend to ask questions as to why in a free market economy governments involve. Should the government play an economic role in such an economy? If the government must play an economic role, what role, and how big should it to be? The following sections tend to address these and related questions.

1.3 Reasons for Government Participation in the Economy

I. The need to provide Public Good**s:-** In a free-market economy, the market is expected to provide goods and services needed by individuals. However, there are goods and services needed by individuals that a free market cannot provide. The nature of these goods and services obliges that only the government can provide them. Protection against foreign aggression for instance cannot be accessed from the market since only a government institution can do that. The private market does not also provide city streets, city lights, canals, and other major infrastructures.[20] These goods which cannot be provided by the private

[16] Ian Berle, State Paternalism and Autonomy, in Ian Berle (eds), Face Recognition Technology, Law Governance and Technology Series, Vol. 41., 2020, pp 125–146
[17] Ronald Dworkin, Supra Note 13, P. 36
[18] Lindsay J. Thompson, Paternalism, available at https://www.britannica.com/contributor/Lindsay-J-Thompson/9433345, last accessed on June 16, 2022
[19] Laurence S. Seidman, Public Finance, Mcgraw Hill Publisher, 2009, PP. 8-22
[20]Samuelson Paul Anthony, The pure theory of public expenditure, Review of Economics and Statistics, 37, 1954, pp. 387–9.

market are called public goods. Public goods are not capable to be provided by the private sector efficiently due to two reasons. These are the non-excludability and non-rivalness nature of the goods.[21]

II. The Need to Provide Merit Goods**:-** Musgrave argues that merit goods/services are goods/services that society might need to encourage for the sake of the public interest, although they do not have the character of public goods.[22] He added that some goods or services were so meritorious (or demeritorious) in certain situations as to consider abandoning the principle of consumer sovereignty[23]. They are goods that the public sector provides free or cheaply for the government need to encourage their consumption. Merit goods are those goods and services that the government feels that people will under-consume, and which ought to be subsidized or provided free at the point of use so that consumption does not depend primarily on the ability to pay for the good or service. They are goods that are deemed to be socially desirable, and which are likely to be under-produced and under-consumed through the market mechanism. The unique characteristics of merit goods are generating positive externalities, creating an unequal distribution of income, lack of perfect information by consumers and the possibility of monopoly. Examples are free health services, free education, low-cost housing, etc.

III. The Need for Redistribution**:-** Musgrave defines distribution as anything the government does that affects the distribution of income and wealth.[24] Sometimes the income inequality among individuals might be very high even though the market and resource allocation are perfect.[25] This situation requires the government to intervene by taxing the reach and transfer the revenue to the poor. Hence, the government can intervene in the economy to make redistribution when the income gap between the poor and the rich is high.

IV. The Need to Correct Market Failure:- The fundamental and the dominant view is that markets regulate themselves through the supply and demand interaction. However, it is gradually recognized that markets are not perfect as market failures might occur. Hence, the need arises for a government

[21] Toshihiro Ihori, Principles of Public Finance, Springer publishing, 2016, P.2
[22] Musgrave Richard, The Theory of Public Finance (New York: McGraw-Hill Book Company), 1959, P.13
[23]Ibid
[24] Ibid
[25] Toshihiro Ihori, Supra Note at 21, P.3

intervention when market failures happen. The situations that may cause market failure include; monopolies, missing markets, information asymmetry, positive externality and negative externality.[26]When the market fails to produce relevant goods and services or fails to produce them in a satisfactory quality and/or, or when it produces unwanted goods and services or produces too many goods with harmful spillovers, then the need arises for the government to intervene so as to reinstate the economy into normal conditions.[27]

Hence, to carry out the functions of the government, the government needs public revenue. One of the most important sources of revenue for the government is tax revenue which is the subject of discussion in this chapter. The following sections will try to explain the meaning, relevance, nature, theory, principles, classifications and purposes of taxation and taxation law.

1.4 Understanding Taxation and Tax revenue

Taxes are enforced proportional contributions from persons and property levied by the lawmaking body of the state by virtue of its sovereignty for the support of the government and all public needs Tax is the most dependable source of revenue for any government. It is an ancient and omnipresent concept that forms one of the central pillars of major civilizations. Mills contends that:

> *It is one of the empirical certainties of history that no structural society has ever arisen without taxation. The power of taxation is one which is particularly liable to abuse … but without that power no Government … is possible. 'The power to tax is the one great power upon which the whole national fabric is based. … It is not only the power to destroy but the power to keep alive.'*[28]

Taxation plays a significant function in society since it has the capacity to impact the lives of everyone. Benjamin Franklin, a famous American President, once said that in this world nothing is certain except death and taxes.

Nevertheless, when we come to defining tax, it is difficult to get an all-inclusive definition due to the multidisciplinary and complexity of the subject. Tax is a concept you may know very well but that you cannot define. Many of us do not

[26] Vito Tanzi, Supra Note at 5, P. 25-30
[27] Holley H. Ulbrich, Public Finance in Theory and Practice, 2nd edition, South Western College Publishers, 2003, P. 7
[28] Stewart Mills, Taxation in Australia, Macmillan Publisher,1925, P. 1

understand taxation though it affects all our lives on a daily basis. Several attempts have been made to define the term taxation by many scholars though the definition of most of them is not exhaustive and satisfactory. Some of the definitions are discussed below. Despite efforts by many to define it, the concept of “tax” doesn’t have a universally accepted definition and therefore is not possible to exhaustively define it. But it is only possible to discern some common elements with respect to it. This seems the reason why most jurisdictions do not define the term tax. While we can understand that concept of “tax” does not have a universally accepted clear-cut definition and therefore is not possible to exhaustively define it; it is nonetheless possible to provide some common characteristics. The following are the common elements of “tax” as determined by various writers;

They are obligatory (enforced) contributions**:-**Payment of taxes is in not based on the consent of the person taxed. While individual consent is not an element; there might be an element of collective consent through a democratic process. Imposing taxes on individuals, properties and/or rights is the inherent power of the state for the purpose of generating revenues for public purposes.

They are usually payable in the form of money:- Taxes are paid usually in the form of cash, though in the past they were paid in other forms such as forced labor and currently the law may sometimes allow payment in kind. The reason why tax should generally be paid in the form of cash is liquidity. The Government needs cash for its operation (to pay employees, etc.). Another reason is valuation. Money has a value certain on its face; whereas, real or personal property still needs appraisal and its market value may fluctuate.

They should be progressive, as much as possible, in nature**:-** Taxes are calculated following a widely accepted principle of apportionment which is usually based on the ability to pay. It is an agreed idea that payment of taxes must be based on the “ability-to-pay” principle; thus, the higher the income of the taxpayer, the bigger the amount of the tax paid. Nevertheless, in practice, this may not be always true since governments apply taxes that are contrary to the ability-to-pay principle due to efficiency gains from the regressive taxes.

They are levied on persons, property, rights, acts, privileges, or transactions. The legislator, through its plenary legislative power, can choose with almost unlimited discretion the subjects and tax base of taxation. In fact, courts cannot inquire into such discretion unless there is a violation of the inherent and constitutional limitations of taxation.

They are levied by the State which has jurisdiction or control the subject to be taxed. Any tax must have a firm basis in law as it should be levied by the law-making body of the state.[29] The power to tax is a legislative power. In other words, although taxation is an inherent power of the state, it is exercised through law. Although the State has the right to levy taxes; its implementation must obtain the consent of the people through legislation. In other words, the tax must be imposed by a legitimate body authorized by the people to impose taxes and should be accountable to ensure that taxes are not levied in a manner that violates fundamental human rights.[30] For a given charge to be regarded as a tax, a levy must be exacted under legislative authority assessed and collected either by the government itself or by an institution carrying out functions of a public nature and 'intended for a public purpose.[31]The power to tax is peculiarly and exclusively legislative means any taxing power cannot be exercised by the executive or judicial branches of the government except in cases of a legally permitted delegation from the legislature.

They are paid without any reciprocal service from the government or *quid pro quo***.** In other words, individuals are obliged to pay taxes without being entitled to get services or goods in proportion to the value of the money they pay to the tax officials. This, however, does not mean that the government is not expected to deliver services to the public. In fact, the government carries out numerous functions for society as a whole. But the services provided are not necessarily in proportion to what individuals pay and they cannot claim direct services as a matter of right.[32]

[29] Victor Thuronyi, Tax Law Design and Drafting, Vol.1. International Monetary Fund, 1996, P.3

[30] Ibid

[31]M. Bowler Smith and H. Ostik, Towards a Classification of the Central London Congestion Charge as a Tax, British Tax Review, Vol – No-. 2011, P. 487– 508.Cited in Monica Bahandary, Philosophical Foundations of Tax Law, Oxford University Publishing, 2017, P. 9

[32]According to the Australian Treasury, a core characteristic of a tax is that there is no clear and direct link between the payment of the tax and the provision of goods and services to the taxpayer. The funds that the government raises from taxes may be used to provide goods or services to the community as a whole, and this may provide a benefit to the taxpayer, but the payment will still be considered a tax if there is no direct relationship between the amount of the payment and the benefit to the taxpayer.

1.5 History of Taxation

The history of taxation dates to the days of ancient civilizations and it has been a part of much of the human recorded history.[33] The world history of taxation might be divided into the ancient, the dark & middle-age, and modern eras of taxation. The world's earliest civilizations of the Greeks, the Mesopotamians, the Egyptians and the Sumerians used to collect taxes on their subjects and use the money collected to finance military operations, public services and maintain key strategic reserves of food stocks, gold to mention but a few.[34]Some traced the earliest recorded evidence of taxes back to 4000 BC when the Sumerians of southern Mesopotamian civilization were imposing taxes.[35] For instance, an inscription on a clay cone reads that" You can have a lord you can have a king, but the man to fear is the tax collector."[36] The cuneiform inscribed on clay tablets reveals that taxes in the forms of gold, animals, and slaves were paid to the temples.[37] The earliest and most familiar type of taxation in ancient Egypt, Mesopotamia, Greece and other places was the corvée, which was a kind of enforced labour and providing construction works for the state by giving military service and mainly to the poor.[38] The other common method of paying taxes was done through a tithe of crops harvested on land or other kinds of production.[39] The tithe was a payment made in kind as a proportion of agricultural produce and other products.[40]

In the ancient city-states of Athens and Rome, revenue from the land was supplemented with indirect taxes like customs duties and sales taxes. Customs duties were imposed at the ports and sales taxes were levied at the markets for

[33]S. James, Self-Assessment and the UK Tax System (The Research Board of the Institute of Chartered Accountants in England and Wales, 1995, 11–1

[34]Musonda Kabinga, Principles of Taxation, Jesuit Center for Theological Reflection, 2016, P.3

[35]Hanneke Du Preez, A Construction of the Fundamental Principles of Taxation, University of Pretoria, Phd dissertation Unpublished, 2015, P. 49

[36] Adams C., For Good and Evil: The Impact of Taxes on the Course of Civilization, Second edition, Lanham, MD Madison, 2001, P 1; cited in Hannake Preez's dissertation A Construction of the Fundamental Principles of Taxation, University of Pretoria, Phd dissertation, 2015.

[37] Stephen Smith, Taxation, a Very Short Introduction, Oxford Publisher, 2015, P.4

[38]Burg D.F, A World History of Tax Rebellions, An Encyclopedia of Tax Rebels, Revolts, and Riots from Antiquity to the Present, New York and London: Routledge. 2004, P.XI; Cited in Jane Frecknall, The Theory Principles and Management of Taxation, 2017.

[39]Jane Frecknall, The Theory Principles and Management of Taxation,. Oxford Publishing, 2017, P.7

[40]C. Webber & A. Wildavsky, A History of Taxation and Expenditure in the Western World 44, Simon & Schuster, 1986, P.43 Cited by Allan Schenk& Oliver Oldman in his VAT, A Comparative Approach, 2007, P.2

goods that arrived by land.[41] Customs duties (*portoria*) which were levied by Roman kings during the 7th century BC, were reintroduced together with a broad-based excise tax by Emperor Augustus in the Roman Empire and brought to Britain by the Romans up on its conquest.[42]

Later on by the end of the 1st century BC, the Roman Emperor Augustus implemented a radical reform to the system of taxation of Rome by substituting the existing taxes in the form of a fixed property levy and a head tax (poll tax) to be levied on the provinces.[43] The end of the Roman Empire was marked by the return to the rudimentary forms of taxation of the tithe and forced labour until the beginning of the era of enlightenment.

The modern age, which began in 1500, was marked by the emergence of strong kings who were absolute and who have centralized administrative controls.[44]Spain, which had one of the largest empires at that time, had introduced several kinds of taxes one of which was the "alcabala".[45]Alcabala, which was a tax on all property, was the most hated tax. Because of its unpopularity as it was severely criticized for being responsible for damaging the economy of Spain.[46] As a result it was widely resisted.[47]Finally it was demised in 1845.[48] During the middle ages, governments who were desperate for revenue had introduced taxes on consumption like food and beverages and luxurious commodities; direct taxes on income; direct taxes on land and taxes on monopolies.[49]In Britain, during these periods window tax was introduced.[50]Later on, a subsidy on goods and land and a "Dangle", a tax on land based on the amount of land held by individuals, was levied in England

[41]Ibid
[42]Stewart Mills, Taxation in Australia, Macmillan, 1925, 1, PP. 3-4
[43] Stephen Smith, Supra Note at 37, P.5
[44] Seligman, Income Tax, New York, Macmillan Publishing, 1914, P. 5
[45] Cipola C, the Economic Decline of Empires. London, Methium, 1970, P.20
[46] Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nations, 1937, PP. 850-851. Alcabala is a type of tax which is levied on the sale of any type of property and it is repeatedly imposed every time the commodity changes hands.
[47] Cipola C. Supra Note at 45, P.20
[48] Richard D. pomp, Turn over taxes, their origin, Fall from grace, and Resurrection, 40. Journal of State taxation, 23, 2021; available at https://ssrn.com/abstract=409330, last accessed on June 10, 2022
[49] Webber and Wildavisky, A History of Taxation and expenditure in the Western World, New York, Simon and Schuter Publisher, 1986, P. 21
[50] Adams C., For Good and Evil: The Impact of Taxes on the Course of Civilization, Second edition, Lanham, MD Madison, 2001, P. 6

during the early middle ages.[51]Later on, another type of tax, called "Ship Money" was introduced in the early 17th century by the Stuart Kings.[52]This tax was a medieval tax levied intermittently in the kingdom of England and it was assessed on the inhabitants of coastal areas.

During the second half of the eighteenth century, unfair and burdensome taxes often led to a revolution in various countries including France and USA. Remarkable developments in the complexity of taxation and in the scale of tax revenues took place after the era of enlightenment in all industrialized countries resulting in the rapid industrialization and democratization that swept Europe in the 19th and 20th centuries.[53] Following the revolutions and the enlightenment scholars, who debated and formulated principles and theories to establish fair and equitable tax systems, governments of many countries began introducing taxes that were not oppressive and acceptable to the people.[54]

1.6 The History of Taxes in Ethiopia

Due to the lack of recorded history, the exact period whereby taxes began to be levied in Ethiopia is not well-known. Generally, the Ethiopian tax history can be grouped into three phases the pre-1941 period, the 1941-2002 period, and the post-2002 period.

It is estimated that a system of taxation in Ethiopia began during the era of the Ancient Axumite Kingdom in the form of tithe and forced labor contribution.[55]The pre-1941 system of taxation was mainly related to the land tenure system and was widely viewed as an arbitrary, abusive, and subjective tax system. Taxes were paid in kind or in the form of forced labour. In the words of Gebrehiwot Baykedagn, Ethiopian taxation during the earliest times was imposed in kind and was numerous.[56]Peasants, hunters, handicraftsmen, traders and so on used to pay taxes on whatever commodities they

[51] BEV Sabine, A History of Income Tax, George Allen &Unwin, 1963, P. 12.
[52] Ibid
[53] Stephen Smith, Supra Note at 37, P.5
[54]Hanneke Du Preez, A Construction of the Fundamental Principles of Taxation, University of Pretoria, PhD dissertation Unpublished, 2015, P. 64
[55]Fasil Nahum, Constitution for A Nation of Nations; The Ethiopian Prospect, Lawrenceville NJ, Read Sea Press, 1997, P. 215.
[56]Gebrehiwot Baykedagn, State and Public Administration, Commercial Printing Press, 1925, P.12

possessed.[57]Eshetu Cholle described the tax system of ancient Ethiopia (the Gabbar system) as more of a system of tribute than a system of taxation.[58]The pre-1941 system of taxation persisted until the subsistence nature of the economy and the lack of a well-developed monetary system made the system unworkable.[59]

The second phase of the Ethiopian tax history witnessed some major developments. The first attempt to introduce a modernized tax structure was in 1941 after the end of the Italian Occupation. A land tax was issued in 1943 prior to the 1944 modernization attempt.[60]The first modern income tax was also adopted in 1944 with three schedules in it.[61]From 1941-1944 a comprehensive reform of different taxes including excise tax, wholesaler's sales tax, and customs duties was undertaken. An education tax in 1947 and health tax in 1959 were added to the already growing pool of taxes. In this way, tax laws proliferated from time to time one replacing or amending the other. The Ethiopian tax system laid a base for its present status during the period 1941-2002.

After the comprehensive reform of 1941-44, fragmented reforms were common until a comprehensive reform of 2002 took place which introduced new taxes such as the value-added tax, turnover tax and which completely changed the existing income tax, excise tax and customs duties. After the 2002 comprehensive reform, fragmented reforms were restored.[62]Comprehensive reform is a type of reform that makes a sweeping reform to the existing tax system by making a major change to the existing taxes which extends to introducing new taxes.

1.7 Theories Justifying Taxation

The first step to encourage citizens to comply with their tax obligation towards the state is making awareness for taxpayers of the reasons and justifications as

[57] Richard Pankhurst, Tribute, Taxation and Government Revenues in Nineteenth and early Twentieth Century Ethiopia, Part I, Journal of Ethiopian Studies, Vol. 5, No. 2, 1967, pp. 37-87
[58]Eshetu Cholle, Towards a History of The Fiscal Policy of the Pre- Revolutionary Ethiopian State, Journal of Ethiopian Studies, Vol. 17, 1984, PP. 88-106
[59] Ibid
[60] Ibid
[61] Tadesse Lencho, Towards a Legislative History of Modern taxes in Ethiopia,(1941-2008), Journal of Ethiopian Law, Vol. XXV No. 2, 2012, p. 13
[62] Ibid

to why the state needs taxation and why individuals should pay taxes. Edmund Bruke holds the view that "*To tax and to please, no more than to love and to be wise, is not given to men*."[63] Nevertheless, obliging individuals to pay taxes after awaring them of the necessity and relevance of paying taxes is much better than taxing them blindly. Unfortunately, the justification for taxation is one of the most neglected topics.

A handful of theories trying to justify taxation have been formulated by economists, Some of the major theories of taxation include; an emergency levy theory, the benefit theory, the social contract theory and the sacrifice theory (minimum sacrifice theory and equal sacrifice theory). These theories are explained in detail below. The contemporary literature seems to combine these theories altogether to justify the taxation rights of the government.[64]

I. The benefit or the cost of service theory

This implies that all individuals should contribute to the state from which they receive protection and benefits; the benefits principle of taxation was a widely recognized principle in the past. The Benefit theory of taxation historically originated from the social contract theory from the leading proponents of the theory such as John Lock and Thomas Hobbs.[65] For instance, the British philosopher, Thomas Hobbes, reckoned that "the equality" of taxes depends "not on the equality of riches but on the equality of the debt that every man owes to the commonwealth for his defense.[66] Adam Smith was also known for his support of the benefit theory since he explains that "the subjects of every state ought to contribute… *in proportion to the revenue which they respectively enjoy under the protection of the state,"*[67]*But it is not clear whether Adam Smith is an advocator of Ability-to-pay principle or the benefit principle as both cannot be realized at a time.* Benefit-based theory of taxation has been at the forefront when local taxation is practiced and is frequently used in the theory of

[63]Edmund Burke, Speech of Edmund Burke, Esq., on American Taxation,‖ in Select Works of Edmund Burke. A New Imprint of the Payne Edition, ed. E. J. Payne Indianapolis, IN: Liberty Fund, 1999, 1:149.

[64] Pasquale Pistone, et al, Fundamentals of Taxation; an Introduction to Tax policy, Tax Law and Tax Administration, IBFD, 2019, p.5

[65] Richard A. Musgrave and Peggy B. Musgrave, Public Finance in Theory and Practice, McGrew-Hill Book co, 1989, PP. 219

[66] Thomas Hobbes, Leviathan. Edited with an introduction and Notes by J.C.A. Gaskin. Oxford's World Classics. Oxford University Press. 1996, p. 229

[67] Adam Smith, Supra note at 46, P.777

public finance for sub-national governments.[68] Nevertheless, several criticisms are forwarded against this theory. This includes the difficulty of measuring the benefits received by individuals; the burden will be high on the poor; the indivisible nature of the benefits provided by the state and the effect on income distribution will be negative.[69]

II. The social contract theory

The founding fathers of this theory were Tomas Hobbs and John Lock who discussed the social contract theory in detail in his book titled Leviathan. Locke's social contract theory tried to legitimatize the imposition of taxation through voluntary alienation of individual rights in exchange for state protection of individuals 'property.[70] According to this theory, all must contribute to the greater good of the community. The Views of both Lock and Hobbs can be taken as a benefit-based view of taxation. Nevertheless, there are differences between the two writers. While Hobbes considers taxation as the price paid for a security, Locke regards consent as the only reason why a person's property might be appropriated for common use. According to John Locke, open consent by the owner is a prerequisite for a government to apply taxation on individuals: government powers', including the power to tax, has *its Original only from a pact* and Agreement, and the mutual consent of those who make up the Community.[71]

III. The sacrifice (Equal, Proportional and Minimum sacrifice) theory

The sacrifice theory is a derivative of the ability-to-pay theory. According to this theory, all individuals should contribute in accordance with the wealth they generated (the precursor to progressive tax rates) in order for the state to redistribute (to some extent) that wealth.[72] Sacrifice theory has at least three variants; Viz, Equal, Proportional and Minimum sacrifice theories developed by economists through time. Below, we will see them in brief.

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[68] Robert Scherf and Mathew Weinzierl, Understanding Different Approaches to Benefit-Based Taxation, Fiscal Studies, 2019, pp. 1-26

[69] Knowledge team, the Benefit Theory of Taxation and its Limitations; available at https://www.knowledgiate.com/benefit-theory-of-taxation/, last accessed on May 25, 2022

[70] Jane Frecknall, Supra Note 39, P.22

[71] Locke, John. Two Treatises of Government, Edited with an Introduction by Peter Laslett. Cambridge: Cambridge University Press, 1988, P. 382.

[72] Elmer D. Fagan, Recent and Contemporary Theories of Progressive Taxation, The Journal of Political Economy, Vol.16, No.4, 1938, pp. 457-498

I. Equal (Absolute) Sacrifice Theory:- John Stuart Mill was known for advocating the equal sacrifice theory which said "Equality of taxation, therefore, as a maxim of politics, means equality of sacrifice".[73] The equal-sacrifice theory says that the tax must take away such amounts that the resulting pressure or the sacrifice of enjoyments may be relatively proportional.[74]In other words, taxes should be so levied in a manner that needs every taxpayer to give up the same absolute amount of utility as every other taxpayer**.**[75] According to this theory, a dollar of a tax falls more lightly on a rich man than a poor one. Hence, the rich must pay taxes at a higher rate than the poor man so that the sacrifices that the rich and the poor man made become equal.[76] Economists assume that the level of satisfaction (usually known by the term marginal utility) of each additional dollar decrease as the income of a person increases. This leads the "equal-sacrifice" theorists to propose a higher tax imposition as income increases so that everyone shares the same proportion of the cost of the common burden.[77] The Equal Sacrifice Theory is considered by many as one of the basic concepts of distributive justice despite a handful of criticisms against it.[78] Though his theory is no longer the dominant view of fairness, it continues to be a familiar topic of discourse within the public finance and social welfare literature.[79]

II. Equal Proportional Sacrifice theory**:-** According to this theory, each taxpayer should give up the same proportion of the total utility of his income.[80]This theory holds that higher-income individuals should be burdened with a greater sacrifice than lower-income individuals in absolute terms but in proportion to their income.[81]

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[73]Mill, John Stuart, Principles of Political Economy, Longmans Green & Co., London, 1848, p. 28

[74] E.R.A Seligman, Progressive Taxation in Theory and Practice, American Economic Association Quarterly, 3rd Series, Vol. 9, No. 4 , 1908, pp. 1-334

[75] Elmer D. Fagan, Recent and Contemporary Theories of Progressive Taxation, The Journal of Political Economy, Vol.16, No.4, 1938, pp. 457-498

[76] H.P Young, Progressive Taxation and The Equal Sacrifice Principle, Journal of Public Economics,Vol.32, 1987, pp. 203-214

[77] Ibid

[78]Ok EA, On the Principle of Equal Sacrifice in Income Taxation. J Publication Econ.58, 1995, pp. 453-467

[79]Young HP, Equal Sacrifice and Progressive Taxation, Amer Econ Rev 80, 1990,: 253-266

[80] Elmer D. Fagan, Supra Note at 72

[81] Kendrick M. Slade, The Ability-to-Pay Theory of Taxation, The American Economic Review, vol. 29, No. 1, 1939, p. 93

III. Minimum/Least Sacrifice Theory:- The founder of the minimum sacrifice theory is Jeremy Bentham. He is well known for his utilitarian theory. According to this theory, the sum of the areas of utility sacrificed, both directly and indirectly, by all taxpayers "shall be as small as possible in proportion to the revenue secured.[82]This theory purports to impose a lion's share of the tax burden on the rich as it advocates for an excessive kind of progression, approximating to, if not actually attaining, a state of socialistic equality.[83] The minimum sacrifice theory aims to distribute tax burdens in a way that enables the group to suffer as a minimum sacrifice as possible.[84]

1.8 Principles of Taxation

By the principle of taxation, we mean the characteristics or qualities that must be taken into consideration when designing any tax rules for the tax systems to be good enough. Various writers have used different names referring to the criteria of taxation. While some writers call them "criteria," many others use the expressions like "principles," "canons" or "maxims.[85] The problem however is that there is a tradeoff among some of those principles. Historically, the first person who coined the principles of taxation was Adam Smith. Adam Smith 1776 in his book called the Wealth of Nations outlined four principles of any tax what he called the four maxims that every tax system should follow while designing tax rules in order to have a sound tax policy.[86]These are:-

I. The Principle of Equality/Equity: - The subjects of every state ought to contribute towards the support of the government, as nearly as possible and in proportion to the revenue which they respectively enjoy under the protection of the state.

II. The Principle of Certainty:- The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.

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[82] Elmer D. Fagan, Supra Note at 72

[83]C.B. Bastable, Public Finance, 3rd Edition. London: Macmillan Co. Ltd., 1932, p.127

[84]Elmer D. Fagan, Supra Note at 80

[85]Adam Smith called them "maxims" of taxation; while J. S. Mill," preferred to call them "principles." Richard M. Bird called them criteria; see Adam Smith, the Wealth of Nations, p. 777; Mill, Principles of Political Economy, p. 614; Bird, Tax Policy & Economic Development, pp. 13-14; Bhatia used the term" canons," see Bhatia, Public Finance, pp. 41-43

[86] Adam Smith, Supra Note 46, page 1104

III. The Principle of Convenience**:-** Every tax ought to be levied at the time, or in the manner in which it is most likely to be convenient for the contributor to pay it.

IV. The Principle of Economy:- Every tax ought to be so contrived as both to take out and keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state.

Adam Smith's Principles of good tax policy, although he is reputed to have made a great advance in formulating the principles/cannons of taxation in a manner that has never been done before, are criticized by many as obsolete.[87]Nevertheless, almost all modern economists use Smith's canons of taxation to assess the tax systems of different jurisdictions. Apart from Adam Smith's four canons of taxation, modern economists have added more principles of a good tax system. A few of these principles are outlined below.

I. The Principle of Equity (Equality)

The principle of equity holds that taxes must be equitable. Equitability means that taxes must be fair, or just. Everybody agrees on the need for any tax to be equitable. But no one is able to forward an agreeable definition of these terms. Some writers regard "equity" as a fluid concept that depends on many other non-tax factors, such as culture, political influence and the importance of redistribution.[88]As one writer correctly puts it, fairness or equity in taxation, like the fairness of just about anything, involves ethical issues and value judgments that, by their very nature, cannot be decisively resolved.[89] R. Jones defined equitable taxes as those taxes that should satisfy the sense of fairness of

[87]John S. Mill, Principles of Political Economy, with Some of Their Applications to Social Philosophy, London: Longmans, Green and Co, 1909), V:ii:1 (p. 802). Alley and Bentley also forwarded a similar view of the need to revisit and modernize Adam Smith's principles of taxation on the ground that they are seminal in light of modern business practices. The First principle/ cannon of taxation is the most debated principle which is daubed as ambiguous. The cannon of equality though it seems to base tax obligations on the benefit received also suggests tax duties to depend on ability- to pay. This has led commentators to regard it both as ability to pay and benefit based principles.[87] For Murphy, Adam Smith's four canons are outdated because they fail to recognize the obligation of the State to the citizen with regard to the provision of public goods, and relate primarily to the practice of taxation rather than the principles that underpin it.

[88] Pasquale Pistone et al, Supra Note at 64, P. 10

[89]Slemrod Joel and Jon Bakija, Taxing Ourselves, a Citizens Guide to a Debate Over Taxes, 4th Edition, 2008, p. 60

the majority of the community at the time.[90] For the claim that his definition was scientifically unfounded his reply was that there is no measure of what is equitable that any statesman can use except when men consider it equitable.[91]

Equitability has been at the center of attention throughout the history of taxation. There are many reasons that needed any tax system to be equitable. The first one emanates from a moral value that preaches that the appropriate action is any action that treats humans equally.[92]The second justification for making taxes equitable is to encourage voluntary compliance.[93]Moreover, the strong desire by society for the equitability of taxation has forced governments to stick to the principle of taxation.[94]Despite a widespread consensus on the relevance of equity in any tax system, there is no universally agreed method of measuring equity/fairness in taxation due to extensively diverse views on how to gauge the fairness or equitability of a particular tax system and on whether a particular tax system of sufficiently equitable.[95]The problem is that no one can find any objective method to determine who should pay more and how much more the well-to-do must pay.[96]

Equity, or fairness, has two dimensions: Horizontal Equity and Vertical equity.[97] Horizontal equity means people in similar economic conditions should be treated similarly and Vertical equity means people of different economic statuses should be treated differently from those who are better off bearing a greater share of the tax burden. Aristotle was the founder of vertical and horizontal equality who claimed that equals should be treated equally and unequals should be treated unequally.*[98]* Kurt Wise and Noah Berger explain

[90] R. Jones, Fabian Tract 152: Our Taxes as They Are and as They Ought to Be (London: Fabian Society, 1911, P.4

[91]Ibid

[92]Tiley, Revenue Law, p. 10; Torgler, Tax Compliance and Tax Morale, p. 18

[93]Ibid

[94]Tadesse Lencho, the Ethiopian Income Tax System: Policy, Design and Practice, Ph.D. Dissertation, unpublished, University of Alabama, 2014, p. 52

[95] Richard A. Musgrave and Peggy B. Musgrave, Supra Note at 65, PP. 219; See also Commonwealth, Taxation Review Committee (‘Asprey Committee’), Full Report, 1975, 12.

[96] Commonwealth, Taxation Review Committee (‘Asprey Committee’), Ibid

[97]Cooper Graeme et al, Income Taxation: Commentary and Principles. Sydney: Law Book Company, 1989, p. 24. The issue of whether horizontal equity has any independent significance apart from vertical equity remains a subject of debate.

[98]Aristotle, Nicoma chean Ethics, trans. William D. Ross (Oxford university press, 1980), Book 5. Cited in Robert j. Vosslamber’s dissertation taxing and pleasing: The rhetoric and reality of vertical equity in the Development of the New Zealand income tax on employees, 2010, p. 53

that "Horizontal Equity addresses questions of whether or not a tax system makes arbitrary distinctions among taxpayers or distinctions based on irrelevant criteria."[99] Vertical Equity addresses questions of how people at different income levels should be taxed, taking into account their relative abilities to pay.[100] Higher-income earners are expected to be taxed in a large percent of their income than lower-income earners for vertical equity to be realized.[101]

As it is discussed above, despite the fact that equity is the major policy goal of every tax policy, the way to realize it has never been easy for both horizontal and vertical equity. Even though horizontal equity; i.e. persons with similar economic conditions should be treated equally is not contested; its practice is marred with numerous challenges. For one thing, no two individuals are alike economically and secondly, no appropriate base has been found to show the ability of the individuals. The most frequently used criteria to measure the economic status of individuals has been income. Nevertheless, the paying capacity of the individuals might not be correctly known using income as the only base.

As far as Vertical equity is concerned, the consensus is that there should be some degree of progressivity i.e. those with more ability or more money should pay more than those with lower ability. Yet it is one thing to say that those with higher incomes should pay more and another thing to find the how, why, and who. In fact, there are a number of contending views that are suggested to justify progression though two of the theories are notable. These are the ability to pay and benefit principles. The following paragraphs will try to unpack the two principles.

A) Ability-to-pay theory of achieving equity

According to this theory, for a tax to be regarded as equitable, individuals must pay in proportion to what they earn based on their ability to pay. According to this principle, a good tax is one that is based on the principle of equality.

[99] Kurt Wise & Noah Berger, Understanding Our Tax System: A Primer for Active Citizens. Massachusetts Budget and Policy Centre, 2010.
[100] Ibid
[101] Ibid

One of the prominent writers whose name is frequently linked to the ability-to-pay theory is Adam Smith. The following is a direct quote from Adam Smith's book;[102]

> "*The subject of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities, that is, in proportion to the revenue which they respectively enjoy under the protection of the state." Thus, rich people must be subjected to higher taxation in comparison to the poor.He also opined that every individual should contribute according to his abilities so that equality of sacrifice be achieved".*

The "ability to pay principle" which is mostly related to the level of income has a lot of instinctive applicability. Nonetheless, measuring the ability to pay for individuals is fraught.[103] The tax literature has tried to solve that problem by assessing the sacrifice that taxpayers experience when they pay taxes. Accordingly, "equal sacrifice", "proportional sacrifice" or "minimum sacrifice" principles have been some of the proposed alternatives by theoretical literature.

B) The Benefit theory of achieving equity

According to the benefit theory of taxation, Individuals must pay for the benefits they receive from the government in proportion to the benefit they obtain. According to this principle, the more individuals benefited from public services the more they should pay. This principle had been suggested as far back as 1677 by William Perry. This theory presupposes a provision of goods and services by the government to every member of the society for any tax liability. The benefits principle of taxation was a widely recognized principle in the past. One of the leading proponents of this theory was the British philosopher, Thomas Hobbes, who, reckoned that "the equality" of taxes depends "not on the equality of riches but on the equality of the debt that everyman owes to the common wealth for his defense. The benefits principle of taxation has been advocated by those who think that the system of government is a limited contract between citizens who need certain public services and

[102]Adam Smith, Supra Note at 46
[103] Vito Tanzi, Supra Note at 5, P.59

government which has the capacity to provide those services.[104]Davie and Duncombe defined the typical benefit principle of taxes as follows.[105]

> *Taxes are regarded as the prices citizens pay for the goods and services they buy through their government and are assessed on each citizen according to the benefits he directly and indirectly receives. A direct sale to buyers where the government department is making the sale is expected to be self-supporting from revenue represents charging on the benefit principle. The Federal motor fuel excise tax and most state gasoline excise taxes are earmarked for highway construction and maintenance. These taxes are basically assessed on the benefit principle.*

Despite its popularity among well-known writers, this principle is debunked as unworkable and unacceptable in the modern practice of taxation due to various reasons.[106] For one thing, the services and goods provided by the government are public goods that cannot be accurately measured. Sometimes a wealthy person might not have any direct benefit provided but the benefit provided by a police force and army may provide protection for the system that allows for the maintenance of wealth. This benefit is also difficult to measure though it may be proportional to wealth. The other challenge is that public services and goods are non-excludable and nonrival that are provided for everybody's use in spite of any payment on the part of the citizens.[107]The third criticism of the benefit theory is it leads the state to disregard one of its most important duties which is to support the poor through income redistribution using the instrumentality of taxes.[108]

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[104]Tiley, Revenue Law, p. 10

[105]Davie, Bruce and Bruce Duncombe, Public Finance (New York): Holt, Rinehart and Winston, 1972, P.145

[106]Due and Friedlaender, Government Finance, p. 234

[107] Vito Tanzi, Supra Note at 5, P.59

[108]John S. Mill, Supra Note at 87

Longmans, Green and Co, 1909), V:ii:1 (p. 802). See also; Jon Neil, The Benefit and Sacrifice Principles of Taxation: A Synthesis, Social Choice Welfare , 17, 2000, PP. 117-124 See also Mirrlees JA , An Exploration in the Theory of Optimum Income Taxation. Rev. Econ Stud 38, 1971, 175-2008; See also Richard A. Musgrave and Peggy B. Musgrave, Public Finance in Theory and Practice, McGrew-HillBookco,1989, PP. 219

II. The Principle of Certainty

This canon is intended to save taxpayers from unnecessary harassment by tax officials. According to this principle, the time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.[109] A predictable tax system is essential for business planning. Business entities prefer to plan costs well ahead in advance and this includes tax liabilities.[110]Taxes should be certain means that they should not be imposed arbitrarily, and taxpayers should know precisely the amount that they will be paying to the government by the end of the tax period, and also when and how they are going to pay the tax. Taxpayers should not be troubled or made to feel uncertain about what is going to happen to them and the amount of the tax they are going to be asked to pay.[111]

III. The Principle of Efficiency

A tax policy becomes more efficient when it distorts market processes as little as possible since economic agents attempt to limit, avoid and evade tax liability as much as possible.[112]Efficiency is all about the cost on society that the tax policy brings because of its impact on and possible distortion of economic behaviors and the attempt to minimize these impacts and distortions while achieving the societal goals of the particular state.[113] An efficient tax is the one that minimizes the change in behavior which is explained in terms of reducing the distortions that would have happened on individual decision-making due to the imposition of taxes [114]To date, broad-based consumption taxes such as the "modern VAT" are supposed to be the most efficient taxes though there are dissatisfactions amongst the critiques.[115]Nevertheless, Efficiency may not

[109] Adam Smith, Supra Note at 46
[110]Nhekairo, W. A, The Taxation System of Zambia. Lusaka, Jesuit Centre for Theological Reflection, 2014, P.3
[111] Vito Tanzi, Supra Note at 5, P.55
[112]Nhekairo, W. A, the Taxation System of Zambia. Lusaka, Jesuit Centre for Theological Reflection, 2014, P.3
[113] Pasquale Pistone,et al, Supra Note at 64, P.13
[114]Matt Grudnoff, Richard Dennis and David Richardson,Principles of a Good Tax, Evaluating our Taxation Choices, Discussion paper at the Australia Institute, 2021, P.7
[115] Ibid

necessarily be the criteria for evaluating the effectiveness of a given tax when the purpose of the tax itself is to distort behavior.[116]

IV. The Principle of Neutrality

Tax neutrality means that tax should create no advantage or disadvantage with regard to any transaction or investment. Taxation should seek to be neutral and equitable between forms of business activities. A neutral tax will contribute to efficiency by ensuring that optimal allocation of the means of production is achieved. A distortion, and the corresponding deadweight loss, will occur when changes in price trigger different changes in supply and demand than would occur in the absence of the tax. In this sense, neutrality also entails that the tax system raises revenue while minimizing discrimination in favor of, or against, any particular economic choice. This implies that the same principles of taxation should apply to all forms of business while addressing specific features that may otherwise undermine an equal and neutral application of those principles.[117]

V. The Principle of Simplicity

According to this principle, any good tax must be fairly simple for a taxpayer to comply with, for the tax collector to administer and for anyone to be understood without difficulty.[118]The general consensus is that a simple tax system enables individuals and businesses to understand their obligations and entitlements and allows them to make optimal decisions and respond to intended policy choices.[119]Legal simplification is believed to help reduce the costs of taxpayer compliance.[120] It is held that simple tax law can accomplish the twin requirements of being easy to comply with and hard to disobey because it both allows the taxpayer, to be familiar with more easily what is expected from him

[116]Ibid
[117]OECD, Fundamental principles of taxation, In OECD, (Ed.) Addressing the Tax Challenges of the Digital Economy (pp. 29-50). Paris: OECD Publishing, 2014
[118]Ibid; See also Matt Grudnoff, Richard Dennis and David Richardson, Principles of a Good Tax, Evaluating our taxation choices, Discussion paper at the Australia Institute,2021, P.7
[119]Ibid
[120]Henry J. Aaron & Harvey Galper, Assessing Tax Reform 42–44, 1985

and also reduces its manipulability, thereby reducing the chances of tax avoidance.[121] Simplicity, however, can be elusive.

VI. The Principle of Convenience

According to the principle of convenience, taxes should be designed so that the taxpayers are enabled to pay their taxes at a time and in a manner that is most convenient to the taxpayer. The most important advantage of Convenience principles is that it helps ensure compliance with the tax system.[122]

There is no consensus among different writers about the number and type of those additional principles. Indeed, most of the principles listed could be distilled into three or four principles that vary little from Smith's original four. A concluding observation is that an effort to make the tax system equitable by applying one or more of these principles may end up making the tax system very complex and vice versa.

1.9 The Various Classifications of Taxation

In this sub-topic, we will discuss the various ways in which taxes can be classified. Taxes may be classified in several ways based on different mechanisms. The following are the classifications.

I. Central (Federal) and Local Tax

Taxes can be classified as Central and Local taxes based on the type of institution that collects taxes. Central tax is a tax that is imposed and administered by the federal government whereas Local tax is a tax that is levied and collected by the regions and other lower lever governments in a given country. The collection of local tax is conducted by the local government and local revenue will be used for financing the local expenses in conducting the government and development in this area.

II. Direct and Indirect Taxes

Direct taxes are taxes in which the persons who pay the taxes also bear the ultimate burden. Individuals are expected to bear the burden of these taxes and

[121] Victor Thuronyi, Supra Note at 21. P 125
[122] AICPA, Guiding Principles of good tax Policy: A Framework for Evaluating Tax Proposals, Tax Policy Concept Statement 1,2015, P.8

are not able to shift the tax burden to others. In other words, in the case of direct taxes, impact and incidence are on the same person. Indirect taxes are taxes in which the ultimate burden of the tax shifts to other persons or final consumers. In other words, in the case of indirect taxes, the impact and incidence fall on different persons.

A. The Advantages and Disadvantages of Direct Taxes

Direct taxes are considered to have the following advantages.

Direct taxes are Equitable:- Direct taxes are regarded as equitable because they enable us to apply the ability-to-pay Principle, a principle which is widely accepted as a basis for a good tax system. Since they are mostly progressive they are more equitable than the indirect taxes. The ability-to-pay principle can be classified as vertical equity and horizontal equity. Vertical equity is the principle that people with higher incomes should pay more taxes, like increasing marginal tax rates on higher income. Horizontal equity is the principle that people with similar income should pay equal taxes. The alternative to the ability to pay principle is the benefit principle which explains fairness in terms of the benefits people obtain to determine the amount of fair tax that each individual should pay.

Direct taxes are certain:- One of the good qualities of a good tax system is a certainty. Certainty enables taxpayers to be able to know the manner, the time and the amount of tax that is to be paid in advance. On the other hand, direct taxes enable the state to obtain accurate information about the revenue it is going to collect from direct taxes so that it can accordingly plan its financial programs.

Direct taxes create Civic Consciousness:- When the taxpayer directly contributes to the government, he will be very eager to see that the tax money he paid to the government is not wasted and spent unnecessarily. Thus, taxpayers take clever and active participation in the business of the state. Hence, direct tax helps to increase civic consciousness on the part of citizens.

Direct taxes help minimize inequality**:-** Most direct taxes are progressive in that the more individuals earn the more they are taxed. The huge revenue collected by the government in the form of taxes is also distributed to the low-earner

parts of the society. This will reduce the income gap that might exist between the rich and the poor.

The following are disadvantages of direct taxes.

Direct Taxes are Unpopular: Direct taxes are paid directly by the people. Generally, it cannot be shifted. Hence it is painful to the taxpayers. It is more felt by the people and they are more unpopular though they have the parallel advantage of encouraging civic consciousness.

Direct Taxes are prone to excessive tax evasion problems:- It is usually said that direct tax is a tax on honesty. The fact that direct taxes are paid directly from the pocket of the taxpayers and the fact that the taxpayers declare their incomes by themselves paved the way for taxpayers to reduce their income and exaggerate their expenses. This results in little or no tax liability on the part of the taxpayers

Direct Taxes are more Complex than indirect taxes:- The complex nature and tax compliance cost have made is the tax assessment process a daunting task for taxpayers in all direct taxes. Taxpayers usually face difficulty in producing the necessary tax returns and maintaining the proper accounts. Taxpayers are expected to make a daily record of their incomes and expenses, they have to make deductions and arrive at the taxable income. They need to apply the tax rate by themselves. This process is a daunting task which makes the process complex for taxpayers.

Direct taxes have a narrow base:- One of the widely recognized theorems of modern taxation is that the tax base of any tax must be broad as possible. However, the tax bases of direct taxes are usually narrow as they touch up on the smallest sections of the society. In fact, administrative limitations are what make direct taxes narrow-based taxes. A tax base is defined as the total amount of property, consumption, assets, transactions, income, or another sort of economic activity that is subject to taxation. In other words tax base is the income or resource on which the tax rate is applied. The tax base can be either narrow or broad. While a narrow tax base is considered to be non-neutral and inefficient, a broad tax base is known for reducing tax administration costs, allowing for more revenue to be raised at lower rates.

Direct taxes can be arbitrary**:**-To the extent direct taxes depend on valuations of property they can be prone to arbitrariness.

B. The Advantages and Disadvantages of Indirect Taxes

As discussed earlier, indirect taxes are the ones in which the burden can be shifted to others. They are collected on a person who can shift the burden to some other person who will bear the ultimate burden. The most common forms of indirect taxes include the sales tax such as general sales tax, the turnover tax, the wholesalers' tax, the manufacturer's tax, the retailer's sales tax, the value-added tax excise taxes and the customs duties or tariffs. In each case, the person who pays the tax to the government is acting as a kind of intermediary who collects the tax from the actual payer. The following are some of the perceived advantages of indirect taxes:

Indirect taxes are convenient**:** What makes indirect taxes convenient is that they are assessed indirectly by the taxpayer. Indirect taxes are imposed on the production, sale, and movement of goods and services. Taxpayers do not feel the burden of indirect taxes since they are paid in the form of higher prices and when they purchase the commodity or enjoy the services.[123] Moreover, the burdens of indirect taxes are not felt since the tax amount is hidden in the price of the commodity bought.[124] They are also convenient as they are paid in small amounts and at intervals and are not in one lump sum. They are also convenient from the side of the government since the tax amount is collected generally as a lump sum from manufacturers or merchants.[125]

Indirect taxes are elastic**:** Indirect taxes are regarded as elastic because governments can easily increase the revenue from these taxes when there is a need. The simple expedient of raising tax rates accomplishes this. It is easy to increase taxes from demand for inelastic commodities without difficulty.[126] In times of economic development, indirect taxes produce huge revenues to the government.

[123] P.K. Sinha, Indirect Tax Laws, Excel Privet Books Limited, Lovely Professional University, 2012, P.2
[124] Ibid
[125] Ibid
[126] Ibid

Indirect taxes are difficult to evade**:** The reason why indirect taxes have less probability to be evaded is that they are not paid by those who feel the pain rather they are paid by the business persons in the form of withholding. Consumers who are the ultimate bearer of the burden are charged in the form of price. Hence they won't have the chance to evade them as they are not the ones who assess the tax liability. Some types of indirect taxes such as Value Added Tax have an in-built mechanism to prevent tax evasion and avoidance.[127]

Indirect taxes are broad-based: Indirect taxes such as the value-added tax are praised for reaching any economic transaction.[128] This makes them more broad-based than direct taxes. Indirect taxes reach the majority of products and services which are consumed by the general public.[129]

Indirect taxes are less felt than direct taxes: these taxes are usually paid in small bits when goods and services are transacted. Taxpayers do not feel the pain when they pay the tax due to the fact that the taxes are part of the prices of the goods and services they buy and taxpayers are not aware of them since they are included in the prices.

Direct taxes are revenue productive: They enable the government to generate huge revenue by imposing an indirect tax with a lower rate on a broad base. They help the government to collect large money without distorting the economy.

The disadvantages of indirect taxes are the following.

Indirect taxes are regressive:- The hardest thing about indirect taxes is their regressiveness. They are regressive means the low-income group are paying most of the indirect taxes.[130] This leads to the widening of the income gap between the poor and the rich. As the role of the state is to redistribute wealth, indirect taxes will affect this role and play a reverse role.

[127] Ibid
[128] Kathryn James, The Rise of the Value Added Tax, Cambridge Tax Law Series, 2015, P. 7
[129] P.K. Sinha, Indirect Tax Laws, Excel Privet Books Limited, Lovely Professional University, 2012, P.2
[130] Ibid

Indirect taxes are difficult to administer:[131] Since they need to be collected in small amounts from large groups of people, the administrative and compliance costs will be high.

Indirect taxes are uncertain: Indirect taxes are uncertain due to the fact that the total revenue to be collected cannot be estimated accurately. Unless indirect taxes are imposed on necessaries, the revenue yield might not be clearly known. For those goods that have elastic demand, the tax might not bring in much revenue as anticipated.

Indirect taxes do not promote civic consciousness: Since they are collected without the knowledge of the taxpayers, people may not feel the pain and may not feel responsible to control their government.[132] They may not participate in government affairs and hold their officials to be accountable.

Indirect taxes lead to inflation: Since indirect taxes are included in the price of the commodities, they cause an increase in prices. When the prices of commodities are increased, inflation occurs that can exceed the purchasing capacity of consumers.[133]

III. Single tax and multiple taxes

On the basis of volume, taxes are classified as single-stage and multistage taxes. A single-stage tax is a tax that is imposed and levied only at one stage in the process from production to retail level. The lists of taxes that are single-stage include the manufacturer's sales tax, the wholesaler's sales tax, the retailer's sales tax, and the specific excise tax. Multistage taxes include the value-added tax and the turnover tax.

IV. Progressive, proportional, digressive, and regressive

On the basis of method or rate of tax or based on the degree of progression, taxes can be classified as proportional, progressive, digressive and regressive taxes. Professor Taylor is a well-known writer to classify taxes into

[131] Ibid
[132] Ibid
[133] Ibid

Progressive, Proportional, digressive and regressive taxes. He defined each type as follows;[134]

Proportional Taxation**:-** A proportional tax system is the one in which the rate of taxation remains constant as the tax base changes. Seligman defined a tax as a proportional tax when the mathematical relation between the amount of the tax and that of the thing taxed remains the same.[135] For instance, if the tax rate is ten percent, and the income of the person is 100, 1,000 and 10,000 birr, his tax liability will be 10, 100 and 1,000 respectively. Here, the tax rate remains fixed though his income increased. His tax liability increases though the tax rate is constant.

Progressive Taxation**:-** A progressive tax is one in which the rate of taxation increases when the tax base (the income, consumption, or saving) increases.[136]The amount of tax payable is calculated by multiplying the tax base, with the tax rate.[137]For instance, the tax rate to be applied to a certain taxpayer might be increased from 10 percent to 20 percent and then 30 percent when his income grows from 100 Birr, to 5,000 Birr, and to 10,000 Birr respectively. The total tax to be paid will increase exponentially with the increase in income.

Regressive Taxation**:-** A regressive tax rate is a kind of tax in which the rate of taxation decreases as tax base increases. This can occur even though the absolute tax liability of the taxpayer increases. In other words, if the rate of taxation diminishes as the income or property increases, we have regressive taxation.[138] Despite the decrease in the tax rate the absolute tax liability that the person pays might keep increasing. This is due to the larger increase of income. For instance, the tax rate applicable might decrease from 12 percent to 9 percent and 7 percent as his income increase from 10,000 Birr to 20,000 Birr, and then to 30,000 Birr. The taxpayer's tax liabilities will be 1,200, 1,800 and 2,100 Birr. Here, we can see that though the tax rate is declining, the overall tax liability of the person is still increasing.

[134] E.R.A Seligman, Supra Note at 74
[135] Ibid
[136] Ibid
[137] Ibid
[138] Ibid

Digressive Taxation**:-**A digressive tax is a tax in which the rate of tax increases with the increase in income up to a certain level and then becomes constant. The rate may be slightly progressed up to a certain limit and after that, the rate will remain constant. This type of taxation is widely accepted in most tax systems especially for imposing direct taxes.[139]

V. Advolrem and Specific Tax:-

Based on essence taxes are classified as advolrem and specific taxes.

Specific Tax:- A specific tax is a tax of a fixed amount, imposed by the head or number or by some other standard of weight or measurement.[140] It requires no assessment other than the listing or classification of the objects to be taxed.

Ad valorem Tax:- As ad valorem tax is a tax of a fixed proportion of the value of the property with respect to which the tax is assessed. It requires the intervention of assessors or appraisers to estimate the value of such property before the amount due from each taxpayer can be determined.[141]

1.10 Purposes and Functions of Taxation

Taxes are used as the most important source for governments to raise revenue. Without taxation, governments all over the world would be unable to finance their governmental functions and to provide public goods and services to the community. However, taxation does not have fixed goals as they have been varying from time to time, from one tax system to another. Moreover, the functions of taxation depend on the views and value judgments about the economic roles of governments.[142] Different authors suggest their own lists of what they call the functions of taxation. For example, Richard and Peggy Musgrave suggested that taxes play three roles for the government. These are allocation functions whose purpose is the provision of public goods; distribution functions whose purpose is reduce the income inequality between the rich and the poor; and stabilization functions whose purpose is to correct the market defects.[143]

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[139]Ibid
[140] Jane Frecknall Hugh, Supra Note at 39, P. 45
[141] Ibid
[142]Tadesse Lencho, Supra note 94, p.41
[143]Richard and Peggy Musgrave, Supra Note at 65, pp. 3-13

i) The Provision of Public Goods

The main purpose of taxation is to generate revenue so as to cover the expenditure needs of performing various functions. Public goods are goods that cannot be provided by the private market because of their non-excludable and non-rival nature. These goods are needed by society at large. Hence, the government needs revenue so as to provide these goods and the most important source of revenue for any government is Taxation. Taxes as a major source of revenue will enable to provide diverse functions for the society including protection from external aggression by organizing the defense forces, maintaining law and order of the public from internal instability, provision of infrastructures, low-cost supply of meritorious goods such as health, education, water, electricity and so on.

ii) Regulation of Consumption and Production

Regulation of consumption and production is another purpose that can be achieved using taxation. A perfect example of taxation that can be used to regulate consumption and production is an excise tax.[144].Consumption can be regulated in two opposite ways. The first is to discourage goods that are dangerous to health such as alcohol, cigarette, sugar, etc. The government may impose a high percentage tax. The second is to encourage the consumption of goods that are beneficial for a healthy life such as vegetables; the government may lift all taxes and subsidize the producers.

iii) Encouraging Domestic Industries

Infant industries sometimes may not be able to compete with the established industries of the developed world. Due to this reality, developing countries are trying to apply mechanisms that they believe will improve the competitiveness of these infant industries. Taxes can be used to encourage domestic infant industries. This can be done either by imposing high taxes/tariffs on imported commodities or by subsidizing domestic industries from using the government money which is collected in the form of tax.

[144]Sijbren Cnossen, The Economics of Taxation, International Studies Program working Paper, 2010, P.3

iv) Stimulating Investment

Taxes are used to encourage investment activities whose ultimate goal is to encourage economic growth. Governments use taxes in two ways to promote investment. The first is through reduction of tax rates, exemption from taxes, and tax holidays. The second way is by investing the public revenue collected in the form of taxes on infrastructure and by making financial grants and loans.

v) Reducing Income Inequalities (Redistributive Functions)

Taxation can be used to reduce the gap between the poor and the rich and to promote equality. This can be described as a distributional purpose. This goal can often be achieved by establishing state-funded social services, using the money raised by means of taxation.[145]Taxes can play a redistributive effect and promote a more egalitarian society if a given tax system taxes the rich more and gives it to the poor, redistributing wealth among citizens.[146] However, taxes might become counterproductive and might increase inequality than promote equality. Problems might occur if a state benefit system is independent of its taxation system, as it can result in people being taxed instead of being supported.[147]Not all kinds of taxes are effective in reducing income inequality between the rich and the poor. Regressive kinds of taxes such as the value-added tax, sales tax, and customs duties derive the lion's share of the revenue from the poorest section of the society.[148]

vi) Promoting Economic Growth

The view that taxes can be used to promote economic growth has been echoed for a long period of time. Indeed, some people consider tax as a silver bullet for economic growth. For instance, Justice Oliver Holmes reckoned that taxes are the price we pay for civilization.[149]Taxes fund the provision of goods and services that the private sector cannot or will not provide, are of crucial importance in the way we live and provide us with resources to pay for vital

[145] Jane Frecknall, Supra Note at 39, P. 4
[146] Monica Bhandari, Philosophical Foundations of Tax Law, Oxford University Press, 2017. P. 16
[147] Jane Frecknall, Supra Note at 39, P. 4
[148] Action aid, Value Added Tax, Progressive Tax Briefing, 2018, Available at http://www.actionaid.org/, last accessed on June 19, 2022
[149]Compania de Tobacos versus Collector, 275 US 87, 1904, 100

community services such as roads, hospitals and medical care, schools, colleges and universities, defense of the nation, courts, police, museums, libraries, sporting facilities and parks."[150]

vii) Development of Backward Regions and reducing regional imbalance

It is common to see that some regions of a country might be less developed than other regions even though all regions are within a single system of governance. Governments might use taxes to reduce regional imbalances by investing more in the less developed regions and by taxing more developed regions. The imbalance might also be minimized by encouraging more investment flow to the backward regions through tax holidays and rate reductions.

viii) Ensuring Price Stability

Governments can use taxes to stabilize the economy when it is affected by either inflation or deflation. For instance, in times of inflation governments can use money collected from taxes and subsidize the inflated basic goods. Government can also waive taxes on inflated commodities so as to cushion the high inflation. On the other hand, in periods of deflation governments can buy and accumulate the deflated commodities at a higher price using the money collected in the form of taxes.

1.11 Understanding Tax Law

1.11.1 Meaning and Purpose of Tax Law

Tax is regulated by law because it is a universally agreed principle that every tax should have a firm basis in law.[151]That is why laws governing taxes exist in every country. Tax law is the body of rules that governs an individual's liability to pay tax to the government of a given country. It covers the rules that establish the incidence of tax and the tax base (i.e who and what is subject to tax). It also extends to the rules relating to the administration and enforcement of the tax system, including the rules dealing with the collection and recovery of taxes. One of the basic characteristics of tax law is the fact that it restricts the

[150] Brisbane, What We Get for our Taxes', Address to the Taxation Institute of Australia, 26th National Convention, 2011, P. 1
[151] Toshihiro Ihori,Supra Note at 21, P22

rights of private actors and, primarily, property rights considerably.[152] Tax law includes a large number of coercive components, which requires precision in establishing the rights and duties of all relevant actors, as well as clearly established tax procedures.

Tax is a multidisciplinary subject that touches up on several disciplines including accounting, economics, Political science, business, management, sociology, philosophy, and history.[153] This needs the participation of experts from various disciplines during the tax drafting process.

Encyclopedia Britannica defines tax law as "a body of rules under which a public authority has a claim on taxpayers, requiring them to transfer to the authority part of their income or property".[154] As a branch of public law, it determines and limits the activities and reciprocal interests of the political community and the members composing it.[155]Law insider Dictionary, on the other, defines tax law as "all applicable statutes, laws, ordinances, regulations, rules, rulings, orders, restrictions, requirements, writs, inactions, decrees or other official acts relating to the reporting, imposition, rendition, collection, enforcement, or other aspects of the issue of taxes of every kind or character imposed or enacted by a public authority."[156]

1.11.2 Substantive versus Procedural Tax Law

Substantive tax law refers to the design of tax law with reference to the tax and economic policies of a country.[157]More generally it can be said that substantive laws determine who pays taxes whereas procedural laws are rules which entitle tax authorities to the power to enforce the levying and collection of taxes.[158]

The Substantive part of tax law determines (i) who should be taxed (the person or entity who is liable to pay tax); (ii) what will be taxed(the base up on which taxes are to be imposed); (iii) when it will be taxed (the time where by the tax

[152] Alexander V. Demin, Certainty and Uncertainty in Tax Law: Do Opposites Attract?, MDPI, 2020, P. 3
[153] Jane Frecknall, Supra Note at 39, P.2
[154]Available at https://www.britannica.com
[155] Ibid
[156]https://www.lawinsider.com/dictionary/tax-law, last accessed on June 01, 2020
[157]Pistone et al. Fundamental Principles of Tax Law, P.71
[158]Ibid

liability arise); (iv) how it will be collected (the manner, the period and method of calculating the tax liability); (v) how to deal with tax avoidance and evasion (anti-avoidance and anti-evasion provisions); and (vii) consideration of the international transactions in which tax treaties are signed.[159] The substantive part of the tax law covers or regulates the subject of the tax, the object of the tax, the base covered by the tax, the rate of tax to be applied on the base, entities that are exempted from tax liability, the term of payment, the tax due and payable, the tax refund and credit to the tax payer.

On the other hand, the procedural part of the tax law covers issues such as who is authorized to collect tax, how the taxpayers calculate tax liability, the rights of taxpayers, the limitations on tax authorities while collecting taxes, the sanctions on taxpayers who failed to comply with duties, the manner and procedure of imposing and collecting the taxes, etc.[160]Despite a theoretical demarcation, there is no clear line that can separate substantive law from procedural law.[161]

Summary

In any free market economy, governments intervene to distribute public goods, prevent market failure, and redistribute income. The fulfillment of these tasks by the government needs some sort of revenue. One of the most important sources of revenue for governments is tax. Tax is a compulsory charge by the government on individuals without any direct reciprocal service. Taxes are as old as human beings. Despite the old-aged nature of taxes, their imposition has never been smooth.

Theories and principles that were supposed to improve tax systems and enable the creation of good tax systems have been coined by several authors and thinkers. Those principles and theories have guided tax policy makers and legislators and they have improved taxes and tax systems tremendously. Nevertheless, none of them have been perfect to be free of criticisms and they have not succeeded in creating a perfect tax system. Sometimes the prevalence of trade-offs among the accepted principles of a good tax system has created challenges in realizing a good tax system. That makes the development of taxes

[159]Ibid
[160]Ibid
[161] Toshihiro Ihori Supra Note at 21, p. 100

is a continuous and unfinished process. So far we have got a grasp of the basic concepts of taxation and tax law. It is expected that the knowledge obtained here will be used to evaluate the contents that are to be discussed in the subsequent chapters. Once one has acquainted with the basic notions of taxation in this chapter, he/she will be confronted by detailed chapters covering various types of taxes that are currently in use by the government of Ethiopia. The following chapters will discuss various types of taxes such as the Income-tax, the Value Added Tax, the Property Tax, the Stamp Duty tax, the Turnover Tax, the Customs Duties, and other related taxes that are in use currently.

Review Questions

1. Explain the basic principles of a good tax system
2. Discuss why governments need to tax their citizens
3. Taxes may be classified into different categories. Discuss the various classifications of taxes and the bases for the classification
4. Analyze the ability to pay and the benefit theories of achieving equity
5. Sacrifice theory has at least three variants. Explain these three types of the sacrifice theory and which one is more operational than the others.
6. Explain the common elements of any tax to be regarded as a tax

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Chapter Two

An Introduction to the Ethiopian Tax System

Introduction

Tax collection in Ethiopia is assumed to be as old as the state itself. The "modern" Ethiopian tax system has undergone more or less continual reform over the last seven decades. The current Ethiopian tax system covers various forms of taxes governed by independent and separate legislation and enforced by revenue institutions at federal, regional, and local levels. The process of levying and collecting tax (and non-tax) revenue sources is supposed to serve as a powerful instrument to bring socio-economic changes on top of financing public expenditures. The system of fiscal federalism and related Constitutional provisions are of great importance when the tax system in Ethiopia is considered. The FDRE Constitution provides revenue sources for federal and regional governments. The exercise of taxing powers may affect the right to property, equality, privacy, freedom of expression, speech, religion, etc or might goes into conflict with the tax powers of other governments. It, therefore, sets guidelines and limitations on the exercise of tax powers. These Constitutional provisions are of great importance when the tax system of Ethiopia is considered. It has been agreed that the Ethiopian system suffers from the problems of disorganization and incoherence in policy, laws, and institutions. Although Ethiopia is squarely found in the camp of civil law countries, its tax laws remain outside the code system and are found scattered. The lack of predictable tax reform and lucid tax policy documents remain a headache to the system. The Ethiopian tax system has in effect suffered from chronic and persistent fiscal deficits and low revenue performance.

This chapter is designed to answer questions such as how has the Ethiopian tax system evolved? Is there a system called a tax system in Ethiopia today? What are the major limitations pertaining to tax policy, law, and administrative institutions? What are the legal and non-legal factors responsible for the low tax performance in Ethiopia? How tax power is distributed among federal, regional, and local governments in Ethiopia? What are the directives and limitations in the exercise of tax powers in Ethiopia? All attempts to answer these and other related questions aim to provide an introduction to the Ethiopian tax system. The chapter comprises five sections excluding this introduction and the conclusion part. It begins by providing a brief overview of the Ethiopian tax

system. In this section, an attempt is made to highlight gaps in the tax reform, tax policy, tax administration, and revenue mobilization. In section two a separate and detailed explanation is provided of the organization and source of tax laws in Ethiopia. The third, fourth, and fifth sections deal with the systems of fiscal federalism, the structure of taxation power, and limitations on powers of taxation in Ethiopia respectively.

2.1 A Brief Overview of the Ethiopian Tax System

The term "tax system" has been widely used in legislation, administrative documents, the literature, and the media although none of them have defined or conceptualized what it means.[1] In the literature, the term "tax system" is used to denote the nexus between and among tax policies, laws, and administrations.[2] Tadesse Lencho has tempted to describe the Ethiopian tax system as a loose agglomeration of proclamations, regulations, directives, rules, etc. and he goes on to say that "it does not as yet exist" borrowing the conclusion by Jacques Vanderlinden about the Ethiopian legal system.[3] Yet, despite all the disorganization, incoherence, and other gaps, **t**here are guiding policies, operating laws (the constitution, proclamations, regulations, directives, etc.), legal institutions (such as the parliament, tax authorities, and tax appeal tribunals and courts), administrative procedures (such as the declaration, assessment, collection, and complaints handling), etc. The question is whether the tax policies laws and institutions function as a unit or in a system like the respiratory or the breathing system does biologically.

Tax systems improve their efficiency or equitability and maximize the economic and social benefits through tax reforms. Tax reform is the process of changing the existing tax system (the status quo) or introducing new systems. The literature recommends a good tax reform (in approach, process, and practice) in order for it to bring forth good fruits in tax policy, law, and administration. As an ancient and continuously sovereign nation, Ethiopia experienced different ancient and medieval periods of taxes. However, the

[1] Federal Income Tax Proclamation No. 979/2016, Preamble Paragraph 1, 2 & 33; Federal Tax Administration Proclamation No.983/2016, Preamble Paragraph 1-3, 82 and 111; Peter Schwab, The Tax System of Ethiopia, American Journal of Economics and Sociology, Vol. 29, No. 1, 1970, PP. 77-88; Taddese Lencho, The Ethiopian Tax System: Excesses and Gaps, Michigan State International Law Review, Vol. 20 No. 2, 2012

[2] Vladimir N. Nazarov, Tax System: The Concept and its Legal Content, IEJME-Mathematics Education, Vol. 11, No. 7, 2016, PP. 2195-2201

[3] Taddese Lencho Supra Note 1

modern Ethiopian 'tax system' is a product of not more than half a century of experimentation in legislation and tax reform. It took a root in the 1940s. The Ethiopian tax system had been under fragmented and gradual tax reform until 2002 when governments of each time have reformed their tax policies so as to enhance tax revenue and correct the economy of each time. The country undertook comprehensive and inclusive tax reform in 2002 in line with the developmental state paradigm. Many of the current direct and indirect tax laws were amended. The country has engaged in fragmented and gradual tax reform in the post-2002 period.

A good tax system enables to raise of adequate revenue mainly from internal sources to finance essential expenditures. What are the different types of taxes applicable in Ethiopia? What are the governing laws? The Ethiopian legal system provides for two major categories of tax structure: direct and indirect taxes.[4]In the Ethiopian context, direct taxes are by and large income taxes pending the property tax reform. Currently, at the federal level, the income tax regime is government by Proclamation No. 979/2016 and Council of Ministers Regulation No. 410/2017. Regional governments also enacted the same laws in their respective jurisdiction. The income tax laws provide for the taxation of thirteen types of incomes in accordance with five schedules. These are Schedule A (income from employment), Schedule B (income from the rental of buildings), Schedule C (income from business activities), Schedule D (other income[5]), and Schedule E (exempt income). The different sources of income are taxed separately and subject to their own tax rates and rules regarding the tax base. Income sources that fall outside the five schedules are taxed at 15%. The domestic indirect tax regime includes the Value Added Tax (VAT) and Turnover Tax (TOT), the Excise tax, and Stamp duty. The VAT and ToT were introduced as complementary sales taxes into the Ethiopian tax system in 2003 through Proclamation No. 285/2002 and Proclamation No. 308/2002 respectively. Excise taxes are applied to selected locally produced goods and

[4]As already discussed under chapter one, direct taxes are taxes levied directly on individuals and corporate entities and cannot be transferred to somebody else, and indirect taxes are taxes indirectly levied on the consumer of goods and services through the seller. Accordingly, the common forms of direct taxes in Ethiopia include the various types of income taxes whereas the major forms of indirect taxes includes value added tax (VAT), turn over tax, stamp duty tax, sur tax, custom duty etc.

[5] other incomes include royalties, dividends and other distributions, interest, income from games of chance, capital gains, management or technical fees, Income from casual rentals of property.

imported goods, which are identified as hazardous and/or luxurious, through the recently enacted Proclamation No. 1186/2020. Stamp duty is designed to charge selected legal, commercial, and financial instruments through Proclamation No. 110/1998. These domestic direct and indirect taxes are collected by the ministry of revenue or the respective regional revenue bureaus. The international trade tax regime includes customs duties, surtax, withholding tax on imports, VAT, and excise tax on imports. Customs duties are levied on the CIF value of goods imported into Ethiopia in accordance with Customs Proclamation No. 859/2014. It's administered and collected by the Customs Commission division of the federal MoR, and must be paid before the imported items can be released to the importers. Sur tax is a flat rate of 10% levied on the CIF value (plus all customs duty, excise tax, and VAT payable) of selected imported goods through Council of Ministers Regulation No. 133/2007. Withholding tax on imports, VAT, and excise tax on imports are regulated by the Income Tax Proclamation No. 979/2016, the VAT Proclamation No. 285/2002, and the Excise Tax Proclamation No. 1186/2020 respectively.

Tax policy is the means by which a government is guided in tax legislation and tax administration. Using tax policy, governments determine what taxes to levy, in what amounts, on whom and how, and why to the service grand national objectives such as stimulating economic growth, augmenting social development, and nation-building at large. The choice among the goals often involves trade-offs and striking a balance (however difficult) is the goal of successful tax reforms. For example, the choice between the two most common criteria for evaluation of a tax system (i.e. efficiency and equity) is a big trade-off because an equitable tax system is not necessarily efficient and an efficient tax system may not be equitable. Tax policy also helps to meet the twin goals of offering a tax system attractive to investment and raising adequate revenue to meet public expenditure. Thus, a viable and overarching tax policy is a sine qua non for Ethiopia's realization of building a good tax system. However, there is no national document called tax policy unless read from the different federal and regional tax laws and other policies of the government. Most referred periodic policy documents such as the Growth and Transformation Plans (GTP I & II) (2010-2020) and the new 10-year development plan (2020-2030) don't adequately address the tax policy issues. What are the target goals during these plan periods? Can these development plans replace the role of tax policy?

Setting a predictable tax administration and tax administration institutions are crucial parts of a tax system. Tax administration law covers enormous issues that will be separately discussed in chapter eleven of this book.[6] For now, we will focus on the institutional aspect. Building a unified, professional, technological, and autonomous revenue body is an important unit of the tax system.[7] In Ethiopia, for a long period of time, tax administration institutions were only units or departments of finance and trade ministries with no or little administrative specialization. Later administrative units are categorized as customs departments (for international trade) and Inland Revenue departments (for domestic taxes). In 1995, the Federal Government Revenue Board (with three agencies i.e. the Inland Revenue Authority, the Ethiopian Customs Authority, and the National Lottery Administration) was established as the first separate and autonomous government Tax Administration body. The board with the same agencies was reorganized as the Ministry of Revenues in 2001. In 2008 the three agencies merged into one authority i.e. Ethiopian Revenue and Customs Authority (ERCA) with strengthened powers and functions including investigation and prosecution, seizure and foreclosure, and special personnel administration rules and procedures (e.g. salary, recruitment, disciplinary measures, etc.). In 2018, ERCA is reorganized as the Ministry of Revenue (MoR) taking the customs department as a discrete and semi-autonomous commission.[8] Despite these progressive developments, still, the MoR is not the sole player in tax administration as several ministers and regional authorities would be involved in different capacities which sometimes conflict/overlap with each other. Especially the Ministry of Finance is the major player in issuing directives providing the exemption. Other organs such as the investment commission, Ministry of Trade, Ministry of Urban and Construction, civil service Ministry, National Bank of Ethiopia, the Ethiopian airlines, etc. are often blamed to intervene in the affairs of custom and taxation.

Over the last 15 years, the Ethiopian economy has registered growth of around 10.2% while the real GDP per capita expanded by around 7.4% per year on

[6]Tax Administration covers a broad area of the tax system including identification and registration of taxpayers, the investigation, assessment, litigation or collection of tax liability.

[7] William Crandall, Revenue Administration: Autonomy in Tax Administration and the Revenue Authority Model International Monetary Fund, June 2010

[8] Proclamation to Determines the Powers and Duties of Executive Organs No. 1097/2019

average.[9] However, like other developing countries, Ethiopia has suffered from chronic and persistent fiscal deficits and low revenue performance. The tax-to-GDP ratio remains one of the lowest by African or world standards and fell from 10.9% in 2009/10 to 10.0% in 2018/19.[10] Between 2009/10 and 2018/19, revenues from direct taxation increased from 3.8% of GDP to 4.3% of GDP while domestic indirect tax revenue has seen slightly weaker growth, increasing from 2.7% of GDP to 2.9%. [11]The new 10-year development plan intends to achieve a general tax-to-GDP ratio of 18.2% by the end of 2030.[12] In terms of federal-regional share, the federal government collects about 72% of national revenue, 54% of domestic direct tax, and 73% of domestic indirect tax while regional states collect only 28%, 46%, and 27% respectively.[13]Do you think that such structures and tax performances are healthy? Empirical studies have found different structural and legal factors for the low tax effort in Ethiopia. The structural constraints include slow structural transformation (dominance of subsistence agriculture and low share of industry and service sector), poverty (low per capita income and savings), the large size of the informal sector (40% of GDP), the mono-commodity export sector, low level of monetization of the economy, and macro-economic problems (inflation, unemployment, low volume of exports, and low FDI share). The legal and institutional factors include poor tax culture, huge tax incentives/ exemptions, high tax evasion, tax avoidance, administrative limitations, corruption, illicit financial flows, hostility between taxpayers and tax officials, etc. This takes us to the need for a revenue enhancement plan (optimizing the revenue sources that are legally and administratively available) at the country, regional or local administration levels. Government must explore opportunities to diversify revenue sources and put in place a wide-ranging series of improvements to its policies, procedures, staffing, and organizational structure.

2.2 The Source and Organization of Tax Laws in Ethiopia

Well drafted and logically organized tax laws are critical for the proper understanding and implementation of a tax system. The well-drafted tax law has

[9]Tom Harris and Edris Seid, 2019/20 survey of the Ethiopian tax system, The Institute for Fiscal Studies, Report R187, March 2021 P.5
[10]Ibid
[11]Ibid, Pp. 44
[12] FDRE Planning and Development Commission, Ten Years Development Plan: A Pathway to Prosperity 2021-2030, 2020
[13] Tom Harris and Edris Seid, Supra Note 9, P.10

to meet some interrelated criteria such as understandability, organization, effectiveness, and integration.[14] That is to say, tax laws should be simple to read and follow, avoid legalistic languages, and organized with a clear numbering of sections and sentence structure, etc. The second criterion of organization concerns both the internal organization of the law (including numbering and chapterization) as well as its coordination with other tax laws. The third criterion underlines the need to consider the law's policy implication, interpretation, enforcement, and relation with other laws. The fourth criterion requires that a new tax law must be fully integrated into and consistent with the rest of the legal system. An examination of the Ethiopian practice of tax law drafting in light of these criteria requires a separate and detailed study that falls beyond the scope of this work.

Unlike the experience in other laws, the organization of tax laws feeds a paradoxical and mixed experience. For example, while France has only consolidated tax rules (also known as the general tax code), many other civil law countries remain without tax codes or consolidated rules, and the United States has a tax code although it is a common law country.[15] Perceptibly, the organization of tax laws into a code requires huge investment and preparation but has many advantages including accessibility, intelligibility, certainty, elimination of duplicative provisions, uniformity in interpretation, facilitation of compliance, and ease of subsequent amendments to name a few salient factors.[16] However, organizing tax laws into codes is not a simple project that a nation can accidentally join and is found difficult to achieve. This emanates from the very nature of taxation and tax law. Taxation is a fast and frequently changing or most dynamic area of law. Attracted by its comparative advantages, countries that do not have tax codes have opted for what is known as consolidation. Consolidation is nothing but a careful organization and archival of separate tax laws with cross-references that virtually achieve the same result as the tax codes. In short, organizing tax laws in a coded form is not always desirable and even some countries including the civil law legal system followers prefer consolidation while other countries have only general fiscal or revenue law, leaving the details for piecemeal legislation.

[14] Victor Thuronyi, Drafting Tax Legislation in Victor Thuronyi, Tax Law Design and Drafting, International Monetary Fund, 1996
[15] Ibid
[16] Ibid

In terms of organization of laws, Ethiopia is squarely found in the camp of civil law countries and has organized most of its civil, commercial, criminal, and procedural laws since the 1950s and 1960s in a coded form. However, many laws, most notably in the tax area, have remained outside the code system of organizing laws. The country has not attempted to organize the tax laws since modern tax laws were introduced in the 1940s. The closest Ethiopia has come to organizing tax laws into a systematic body of laws is through the Consolidated Laws project, which was unfortunately terminated or forgotten in 1975, 1990, and 2002. The rampant fragmented tax reforms and the successive amendment to tax laws can be mentioned as one of the reasons that prevent codification or consolidation efforts. Currently, the tax laws of Ethiopia are found scattered not just indifferent tax laws but also in other laws of the country. The investment law, which contains tax incentives, is a good example in this regard. The field of Ethiopian tax legislation is chaotic, disorganized, uncoordinated, and worse, making it difficult for an average taxpayer or tax expert to make sense of her obligations under the various tax laws in force. Because tax laws are uncoordinated, most tax legislations repeat certain provisions as if they were not already provided for in other tax legislations. The dearth of publication and distribution of law have made the concerns more worrisome.

With the foregoing as background, we can proceed to the sources of tax law and their hierarchical integration in Ethiopia. The first source of law is the constitution. When are taxes said to be Constitutional? What parts or provisions of the constitution deal with taxation? As the supreme law of the land, from which other laws take validity, the constitution decentralizes taxing power across tires of government, sets limitations on taxing power, and provides for taxpayers' rights. The FDRE Constitution assigns revenue powers into four headings: revenue belonging to the federal government (federal power of taxation), revenues belonging to regional governments (state power of taxation), revenues jointly owned by both (concurrent power of taxation), and new revenue sources (undesignated powers of taxation.[17] The constitution also sets limits to the power of taxation in Ethiopia.[18]

[17] FDRE Constitution, Arts 96-99
[18] Ibid, Art. 100

Secondly, tax proclamations, international tax treaties, and regulations are important sources of tax law from which most substantive and procedural rules pertaining to taxation flow. Tax Proclamations come below the Constitution in the hierarchy. They are acts of parliament, discussed and voted on in the HPR and signed by the president of Ethiopia.[19] Regional tax proclamations are enacted by state councils and signed by regional presidents. International tax treaties that have been ratified by Ethiopia have a similar status to proclamations because they are also enacted by the HPR.[20] What if there is a conflict between the two? According to Article 48 of the Income Tax Proclamation, the tax treaty shall prevail except when the treaty provides an exemption, exclusion, or rate reduction. Tax Regulations are the next level. They are issued by the Council of Ministers at the federal level and by regional cabinets at the regional level to supplement a proclamation. As mentioned above, proclamations and regulations are enacted to regulate almost all areas of taxes in Ethiopia. Regulations are expected to have detailed descriptions of the provisions of the respective proclamations. The problem is that as we commonly observe, it has become difficult to differentiate the substance of the two levels of legislation. For example, tax regulations are derivative legislations issued only pursuant to the authority given in tax proclamations. But in terms of the subject matters covered, there is really very little difference between tax proclamations and regulations. Accordingly, tax proclamations contain unnecessary technical details that are better left to regulations. On the other hand, tax regulations rather than dealing with technical problems, and details, regulate very general and essential elements (e.g. tax base, rate, exemption, etc).

The third area of tax law is tax directives, which are the lowest level in the Ethiopian legislation hierarchy. Tax directives are issued by either ministerial bodies (most notably the Ministry of Finance and Ministry of Revenue) or other public bodies organized as authorities or commissions. In the same way, specific regional bureaus enact directives. The jurisprudence of directives is little explored and little known despite the recent proliferation.

The fourth possible sources of Ethiopian tax laws are advance rulings. These are tax authority statements or explanations on specific issues. Advance rulings, or administrative rulings, have become important instruments in the

[19] Ibid, Arts.51 (10) & 55 (11)
[20] Ibid, Arts. 9 (4) and 55 (12)

implementation of tax laws in many tax systems. In many countries, tax authorities issue (with their own initiation or upon request of taxpayers) fact-specific opinions or interpretations of the tax law in a way that avoids future conflict and litigation or informs and guides taxpayers and tax officers. The practice of issuing advance rulings has not been as such known and established in Ethiopia except in a few instances where government and private organizations wrote letters to the Tax Administration asking for its opinion. Currently, the Federal Tax Administration Proclamation No. 983/2016 has formally recognized it. Accordingly, Arts. 68-75 provides two types of advanced rulings (public and private) that can be binding to the tax authority unless withdrawn.

Sixthly, the role of administrative publications, tax guides, tax forms, and public notices as a source of tax law cannot be overlooked. It has become an unavoidable feature of modern tax administration to assist in tax administration with voluminous administrative commentaries, manuals, guides, and circular letters. It is mainly issued by tax authorities for an easy understanding of tax laws. Tax authorities assist tax administration with administrative commentaries, manuals, guides, and circular letters, which are binding to the administration unless it's made with a disclaimer. In Ethiopia, the tax administration prepares guides, manuals, tax forms, public notices, etc. to guide taxpayers and officers even if their legal significance is debatable. The Federal Tax Administration Proclamation No. 983/2016 provides publications or other advices, communications, forms, and notices by the authority as a source of law.[21] Their main aim is to facilitate law enforcement.

Finally, tax cases are a growing source of tax law. In the design of an efficient tax system, the judiciary needs to render rulings that balance taxpayer rights with the goal of securing adequate public revenue. The interpretation of tax legislation is complex. As in many other countries, tax disputes in Ethiopia follow a slightly different channel of dispute settlement from other forms of disputes involving the Review council, Tax Appeal Commission, and High Court.[22] Some argue the involvement of the executive is an opportunity to aptly resolve disputes with the concerned tax administration as it saves time and resources, creates mutual understanding, etc. On the other hand, it is criticized

[21] Federal Tax Administration Proclamation No. 983/2016,Arts. 76- 85
[22]Ibid, Art. 52-60

for being short of niceties of judicial fairness (e.g. down payments, adversarial measures, the burden of proof), and members are impugned to be partial and lack the necessary expertise. Although the modern Ethiopian legal system subscribed to the civil law tradition, the role of courts in the creation of legal norms through interpretation received a growing trend since2005. Proclamation No. 454/2005 provides decisions of the cassation division, rendered by no less than five judges, are binding on all federal and state courts at all levels.[23] Currently, tax and customs cases are separately published and serve as good sources of tax law.

2.3 Taxation in the Ethiopian Systems of Fiscal Federalism

Discussions on the Ethiopian systems of fiscal federalism are crucial parts of understanding the Ethiopian tax system. Fiscal decentralization (also known as fiscal federalism) deals with three major issues of public finance: allocation of expenditure responsibilities, the allocation of revenue-raising power, and the adjustment of fiscal imbalances (vertical or horizontal) through intergovernmental fiscal transfer.[24] It should be noted that such ideas are relevant for all unitary, federal and confederal forms of governments.

Throughout the ancient and medieval history of Ethiopia, the center-province administrative and fiscal relations depict the features of fiscal decentralization. The regional lords submitted themselves by paying taxes and tributes to the center and laying no claim to the throne provided that the center recognized and did not obstruct the regional autonomy and kept its power strength to defend against external aggressions and internal conflicts in the empire. Many agreed that, historically, Ethiopia remained to be a de facto federal state except for some periods of centralization in the 19th and 20th centuries. From the adoption of the 1931 Constitution up to the downfall of the Derg Regime, the country became a genuinely unitary state where decentralization in general and fiscal decentralization, in particular, became of little significance and concern to the country. Although Ethiopia was largely a unitary state, there were attempts to statutorily reorganize provincial and local governments during the Haile Selassie and Derg regimes. The principle had a prominent place in Ethiopia only during the transition period as enunciated by the Charter and further

[23] Federal Courts Proclamation Re-amendment Proclamation No. 454/2005, Art. 2(1)
[24] Solomon Negussie, Fiscal Federalism in the Ethiopian Ethnic-based Federal System, Wolf Legal Publishers, 2006

elaborated under Proclamation No. 7/1992 and 33/199. These laws provided for the division of expenditure and revenue-raising responsibilities between the center and the regions. Later, the FDRE Constitution, as an actual progeny of the two laws[25], officially declared the federal form of state[26] and allocates expenditure responsibilities[27], revenue powers[28] , and mechanisms for dealing with fiscal imbalances[29]. Currently, Ethiopia is a federal state which comprises a federal government, eleven Regional Governments, and two city administrations i.e. Addis Ababa and Dire Dawa.[30]

Both levels of government have legislative, executive, and judicial powers, and the overall government functions or expenditure responsibilities in the country are divided between central and state governments as federal, state, concurrent, and delegated functions.[31] The Constitution further hints that regional governments would create local governments and deepens decentralization.[32] In this regard, the country has undertaken various decentralization rounds and regional governments have created various forms of local governments in both urban and rural settings. Regional constitutions and other legislations provide for the legislative, executive, and judicial functions of these local governments. The constitution further indicates that both regional governments and federal governments are required to cover expenditures incurred in connection with their respective functions and responsibilities.[33] As can be evidently observed from the revenue and expenditure assignments addressed in the Constitution, the lucrative (profitable) sources of revenue in Ethiopia are assigned to the federal government while a wide range of expenditure responsibilities are reserved for the regions. This resulted in a significant vertical fiscal imbalance between the federal and regional governments. Moreover, the adoption of the

[25] Proclamation to Define sharing of Revenue between the Central Government and the National/Regional Self Governments, Proclamation No. 33/1992
[26] FDRE Constitution, Art. 1. The Constitution clearly states that Ethiopia is a federal state. The two level of government are organized each having its own sphere of competence in legislative, executive and judicial power have been established. The federal government would not interfere in the functions and powers of state governments and the state governments would not interfere in the functions and powers of the federal government.
[27] FDRE Constitution, Arts. 51 and 52
[28] Ibid, Arts.96-100
[29] Ibid, Art. 94
[30] Ibid, Art. 47. Sidama and South West regional states are the new additions in 2020 and 2021.
[31] Ibid, Arts. 51 and 52
[32] Ibid, Art. 50 (4)
[33] Ibid, Art. 94

federal system has created autonomous regions that vary enormously in area, population size, infrastructure, human and institutional capacity, and socioeconomic status. This resulted in a huge difference in the fiscal capacities or horizontal imbalance among regions. Recognizing the inevitability of fiscal imbalances resulting from the division of powers in the constitution, the disparities in population, natural resources as well as human and institutional capacities among regions, the constitution lays down the legal basis for fiscal transfer from central government to regional governments.[34] As common in other federal systems, the constitution recognizes types of transfers (conditional and unconditional[35]) to lower tiers of government. The literature recommends that recognized principles such as principles of independence, equity, uniformity, adequacy, fiscal access, integration and coordination, efficiency, and accountability must be observed in fiscal transfers.[36] However, the Ethiopian system of transfer is not free from defects and there are a number of concerns.[37] Borrowing is another mechanism for deciphering the imbalance and meeting deficits.[38] Borrowing can be from internal or external sources. In Ethiopia, it is the federal government that has the power to borrow from abroad, and **r**egional or local governments are not allowed to borrow from abroad. Regional governments borrow internally from banks to meet the cash flow timing problem with the permission of the federal government. In addition to this permission, which has also the feature of guaranteeing debts in practice, the federal government may give them loans in the form of advance to be charged to their budgetary subsidy for the following year when regional governments experience a budget shortfall in any fiscal year. Regional governments also do the same for local governments.

In addition to fiscal imbalance, the other problem common in federations is the fiscal competition and challenges in enforcing fiscal harmonization. Tax competition is a regulatory competition by which governments use reductions in fiscal burdens to encourage the inflow of productive resources and tax

[34] Solomon Negussie, Supra Note 24
[35] A conditional transfer from a federal body to a province, or other territory, involves a certain set of conditions. If the lower level of government is to receive this type of transfer, it must agree to the spending instructions of the federal government.
[36] Jamie Boex and Roy Kelly, Fiscal Federalism and Intergovernmental Financial Relations in Richard Allen et al (eds), The International Handbook of Public Financial Management, Palgrave Macmillan, 2013
[37] Solomon Negussie, Supra Note 24
[38] Ibid

harmonization is the process of adjusting tax systems of different jurisdictions in the pursuit of a common policy objective in federations. In this regard, the federal government shall ensure that the tax laws and administration at federal, regional, and local levels adhere to the constitution, the law, and principles of fiscal federalism.

2.4 The Structure of Taxation Power in Ethiopia

The process of levying and collecting tax and non-tax revenue sources is supposed to serve as a powerful instrument to bring socio-economic changes on top of financing public expenditure. This makes the allocation of financial resources among tiers of governmentsof great importance, especially in a federal arrangement. Needless to mention that the allocation of the entire revenue sources either to the center or the states would result in various problems in the relation or association of centripetal and centrifugal forces in the federal systems.[39] If the revenue sources are exclusively given to the states, it will create center dependency, and states are required to transfer or share revenue through an upward revenue sharing system and the state becomes reluctant to participate in common affairs. Moreover, it lessens the principal function of the central government such as income distribution through taxation, stabilizing roles, and tax harmonization policies. On the other hand, if the entire revenue sources are retained by the center, the state governments become fully dependent on the revenue transfer mechanisms. This approach deviates from the basic principles of federalism, i.e. the devolution of powers and function among the federating units and autonomy of each level of government. Therefore, the usual trend followed by most federations is to cautiously divide the revenue sources between the center and the state.

The method of allocation of revenue in federal systems is theoretically intended to follow the division of the expenditure responsibilities in order to accomplish the power and function assigned to each level of government.[40] Just as the legislative, executive and judicial powers of the two levels of government have to be divided between the federal and state governments, the necessary financial powers in respect of raising revenues and utilizing the revenues raised (expending) must also be carefully divided between the two levels of government. The sharing or distribution of revenues between central and state

[39] Ibid
[40] Ibid

governments is principally intended to enable all levels of governments efficiently carry out their respective duties and responsibilities. Moreover, it shall assist regional and local governments to develop their respective areas on their own initiatives, narrow development gaps, and encourage activities for the common interest. In meeting these objectives, the sharing of revenue between and among tiers of governments must be founded on some basic principles. There are some broad principles that are followed by many federal states in tax assignment between the levels of government. These include ownership of the source of revenue, the national or regional, or local character of the sources of revenue, the convenience of levying and collection of the tax or duty, population size, distribution of wealth, the standard of development, and other factors that are the basis for an integrated and balanced economy.[41]

Most writers on fiscal federalism have reached a consensus on the following major recommendations are forwarded in the division of taxing power in federal countries. These are:[42]

- Progressive and redistributive taxes should be central;
- Taxes suitable for economic stabilization should be central;
- Tax bases distributed highly unequally between jurisdictions should be central;
- Taxes on mobile factors of production are best administered at the center;
- Residence based taxes such as sales of consumption goods to consumers are suited for states;
- Benefit taxes and user charges might be appropriately used at all levels; and
- Taxes that are based totally on immobile factors should be assigned to states.

In the USA, the Constitution does not assign tax instruments to different levels of government.[43] Taxes other than on international trade (exclusively reserved for the federal government) and property taxes (exclusively for states and local governments) are practically open to all levels of government. In other words,

[41] Jamie Boex and Roy Kelly, Supra Note 36
[42] Taddese Lencho, Income Tax Assignment Under The Ethiopian Constitution: Issues To Worry About, Mizan Law Review Vol. 4 No.1, March 2010
[43] Solomon Negussie, Supra Note 24

there is concurrent power of taxation as a result of which more than one level of government may tax an activity or tax base. Under the Indian Constitution, the revenue sources are distributed under the Union List, State List, and Concurrent List and beyond the list, residual revenue sources are left to the Union through the parliament legislation.[44] The tax allocation under the German Basic Law devolves into threefold government; the Bund (center), the Lander (state), and the Gemeinden (local).[45] Other federations likewise follow different methods of devolution of revenue sources among their constituent units of the federation. The methods employed by federations can be summarized into three: exclusive power of taxation, concurrent power of taxation, and shared power of taxation. In the exclusive power of taxation, the Ethiopian constitution assigns several tax sources to the federal government and to the states separately, allowing each to have exclusive tax power within its sphere. Concurrent power exists when the constitution allows both levels of government to exercise the power to levy, collect and apportion in relation to some or all taxes. The federal and state governments have the equal constitutional authority to levy the same kind of tax with respect to the same category of persons, businesses, or particular things. This approach entails the overlapping of specific types of taxes exercised by both levels of jurisdiction, which may lead to competition and conflict between them. Shared power of taxation means the constitutional reservation of the power to levy taxes to the federal level, but it guarantees the states' right to some or all of the proceeds from specific taxes.

The FDRE Constitution provides exclusive revenue sources under the title "federal power of taxation", "state power of taxation", "concurrent power of taxation", and "undesignated power of taxation" in the Articles 96, 97, 98, and 99 respectively. Although the titles refer to the "power of taxation", strictly speaking, they do not only deal with taxes as the list also includes other non-tax revenues like fees, charges, rents, and others. The constitution allocates revenue powers based on the tax sources not on the tax bases. Except for custom duties and land use fees, a specific tax is not assigned to either of the governments exclusively. The exclusive domain of each government is not the tax base but the tax source. Hence, it does not result in taxing the same tax source by both levels of government. Although the constitution provides that the sources are

[44] Ibid
[45] Ibid

determined by taking into account the federal arrangements[46], whether the assignment genuinely corresponds with federalism remains unsettled.

a. Federal Power of Taxation

The FDRE Constitution under Article 96 enumerates the exclusive revenue sources of the federal government. Revenue sources such as customs duties including import-export tax and other duties are exclusively reserved for the federal government. With regard to other taxes, the constitution follows a different approach and the federal government only differs in the category of the taxpayers or a particular thing from which the revenue is collected. In other words, other revenue sources from income, sales and excise tax, and charges and fees are also assigned to the states. According to Art 96(1), the federal government has the power to levy and collect customs duties, taxes, and other charges on imports and exports. It seems universal in federations that customs duties are exclusively given to the federal government. This is attributable to the fact that import and export businesses are licensed and regulated by the federal government. Custom duties are part of international relations and fulfilling international obligations such as by reducing tariffs or imposing restrictions. In addition, in order to protect trade distortions within the country and for efficient tax administration the power of custom duties remain in the hand of the federal government. Tax on foreign trade is a major source of revenue in Ethiopia and the reservation of such resources to the federal government enables income redistribution and equalization schemes effective.

The second revenue sources of the federal government include direct taxes particularly income taxes from employment, profits of federal public enterprises, national lottery, monopolies, lease of federal properties, etc. First, with regard to employment income taxes (also known as payroll tax), the federal government is empowered to levy and collect income tax on employees of the federal government, the public enterprises owned by the federal government, and international organizations.[47] Thus, the incomes of employees of public bodies such as ministries, commissions, universities, Commercial Bank of Ethiopia, United Nations, World Health Organization, African Union, and the like are to be taxed by the Federal Government irrespective of their place of work in Ethiopia. Second, the federal government levies and collects

[46] FDRE Constitution, Art. 95
[47] Ibid, Art. 96 (2)

income or profit taxes on enterprises owned by itself.[48] It should also be clear that the federal government assumes the surplus as non-tax revenue from public enterprises, which is one of the largest sources of revenue in the country. Yet, the profits of public enterprises are also taxable. This includes enterprises such as banks, insurance companies, Telecommunication Corporation, the Electric Power Corporation, the Post Office, the Petroleum Corporation, sugar industries, government farms, etc, and branches and subsidiaries in the regions. Third, it is the power of the federal government to levy and collect income taxes arising from the winning national lotteries and other games of chance.[49] Fourth, income obtained from leasing its own property and houses is subject to federal revenue power.[50] The other power of taxation of the federal government is in relation to taxes levied and collected on air, rail, and sea transport services. Thus, if a person engages himself/itself in air, rail, or sea transport services and generates income, the income tax shall be paid to the federal government. The rationale behind giving this power to the federal government seems to be that these services, in most cases, connect (involve) two or more regions. Finally, the federal government has also the power to levy and collect taxes on the income of houses and properties owned by it. It has also the power to levy and collect taxes on monopolies. It should be noted that the shift in sources of these four types of income would give rise to a shift in tax power from the federal government to the states. For instance, the tax on the employees of government-owned enterprises and houses is expected to shift as a result of the ongoing privatization program. The same is true about monopolies.

The third area of revenue given to the federal government comprises sales and excise taxes pertaining to the sale and production or services of public enterprises owned by the federal government.[51] In addition, the introduction of VAT broadens the federal taxation to the sale and production or services of individual traders as will be discussed further at length.

The fourth areas of federal revenue assigned by the Constitution are the different fees, charges, and duties. The Constitution provides the federal government the power to determine and collect fees and charges relating to

[48] Ibid, Art. 96(3)
[49] Ibid, Art. 96(3)
[50] Ibid, Art.96 (6)
[51] Ibid, Art.96 (3)

licenses issued by organs of the federal government.[52] It also empowers the federal government to levy and collect stamp duties provided that the organs of the federal government render the service.[53]

b. State Power of Taxation

Unlike the federal government, the states have no exclusive tax bases assigned to them by the FDRE Constitution. The lists under Article 97 entitled "state power of taxation" enumerates those tax bases shared from the federal tax competence based on different categories of taxpayers or particular things. First, income from employees of the states (public bodies at all levels), regional public enterprises, and private enterprises are subject to the exclusive authority of the states.[54] In practice, these taxes constitute the most important source of revenue for regional states. In addition, tax on the income of public enterprises owned by the states[55], sole proprietorships[56], individual farmers or cooperative associations[57], water transport services provided within the boundary of the state[58] , and small-scalemining operations are exclusively taxed by the state.

There are sales and excise taxes reserved for the states. The states can levy and collect excise and sale taxes against public enterprises owned by them.[59] In addition, the states can levy and collect these taxes from individual traders within their jurisdiction.[60] However, the exclusive power of the states is restricted in some cases since some individual traders are subject to federally administered VAT law.

The other regional taxation power relates to the land and natural resources. One of the most important sources of revenue for the states could be revenue from land lease payments from investors and urban residents. Although the Constitution provides that land and natural resources are publicly owned as a common property of the nations, nationalities, and peoples, it also indicates that

[52] Ibid, Art.96 (7)
[53] Ibid, Art.96 (9)
[54] Ibid, Art.97 (1)
[55] Ibid, Art.97 (7)
[56] Ibid, Art.97 (7)
[57] Ibid, Art.97 (4)
[58] Ibid, Art.97 (7)
[59] Ibid, Art.97 (7)
[60] Ibid, Arts.97 (4) and 97 (7)

the administrative power is reserved for the regional states.[61] Accordingly, states have the power to levy taxes on houses that are privately owned, lease, or rent from land used by usufructuary beneficiaries, royalties from the use of forests, and taxes and royalties on small-scale mining activities.[62] The regional states also exclusively collect rent on houses and other properties theyown.

Finally, similar to the federal list, the taxation powers listed for the state also have provisions authorizing the determination and collection of fees and charges on licenses issued and services rendered by different organs of the state.[63]Although nowhere mentioned under the constitution, states also collect stamp duties from regional stamps. Why do you think the Constitution jumps the power to determine and collect regional stamps? How do the regional states come to determine and collect stamps now?

c. Concurrent power of Taxation

What do you think is the concurrent power of taxation? How do countries exercise the concurrency of power? Literally, it means that the center and the states have the power concerning the subject matter. It has been debatable across all federations save for some variations. In other countries, concurrent power of taxation is used to designate a situation whereby both the federal and the state governments tax the same tax base. For instance, in the USA both the federal and states are free to impose the same type of tax upon the same subject to taxation, and in Germany, the Lander exercises legislative power on concurrent matters only when the federation has not exercised its legislative powers. In Ethiopia, Art. 98 of the FDRE Constitution provides that the federal and regional governments have concurrent powers of taxation. It reads;[64]

1. The federal and regional governments shall jointly levy and collect profit, sales, excise, and personal income taxes on enterprises they jointly establish;
2. They shall jointly levy and collect taxes on the profits of companies and on dividends due to the shareholders; and

[61] Ibid, Arts. 40 (3) and 52 (2)(d)
[62] Ibid, Art. 97 (2), (6), (8) and (10)
[63] Ibid, Art.97 (9)
[64] Ibid, Art. 98

3. They shall jointly levy and collect taxes on incomes derived from large-scale mining and all petroleum and gas operations, and royalties on such operations".

This stipulation is criticized for being general and much different from the case in other federal countries. As this provision stands, what the phrase "jointly levy and collect" connotes is that each level of government cannot levy and collect these taxes independently. While the term levy refers to a legislative function, the word "collect" is to refer the administrative function of receiving money from the taxpayers. Neither the HPR nor the concerned State council can unilaterally modify the bases or rates of such taxes. In the same way, each level of government cannot unilaterally collect taxes and they cannot apportion the proceeds from taxes unless the constitution is amended or other provisions are consulted. For example, one may consult Art. 62 of the Federal Constitution which empowers the House of Federation to determine the division of revenues. The question that remains difficult to answer is how both the federal and states can jointly levy and collect taxes at the same time as the literal interpretation of the law dictates. In addition to the difficulty to sit together at a round table, the problem of tax competition may arise between the federal government and states. It might also produce a serious inconvenience to the taxpayers, a greater possibility of tax evasion, and inefficient administration which may have a direct consequence on the law and limited revenue source of the country. For these reasons, it is said that the Constitution has been "amended" by the joint meeting of the HoF and HPRs. Accordingly, the power to levy and collect tax sources listed under Article 98 is assigned to the federal government and the proceeds are compulsorily shared with the states. The revenue-sharing scheme instructs the Federal Government to share with the Regional States 50% of the proceeds of profit and dividend taxes, 30% of the indirect taxes, and 40% of the mineral taxes. The minute underlines the difficulty in practice and the spirit of the interpretative clause has been taken from the proclamation No.33/92 of the Transitional Government of Ethiopia.[65]In 2020, the formula is revised as 50%-50% for all types of taxes.

There are a number of unsettled claims and concerns in this area. In the first place, it is not clear if this process satisfies the procedures and requirements for

[65] Minutes of the 1st Joint Session of the House of Federation and the House of Peoples Representatives (Meskerem 26, 1996 E.C. in Amharic)

constitutional amendment under articles 104 and 105 of the FDRE Constitution. Moreover, the process does not fit within Constitutional interpretation. Moreover, why the States have easily abandoned their concurrent powers and accepted the tax-sharing arrangement is not clear. The other concern is that although the HoF set the distribution formula in 1995, it actually came into effect in 2002 because the resolution was not communicated officially to the Ministry of finance. This formula served until 2020 without amendment. There are also concerns that the setting of the HoF might open a loophole for manipulation as the two or three most populous states may easily change the rule of the game by establishing a simple majority rule, by forming a coalition, to take lion's share from the concurrent revenue sources.

Finally, it is useful to look at the list of tax sources that fall under this provision. The first list seems to refer to taxes on the profit, sales, and employment income tax from enterprises to be established jointly after the incorporation of the federal system. Practically speaking this revenue source is insignificant due to the policy of the government toward privatizing state-owned enterprises rather than establishing new public enterprises. The second list of concurrent taxation includes taxes on the income of companies and their dividends. The meaning of the word company may not be clear at a first glance and can be a source of debate and confusion. However, the word "company" in the Ethiopian context refers to the private limited companies, share companies, and one-man companies as are recognized under the New Commercial Code of Ethiopia. However, the Amharic version says "ድርጅት" which may include partnerships and other forms of association of individuals. In other words, the issue of partnership and non-agricultural cooperatives is not settled under the constitution. The practice supports that all forms of business organizations are considered taxable under concurrent power. It should be clear that the organization may be established in any part of the country and that doesn't affect the power of taxation. This being the case, taxes imposed upon companies are relatively mobile and involve several states. This mobility factor reflects the fact that their economic activities involve a multitude of factors from different jurisdictions. Factors of production such as capital, labor, and land may be used by several states. Thus, the power of taxation with a huge factor of mobility is suggested to be allocated to the concurrent power of the federal and states governments. Article 98 (2) also carries another problem. One can look disparity between the Amharic and English versions of this article.

While the English version specifically refers to revenue from company profit tax and tax on dividends due to shareholders, the Amharic version includes sales tax. Some say the Amharic version prevails and it is consistent with the ongoing practice. Excise tax is not mentioned in either version, which seems to be "a slip of the pen" and is actually levied on products or the sale of companies. Under the literature, it is the mobility factor or operation in more than one state that is used to determine the allocation of company tax.

The third list contains taxes on incomes derived from large-scale mining and all petroleum and gas operations. This seems a reaffirmation of Art. 40(3) of the Constitution which provides that the right of ownership of all natural resources exclusively vested in the state and peoples of Ethiopia. In most federal systems, taxes on natural resources are not exclusively reserved for the states, because it may aggravate the horizontal imbalance. In Ethiopia, too, issues concerning the equitable distribution of revenue generated from natural resources will be a challenging task when it plays a significant role in the national economy. However, mining operations are qualified as large-scale and small-scale operations, where royalties, land rentals, and income taxes from small-scale operations are left to the states. Attention must be paid to this area because mining operations will be potentially large revenue-yielding areas although contingent upon the exploration of minerals and not significant yet.

d. Undesignated Power of Taxation

From the foregoing discussions, it is possible to understand that the FDRE Constitution has tried to allocate exclusive powers of taxation to the Federal Government, the states, and to both levels of government concurrently. Despite such allocation of the power of taxation, the constitution has envisaged the possibility of the coming existence of new tax bases and provides for undesignated power of taxation.

Article 99 of the Federal Constitution stipulates that any undesignated taxation power has to be designated by a Joint Session of the HoF and HPRs with two-third majority votes. This way the constitution deviates from the common notion of residual power as also enunciated under Article 52 where states necessarily have a residual power. Now, either level of government can only acquire the power of taxation after a decision is reached by the joint meeting of the two Houses of the Federation. The different types of taxes such as gift tax,

inheritance tax or death duties, real property tax, environmental tax, hotel occupancy tax (tourist tax), highway tax, etc. which are found in some other countries are still residual or undesignated taxes in Ethiopia.

As the tax assignments in Ethiopia are not made on a tax base as is the case in other countries and residual taxation power is not granted to the Federal or the states, the issue of undesignated tax remains unclear. There are a number of legal and practical questions that arise with respect to residual taxes. The first and the main one is the problem of demarcating the precise scope of the constitutionally assigned tax powers. For example, Article 97(6) mentions the power of a state to levy and collect taxes on income derived from private houses and other properties within a state. But what kind of properties, what kind of tax, and whether it includes taxation on the transfer and alienation of these properties is not clear. The same confusion as to whether the phrase "other properties" refers to intangible properties to exclude capital gains tax, royalty from the use of patent and copyright, and income from the deposit and interest from the basket of residual taxes. However, this argument seems not to sound when we see the nature of these taxes, the constitutional style of power allocation, and the Amharic version of Article 97(6), which refers to income derived from renting houses and other movable properties. The same issue can be raised about surtax and VAT, despite the fact that the joint session decides it is undesignated. The Federal Government controversially took over the administration of VAT and decided to share the proceeds with the Regional States as per the formula from HoF. It is argued that VAT is not mentioned in the name, but it is mentioned in several provisions of the Constitution in substance.[66] The constitutionality of the VAT assignment has [67]

The States have also legitimized their taxation powers over some sources of revenue pursuant to the joint session of the HoF and HoPR at different times. For example, income on interest tax from earnings on bank deposits, income derived from renting patent rights of individuals, and stamp duties imposed on functions executed by the states are decided as state taxation powers. This drives the conclusion that Federal Houses in making decisions regarding the

[66] FDRE Constitution, Arts. 96(1), 96(3), 97(4), 97(7), 98(1)

[67] Yibekal Tadesse, Value added tax assignment under the FDRE constitution: designated or undesignated? Haramaya Law Review Vol. 8, 2019; Gizachew Silesh, VAT and the FDRE Constitution: Is VAT Really an Undesignated Tax?, Bahir Dar. University Journal of Law,Vol.5, No.2, July 2015

assignment of undesignated tax power should consider both the national and state interests, the nature of the tax, and its impact. In addition, they have to take into consideration the principle laid down under Art.95 which says "the federal government and the state shall share revenue, taking the federal arrangement into account".

Finally, it should be noted that, in practice, states invent new tax sources without waiting for the designation of undesignated taxes by the joint decision of the Houses, provided that the tax base does not refer to any of the Federal Government tax base. For example, all the states impose an agricultural income tax. The pastoral States of Afar and Somali, Oromia (in the Borena Zone) and the SNNP (in Omotic pastoral zones) have also introduced livestock tax. There are similar concerns with regard to the power of the regional states to levy and collect municipal taxes and the federal government to introduce surtax on imports.

e. The Issue of Local Taxation in Ethiopia

In Ethiopia, the FDRE Constitution, which emphasizes the need to transfer adequate power to local governments, leaves the powers and functions of local governments to the respective states.[68] The constitution provides the distribution of revenue-raising powers between the center and the regional states without any indication as to the revenue powers of local government. The international experience is mixed in this regard. For instance, the federations of Russia, German Nigeria, India, Switzerland, and Brazil have three tiers of government (center, state, and local) and thereby the distribution of the revenue follows this arrangement. The constitution or other laws allocate taxation power to the local governments. The German Basic Law assigns taxation power to local governments, setting tax rates such as levying taxes on real property and trades. The Swiss Constitution also recognizes the taxation powers of the municipalities and provides that they have the power to levy direct and indirect taxes unless specifically reserved for the center. In India, the 73rd and 74th amendments of the Constitution recognize the assignment of revenue sources to the local governments. In Nigeria, the Constitution recognizes local government, some revenue sources, and their right to receive a share of the national as well as the state revenue. In other countries such as the United

[68]FDRE Constitution, Art.50(4)

States, Australia, and Canada, the Constitution deals only with the power of the center and the states and leave decentralization of power further to the lower-level governments to the states in their own territory.

The very challenge in the Ethiopian federal system is that local governments don't have constitutional space for both expenditure responsibility and revenue powers. Both are apportioned between the federal and regional governments. This has put the local governments under the mercy of regional states. Most of the regional states have organized themselves at zonal, wereda, and kebele levels of administration in both urban and rural settings. Local governments collect various regional taxes through the finance bureaus that accrue to the state treasury. However, local administrations don't have the actual local tax power, and taxes are determined by the respective regional state laws. While the federal Constitution allocates all the revenue powers to the federal and regional governments only, it is regional Constitutions and other enabling legislation that are expected to allocate taxation powers between the regional and local governments. In this regard, regional constitutions grant rural districts the power to collect agricultural income tax and land use fees. And, urban revenue regulations grant the power to collect lease payments, land rental fees, and other forms of municipal revenues to urban local governments.

The wide local disparities in tax sources and local administrative capacities will continue to be a challenge to delimit local tax powers. There have been insignificant measures to maximize the administrative capacity of local governments and to secure their autonomy to administer and collect specific types of taxes. If it is not possible to allow local governments to levy and collect taxes, they can also share the revenue they have collected with the state government according to a certain agreed percentage. However, in Ethiopia, the tax sharing rule and practice are limited between the federal and regional governments. Looking at the experience from the above countries and the normative nature of the tax, taxes attached to real property can be effectively administered at the local level. Taxes on employment income, agriculture income, rural land use fees, rental income tax, charges and fees, and tax on the sale of real property can be assigned to local governments. The recent practice in the establishment of the local councils and local governments is meant to enable them to implement their own expenditure responsibility by collecting certain local taxes.

2.5 Limitations on Powers of Taxation

The exercise of taxing powers may affect the right to property, equality, privacy, freedom of expression, speech, religion, etc or might goes into conflict with the tax powers of other governments. It's therefore common for constitutions to set guidelines and limitations on the exercise of tax powers. In Ethiopia, Art. 100 of the FDRE Constitution has tried to provide directives and limitations on taxation powers of the Federal and Regional governments. There have been concerns that principles that limit the tax authority not to encroach upon the basic constitutional rights and freedoms are not well articulated under the FDRE Constitution. For instance, common constitutional guidances such as the principles of procedural fairness or due process, principles of ability to pay, benefit received principle, etc. cannot be easily read from Article 100 unless we read them through other provisions. The same is true about obligation imposing principles such as the duty to pay tax, which we can find only in the tax proclamations. Let us see some most important principles to the exercise of taxation powers.

a. Principle of legality

This principle emanates from the public nature of tax law and it means many things. First, it requires taxation (imposition or exemption) must have a legal basis. If there is no law there will not be an obligation to pay tax and there will not be delinquency or liability. Second, the principle underlines that the legislature (representative of the people) has supremacy over tax matters. In other words, there shall only be limited delegation (only where necessary) and no delegation to the executive on some basic or essential elements of the tax such as tax base, rate, exemption, and incentive that increase or reduce tax liability. Although article 100 is silent about this principle, it can be read from the legislative power of the parliament.[69]Thirdly, the principle dictates that no public money shall be collected except when authorized by law. This seems well accepted in Ethiopia as the federal and regional Financial Administration law provides the same rules.[70] There is no such significant problem with regard to the legal prescription of taxes in Ethiopia. However, in practice, the parliament makes too liberal, and extensive use of delegation in tax legislation

[69] Ibid, Article 55(1)

[70]The Federal Government of Ethiopia Financial Administration Proclamation No.648/2010. Art. 10(1)

and Laws by administrative agencies (regulations and directives) have dominated the tax law. A good example of the case in point is the VAT proclamation that delegates the power of exemption and registration threshold to the Ministry of finance through art. 8(4) and art. 16(2) respectively. The various tax incentives in the country including income tax holidays and custom duty-free imports are granted through the investment regulation, where the parliament delegates the council of ministers through the investment proclamation.

b. Principle of Fidelity to Sources of Taxes

The principle serves two purposes i.e. protection of taxpayers from the risk of double taxation and avoiding conflict of jurisdiction. It is recognized under Article 100 (1) of the FDRE Constitution. Both Federal and State Governments shall ensure that any tax is related to the source of revenue taxed. The first requirement in Article 100(1) is that the taxes the Federal Government or the Regional States impose be related to the "source of revenue" taxed. As it is discussed above some "sources of revenue" are designated as "federal exclusive" (Article 96), some as "state exclusive" (Article 97), some as "concurrent" (Article 98), and there are some that are yet to be designated by the joint Houses (Article 99). Meaning governments must in practice be faithful to the sources designated. However, both the Federal Government and the Regional States have in practice continued to levy and collect taxes that are not expressly stated in the Constitution as theirs. For example, Regional States levy and collect municipal taxes and the Federal Government introduced a sur-tax on imports. So far these practices have gone uncontested because both levels of government tend to tolerate one another in the levying and collection of certain taxes. This can be contentious if opposing political forces control the federal and regional governments.

In some countries, another related principle is known as "the prohibition of extraterritoriality of taxes" is adopted. This principle prohibits the extraterritoriality of taxes imposed by the states. This is because such taxes may impose burdens upon the economic activities of other states, or they may result in duplication of taxes. It also preserves the free flow of goods, services, and capital among the states. In the Ethiopian context, those taxes, which by their nature are extra-territorial, are assigned to the federal government.

c. Intergovernmental Immunity and Duty not to Cause Adverse Impact

These are two related principles. It is quite common for federal structures and constitutions to impose the limitation of intergovernmental immunity. The FDRE Constitution is fairly explicit about intergovernmental immunity. Article 100(3) states that neither the Federal Government nor the Regional States can impose taxes on each other's property unless the property is a profit-making enterprise. One might reasonably ask, why does it restrict the principle to "property" or whether it's applicable to income and consumption taxes is not clear. Some also downplay the importance of principle in present-day Ethiopia. In the first place, the Constitution already precludes the possibility of most cases of intergovernmental taxation through revenue assignment rules. Second, for profit making federal or state government enterprises, it is unlikely these enterprises will become the subject of taxation, as both tiers of governments are assigned the power to levy and collect most taxes on enterprises they own.[71] This makes the exception for profit-making government enterprises meaningless. Yet, in practice, the payment of municipal taxes and charges by federal enterprises such as telecommunication and banks, and VAT payment by regional constitution enterprises seem to call the relevance of this principle. Public universities also pay urban land lease fees and land rent.

On top of the immunity, governments should refrain from exercising their tax powers in ways that would adversely impact the tax powers of the other. This is the principle of the duty not to cause an adverse impact, which is recognized under art. 100(2) of the FDRE Constitution. It cautions the Federal Government and the Regional States from exercising their tax powers in ways that would adversely impact the tax powers of the other. In practice, there are a number of instances contrary to this principle. For example, the Federal Government has issued investment incentive laws that have an impact on the capacity of the Regional States to raise revenues from sources assigned to them by the Constitution.

d. Principle of Non-Discrimination

This limitation imposed a prohibition on the federal government from dealing with tax between the states or other levels of government in a discriminatory manner. More important in the Ethiopian context, is that the states should not

[71] FDRE Constitution, Arts. 96 (3) & 97 (7)

enact tax laws that discriminate among taxpayers on ethnic grounds. The limitation prohibits the imposition of different tax rates and tax privileges between the states. The significance of this limitation is that the people of different states should not be exposed to unfair treatment by the federal government on the pretext of the inequality of the states. It is also attributed to the equal constitutional status of the states. But, in some federations like Ethiopia, the asymmetry between the constituent units of a federation cannot be overlooked. The constitution of Ethiopia requires the governments to provide special assistance to those states which are least advanced in economic development. One of the measures taken with regard to taxation is to provide different tax holidays for income from different states. For instance, persons who invest by establishing new enterprises in states such as Gambela, Benishangul-Gumuz, Somali, and Afar are granted an exemption for a period of five years. However, in other states, the same investments are encouraged only by three years exemption. This incentive is meant to attract investment in the above-mentioned least developed states. Discuss the economic and governance implications of such rules in Ethiopian federalism.

e. Procedural Fairness and the Benefit Principle

Article 100(1) of the FDRE Constitution provides that taxes must be determined following proper considerations. How can a tax system ensure that taxes are determined following proper considerations? What are the rights of taxpayers that they can exercise in the course of tax administration? Answering this question requires examining the FDRE Constitution together with principles recognized in other countries. In other legal systems, there are principles such as principles of equality and the principle of fair play or public trust in tax administration. There are no such principles under Article 100. Yet it can be read from other provisions in the Constitution. For example, the principle of equality (as provided under art. 25) and the due process clause (as provided in article 37) can be raised to support the principles.

The “benefit principle” is a well-known and established principle in the literature on taxation. Under Art. 100 (2), the rate and amount of taxes shall be commensurate with services the taxes help deliver. However, it is extremely difficult for taxpayers to challenge a tax on the ground that they receive no benefits, and it is equally difficult for the government to establish correspondence between what it collects from taxes and the public services it

provides to taxpayers. One may recall the various provisions of the Constitution such as Art. 8 (sovereignty of the people, 43 (right to development), and 89 (economic objectives). Yet the questions of justiciability and *locus standi* would remain a challenge to exercise public interest litigation and ensure the judicial determination of the benefit principle in Ethiopia.

Summary

This chapter provides a brief introduction to the Ethiopian Tax System. With all its imperfections, there is a system underlying all of the taxes in Ethiopia. This chapter provides a brief overview of the Ethiopian tax system by focusing on the different types of taxes applicable in Ethiopia, tax reform, tax policy, tax administration institutions, and revenue performance in the country. An attempt is made to indicate gaps in each of these themes and the resultant effect in making the tax system disorganized, incoherent, inefficient, inequitable, and unpredictable. Well drafted and logically organized tax laws are critical for the proper understanding and implementation of a tax system. This chapter thus highlighted the importance of and criteria for tax law drafting and organization. It then dealt with the source and organization of tax laws in Ethiopia. Issues specific to the various sources of Ethiopian tax law including the constitution, proclamations, treaties, and regulations, directives, advance rulings, administrative publications, guides, forms, public notices, and finally court cases are identified and briefly discussed.

The system of fiscal federalism and related Constitutional provisions are of great importance when the tax system in Ethiopia is considered. The role of the FDRE Constitution can be looked into two ways. Firstly, it provides revenue sources for federal and regional governments in four headings: federal, state, concurrent and undesignated power of taxation. One of the major gaps in this arrangement is that local governments don’t have constitutional space for both expenditure responsibility and revenue powers. Specific constitutional problems and gaps concerning the divisions of revenue powers and the plights of remedial measures especially by the joint sessions of HPRs and HoF are identified and discussed in this chapter. Secondly, the Constitution sets guidelines and limitations on the exercise of tax powers. At this point, an attempt is to explore the various commonly applied principles (such as the principle of legality, fidelity to sources, intergovernmental immunity, the duty

not to cause an adverse impact, non-discrimination, procedural fairness, and the benefit received) and their recognition under the Ethiopian tax system.

Review Questions

1. What is a tax system? How do you understand the Ethiopian tax system?
2. Discuss the role of tax policy, law, and administration institutions in building a predictable tax system. What are the major limitations with respect to tax policies, laws, and administration institutions?
3. Identify and discuss the various structural and legal factors for the low tax effort in Ethiopia.
4. The Ethiopian constitutional approach is to divide revenue sources based on the tax sources not on the tax bases and taxpayers. Do you think this assignment corresponds with the type of federalism exercised in Ethiopia?
5. Currently, governments in Ethiopia are organized at federal, regional, and local levels of administration. It is not clear if the distribution of the revenue follows this arrangement. Do you think that the Ethiopian approach makes each level of government self-sufficient in meeting the respective expenditure responsibilities? On the other hand, some argue that the constitution primarily provides the distribution of revenue-raising powers between the center and the states and recommends that more efforts should be exerted to maximize the revenue powers of local governments. What do you think?
6. While Article 52(1) of the FDRE Constitution provides residual power to the states, Article 99 made a provision that the residual power of taxation should be assigned after the deliberation of the two houses jointly. Is there any inconsistency between the two provisions? Why? Why not?
7. The determination of undesignated power of taxation by the two houses' joint session remains more political than legal. How do you see the trend so far? Discuss the constitutionality of the introduction of the federal VAT, regional stamp duty, shared excise tax from companies, etc.
8. Discuss the role and importance of constitutionally providing limitations on powers of taxation. What are the major gaps in the FDRE Constitution?

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Chapter Three

The Law of Income Tax in Ethiopia: Part I

Introduction

Income tax is a type of direct tax. It is levied on the income of persons. The tax is a major source of revenue for the federal government and regional states of Ethiopia. This chapter is intended to acquaint readers with the fundamentals of income tax in general and the Ethiopian income tax system in particular. It begins with the concepts of income and then proceeds to discuss the objectives and jurisdictional principles of income tax. The chapter also looks at the types and features of income tax systems. After making a brief introduction to the Ethiopian income tax system, the chapter discusses the rules and practices relating to Schedule A (employment income tax) and Schedule B (income tax on the rental of buildings).

3.1 The Concept of Income

The concept of income serves valuable and various roles in income taxation. Since income is the basis upon which an income tax is imposed, it is appropriate to start our discussion with the concept of income. Scholars explain the meaning, nature, and features of income from different perspectives. Public finance economists have made a significant contribution to the development of the concept than scholars in other professions. The Schanz-Haig-Simons' definition of income, which is also called the concept of the comprehensive income tax base, is regarded as the most influential definition of income in the tax world. It conceives income as 'the sum of the person's consumption plus accumulation during the taxable period'.[1] Income is broadly defined to include the amount of how much a person could spend on consumption in a given period without reducing their net assets (wealth).[2]

The Schanz-Haig-Simons definition of income incorporates, in the scope of income, not only those conventional economic benefits, such as wage, business profit, interest, dividend, rental income, gifts, and inheritance but also imputed income and a net increase in the value of a person's wealth (capital assets).

[1] Victor Thuronyi, The Concept of Income, Tax Law Review, vol. 46, no. 1, 1990, p. 46
[2] Henry Aaron, What is a Comprehensive Tax Base Anyway?, National Tax Journal, Vol. 22, No. 4, 1969, pp. 543- 544

Imputed income is a type of non-cash or in-kind income that is derived from goods owned and used by the taxpayer.[3] The essential characteristic of imputed income is that the taxpayer received the income from his or her property. In a barter transaction, a taxpayer may receive a non-cash benefit in return for services rendered. Though the benefit is in-kind, it does not fall within the meaning of imputed income as it is derived from the other party to the transaction. The following example illustrates how an imputed income is derived from a house owned by the taxpayer. A woman resides in her own house located in the downtown of a city. If the house were rented, the woman would derive a rental income of 20,000 Birr per month (240,000 Birr per year). Suppose instead of renting to and receiving a rental income from third parties, the woman chooses to reside in her house. The housing benefit is an income that should be equally treated in the same way as a rental income paid by third party-leaser. This housing benefit is deemed imputed income although the woman receives no money from the use of her own house. Not all countries treat imputed income as taxable income. The United States and Ethiopia are prime examples.

The net increase in the wealth of a person is illustrated as follows. A person has 100 shares in ABC Company. At the beginning of the year, the shares are worth 100,000 Birr. The shares rise in value to 150,000 Birr at the end of the year. According to the Schanz-Haig-Simons definition of income, the person derives 50,000 Birr as an income at the end of the year. Though the person does not sell the shares or receive a dividend, his consumption power is increased by 50,000 Birr and still has the same wealth (shares that are worth 100,000 Birr) at the end of the year.

Even if the above definition dominates the theoretical discussion of income, income remains elusive, ambiguous, and difficult to measure in practice. As a result, the legal definitions of income, as enshrined in the tax systems, make some departures from the ideal and comprehensive concept of income. For instance, the net accretions to wealth (capital assets) are not regarded as taxable incomes until the occurrence of a realization event, such as disposal (sale, gift…) of the assets, as stipulated by the applicable tax laws. In the absence of the event, net accretions are difficult to measure. Imputed incomes

[3] Donald B. Marsh, The Taxation of Imputed Income, Political Science Quarterly, Vol. 58, No. 4, 1943, p. 514

also pose a similar challenge. They are usually excluded from the reach of income tax systems.[4]

As a matter of economic and social objectives, other different types of income are exempted from tax. It is common for governments to provide tax incentives, in the form of income tax holidays, for investors to encourage investment. For example, disability benefits (compensations) are usually exempted from tax.

The concept 'income' is used in different parts and provisions of the income tax laws of Ethiopia. The Income Tax Proclamation (No. 979/2016) provides the following definition of income that applies to the income tax laws in general. [5]

> *Income means every form of economic benefit, including non-recurring gains, in cash or kind from whatever source derived and in whatever form paid, credited, or received;*

When the word 'income' is used by the income tax laws, it represents an economic benefit that is capable of being expressed or measured in terms of money. Non-economic benefit, which is difficult to measure in monetary terms, is not considered income since it does not have a monetary value.

Periodicity is the other important component of the definition. An income may be derived on either a regular basis, such as employment and business incomes or rarely, to the extreme once in a lifetime, such as capital gain and income from winning chance games. The latter are examples of non-recurring gains. Based on this assumption, the Ethiopian income tax laws set a monthly tax accounting period for employment income while an annual tax period for incomes derived from the rental of buildings and business activity.[6] No tax accounting period is provided for non-regular incomes, such as income derived from winning lotteries. A person that purchases a lottery ticket may or

[4] Taddese Lencho, The Ethiopian Income Tax System: Policy, Design and Practice, A Dissertation Submitted in partial fulfillment of the requirements for the degree of Doctor of Philosophy, University of Alabama, 2014, p. 194

[5] Federal Income Tax Proclamation ((No. 979/2016)), Federal Negarit Gazette, 22nd Year No. 104, Article 2(14)

[6] Ibid, Articles 10(1), 13(1), 18(1)

may not win the game and earn the income. As a result, it is difficult to provide a tax period for such income.

As regards its form, the income may be derived either in cash or in-kind. The awarding of houses, vehicles, and mobile phones to winners of lottery games and employee fringe benefits are typical examples of in-kind incomes. The income tax laws contain valuation rules to compute the monetary value of the in-kind benefits and determine the amount of taxable income.

The phrase ''*from whatever source derived'* is worthy of special attention. There are different sources of income. Employment is a source of income for employees. Leasing a building is a source of income for homeowners. The sources of income are not restrictive. Based on the plain words of the definition, one may argue that the type of the source of the income does not affect the taxability of the income. That is not always right. Though the general definition recognizes that an income may be derived from whatever source, this does not mean that an income from whatever source is taxable. An income is taxable only if it is not exempt income. There are specific legal provisions that exclude some sources of income from the reach of the tax. For example, an income derived from a personal gift or inheritance is an exempt income in Ethiopia. This exemption does not extend to gifts made in the context of employment, rental of buildings, and business activities. If an employee receives a gift from the employer for his outstanding performance, such gift is regarded as employment income. The disposal of buildings and shares in the form of gifts brings capital gain tax.[7]

The taxability of illegal income (income from illegal activities, such as contraband, ransom, drug, and gun trafficking) is a source of debate in taxation. In the tax literature, there are supporters as well as opponents of the taxation of illegal incomes. The states' approach toward the issue is not uniform. Some countries have developed a precedent that permits the tax administration to levy tax on such incomes. Under the USA tax system, the definition of income incorporates the phrase 'from whatever source', and this phrase is interpreted so broadly to include illegal income.[8] In the Ethiopian

[7] Ibid, Article 65(1)(j), 59, 67

[8] In the history of US income tax system, the taxation of income from illegal activities was coined with the trial and sentencing of Al Capone, a notorious gangster, in the 1931. Al

context, it may be argued that illegal income should be taxed under Article 63 of the Income Tax Proclamation (No. 979/2016) based on two grounds. First, while defining income, the Proclamation does not require the source to be a lawful source. Second, illegal incomes are not found in the list of exempt incomes. But, one can raise a strong counter-argument based on the objective and rules of the criminal law of Ethiopia. The taxation of illegal income amounts to encouraging illegal activities. It is against the public policy of the country. The Criminal Code of Ethiopia states that when criminals derive an economic benefit from their criminal activities, the court shall impose a fine and order the confiscation of the profit made by the criminal.[9]

The words '*…derived and in whatever form paid, credited, or received'* are relevant to know the timing for the realization of income and the existence of a duty to pay income tax. A given economic benefit is recognized as an income and subject to tax when it is derived by a person (taxpayer). If the income is not derived, there will be no duty to pay income tax.[10] The deriving of an income may occur in various forms- as demonstrated by the words paid, credited, or received. It includes not only the actual receiving of an income (such as cash) by a person but also the existence of constructive receipts or the right to receive an income. For example, an income credited to the taxpayer's bank account is deemed to be derived by the taxpayer even if he/she does not withdraw or physically possess it. This is called the doctrine of constructive receipt. It is incorporated into Ethiopia's income tax laws.[11]Constructive receipt is an accounting or tax concept/doctrine that indicates the time when a person has received an income. It does not require physical possession of the income in question. A person is assumed to have received an income if the income is made available to the person so that he/she can get it at any time, particularly before the end of the tax year. For example, even if it is not cashed out, writing or drawing a check to a person brings the constructive receipt of the payment. The main purpose of recognition of constructive receipts as a taxable income is to prevent tax evasion or unreasonable delay of payment of tax by taxpayers. Another issue that is worthy of consideration is how the tax concept of income treats loans. A person that borrowed money

Capone was sent to prison for the crimes he committed, including failing to file tax returns for the incomes he generated from illegal liquor trade.

[9] The Criminal Code of the Federal Democratic Republic of Ethiopia, 2005, Article 92

[10] Supra note 5, Article 9

[11] Ibid, Article 2(5), 2(19)

from a lender is not regarded as deriving an income. Money received as a loan is generally not considered income because it is subject to an equal and offsetting obligation to pay back the loan. But, if the lender waives the borrower from paying the loan, it will create a different scenario and tax consequence. When a creditor or lender relieves the borrower from paying all or a portion of the debt, it is called cancellation of debt. Unless exempted by tax or other laws, canceled debt is considered a taxable income. A person, whose debt is canceled, shall pay income tax on it. Look at the following provision. It regulates the taxability of cancellation of debt in the context of employment income.

Debt Waiver Fringe Benefit (Article 9 of the Income Tax Regulation, No. 410/2017)

1. The waiver by an employer of the obligation of an employee to pay or repay an amount owing to the employer is a debt waiver fringe benefit.

2. The value of a debt waiver fringe benefit shall be the amount waived.

Given the predominant schedular feature of the Ethiopian income tax system, the Income Tax Proclamation (No. 979/2016) is not limited to just a general definition of income. There are also specific definitions of income on each schedule or charging provisions of the Proclamation. For instance, the Proclamation provides the definitions of employment income, business income, royalty, dividend, and interest to identify the type of the income that falls under Schedules A and C, and Articles 54, 55, and 56 of the Proclamation respectively.

The following are relevant terminologies that are used in income tax laws, including our Income Tax Proclamation (No. 979/2016).

- Gross Income: Gross income refers to the total amount and type of income of a person that is subject to income tax, without deduction of expenses.[12] It does not include those incomes that are specifically exempted by laws. The Income Tax Proclamation ((No. 979/2016)) defines gross income as a total taxable income without deduction of

[12]Lee Burns and Richard Krever, Individual Income Tax, in Tax Law Design and Drafting (volume 2; International Monetary Fund: 1998; Victor Thuronyi, ed.), p. 478

expenses and inclusion of exempt income.[13] The Proclamation uses the term gross income for different purposes. For example, gross income is used as a parameter for classifying taxpayers into categories A, B, and C. Though the principle is to impose a tax on net income, an income tax may be imposed on the gross income in some specific cases. The tax base of many taxable incomes of Schedule D is the gross income of the taxpayers.[14]

Taxable Income: In most cases, taxable income is defined as the gross income of the taxpayer less (minus) the total deductions allowed to the person for a given tax period.[15] It is an accepted principle of taxation that taxes should be imposed in consideration of the ability to pay of taxpayers. Taxable Income is presumed to be the appropriate parameter for ability-to-pay. It indicates a person's increase in an economic capacity and hence it is used as an income tax base upon which an income tax rate is imposed.[16] On the contrary, gross income does not reflect the true financial capacity of taxpayers. Deduction of expenses is justified on the ability-to-pay principle of taxation. The rental and business income taxes under Schedules B and C are assessed on the net taxable income of taxpayers.[17]

- Deductions: They are amounts that are specifically allowed as subtractions from gross income. Tax laws determine which amount is deductible and which one is not. Deductions may be characterized as expenses, and losses.[18] Expenses are expenditures that are incurred to derive the taxable income. They may be classified as ordinary (revenue) and capital expenditures. In tax accounting, ordinary expenditures are short term-expenses that are incurred to cover the day-to-day operational costs of the taxpayer's activities. Wages paid to employees, and utility costs, such as water and electricity costs, are examples of ordinary expenditures. Capital expenditures are defined as those expenses incurred in acquiring capital assets that can be used for more than one tax period (year). Tangible assets, such as machinery, vehicles, buildings,

[13] Supra note 5, Articles 2(12), 15(4), 21(2)
[14] Ibid, Articles 2(12), 3(1), 51, 53, 54, 55
[15] Supra note 12, p. 478
[16] Ibid, p. 477
[17] Supra note 5, Articles 15(1), 20(1)
[18] Kevin E. Murphy, Mark Higgins, Concepts in Federal Taxation, 2012 Edition, Cengage Learning, p.1-19

land, and intangible assets, such as patents or licenses, are the main examples of capital assets. Losses are amounts that result when expenses exceed gross/taxable income. For instance, there is a loss of 1 million birr if the person's gross annual income is 2 million birr while the expense is 3 million birr. Income tax systems allow deduction of expenses that are incurred in connection with deriving the taxable income. By contrast, there is a denial of deduction of expenses of (1) personal nature, which is incurred for purposes other than deriving the taxable income, and (2) policy-motivated ones, such as fines, bribes, taxes, pension contributions, political contributions.[19]

- Exempt Income: If income is exempted from tax, it will not be taxed. Unlike a deductible expense, an exempt income is not subtracted from gross income. It is excluded from both the gross income and deduction and not considered in the assessment or calculation of an income tax.[20] Governments exempt some kinds of income for different reasons. First, welfare or pension payments, scholarships, injury compensations, and income earned by institutions like religious, charitable, or educational institutions are the usual examples of incomes that are exempted from tax on socially motivated grounds.[21] Second, it may be the case that an income may be exempted for economic reasons. Income tax holidays are offered to investors to encourage investment activities. Third, an income may be exempt from tax by international law. For example, the exemption of diplomatic communities from the payment of employment income tax in the host states originates from the Vienna Convention on Diplomatic Relations. Finally, there may be other exemptions for political or administrative reasons.[22] The Income Tax Proclamation and Regulation of Ethiopia contain a list of incomes that are exempted from income tax. The exempt incomes are neither added to gross income nor separately subject to income tax.[23] Some of the exempt incomes include the following.

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[19] Victor Thuronyi, Comparative Tax Law, Kluwer Law International, 2003, p.274

[20] Supra note 12, p. 481

[21] Income tax systems do not totally exclude these institutions from the payment of an income tax. Some of the incomes derived by the institutions may be subject to tax. For more on this issue, see the discussion made under section 4.1.2 (Tax Base of the Schedule) of Chapter 4.

[22] Supra note 12, p. 481

[23] Supra note 5, Article 65; Income Tax Regulation, Proc. No. 410/2017, Federal Negarit Gazette, 23rd Year, No.82, Article 54

- A payment made by an employer to cover the medical expense of its employee/s
- Transportation allowance paid by an employer to its employees as per their employment contract.[24]
- hardship allowance
- per diems and transport allowance paid to an employee traveling on a tour of duty
- Employment injury compensations paid to employees
- a scholarship or bursary for attendance at an educational institution
- salary paid to domestic servants

3.2 Why Tax on Income?

Some justifications support the imposition of tax on income (income tax). As is common with all taxes, an income tax is an important source of revenue for states. It generates revenue for the states to cover their expenditures. Several developed and developing states raise the largest part of their tax revenues from income taxes. For example, income tax accounts for the highest share of total tax revenues among the OECD members. In 2018, the average share of income tax in the overall tax revenue of all OECD members was 34.3%. The income tax share exceeded 40% of the total tax revenues in the eleven members of OECD – Australia, Canada, Denmark, Iceland, Ireland, Luxembourg, Mexico, New Zealand, Norway, Switzerland, and the United States. [25] Unlike OECD members whereby income tax is a more important source of tax revenue, developing countries depend significantly on indirect taxes, principally taxes on trade and consumption.[26]

The more specific justifications for the levying of income tax are the following. First, income is regarded as the best indicator of the ability to pay of persons.[27] The amount of income derived by persons indicates their economic capability. Through proportional or progressive tax rates, taxpayers pay income tax in a proportion of their income. The rich pay more income

[24] As per Article 4(2) of directive no. 21/2001, commuting expense (work to home transportation allowance) is not exempted from tax as at gives personal benefit to the employees.
[25] Revenue Statistics 2020: Tax revenue trends in the OECD, OECD 2020, p. 9.
[26]Esteban Ortiz-Ospina and Max Roser, Taxation, available at https://ourworldindata.org/taxation, last accessed on Oct. 19, 2021
[27]E. Gordon Keith, Income tax, available athttps://www.britannica.com/topic/income-tax, last accessed on Oct. 19, 2021

taxes and the poor pay less. Imposing a tax on the income of persons conforms with the ability-to-pay principle of taxation.[28] On the other hand, indirect taxes like sales taxes fall on the rich and poor with equal force. The indirect taxes are imposed on goods and services with no regard to the economic status or capacity of persons bearing the taxes. They raise the price of consumable goods and services in the same way for both the rich and poor. In this regard, an income tax is more equitable than a tax on consumption or expenditure.

Second, an income tax is also commended for income and wealth distribution. By adopting progressive tax rates, a state can collect more income taxes from the rich and then spend the collected income taxes on pro-poor public projects. For a state to function effectively, it needs to maintain the well-being of its members (citizens) which in turn is based on the principle of distributive justice.[29] The fair distribution of income and wealth is thought to give citizens a sense of full-fledged membership in the state. It makes the occurrence of criminal and political violence less likely. Income inequality has been a driving force of protests, high crime rates, and violence in many states. In this regard, it is noted that

> *decreasing inequality could increase trust in government, thereby increasing compliance and hence strengthening the fiscal (and borrowing) capacity of states... This would not only support state-building through revenue contribution but would also give citizens a stake in the process of governance, fostering the development of democratic values in society*.[30]

Since the beginning of the 20th century, states have broadened their functions, beyond maintaining law and order, to the economic and social life of their citizens. These functions created the conditions for taxes to play stabilization and distributive roles. It became a norm to use income taxes as an instrument

[28] H.L Bhatia, a scholar that wrote extensively on public finance, argues that 'ability-to-pay' should not be measured by a sole indicator. A combination of different indicators, such as income, wealth, expenditure, gifts, capital, etc, should be used for this purpose. H L Bhatia, Public Finance, 29th Edition, p. 132

[29] Michelle Maiese, Distributive Justice, available at https://www.beyondintractability.org/essay/distributive_justice, last accessed on Dec. 01, 2021

[30] Roel Dom and Mark Miller, Reforming tax systems in the developing world: What can we learn from the past?, Overseas Development Institute Publication,(2018), p. 10

for distributive justice. According to Richard A. Musgrave and Peggy B. Musgrave, redistribution of income and wealth should be implemented by

> *… a tax-transfer scheme, combining progressive taxation of high-income with a subsidy to low-income households… [or by] progressive taxes used to finance public services, especially those such as public housing, which particularly benefit low-income households...[or by] a combination of taxes on goods purchased largely by high-income consumers with subsidies to other goods which are used chiefly by low-income consumers.*[31]

Finally, an income tax has some disadvantages. Common to direct taxes, the tax is criticized for discouraging persons from working and earning income. If a taxpayer's tax obligation is increased with increasing income, the idea is that the taxpayer has a disincentive to work more. An income tax that increases tax liability with the increase of income affects persons' will to work and save more money. This ultimately leads to the slowing down of economic growth in the state.[32]

3.3 Income Tax Jurisdiction Principles

States' power of taxation is one of the attributes of their sovereignty. The taxing power, which encompasses the ability to impose and collect taxes, needs to be exercised within the taxing jurisdiction of states. States cannot exercise their taxing powers in the absence of jurisdiction to tax.[33] It became an accepted norm that states' taxing powers should have some sort of connection with taxable subjects (persons) and objects. The connection is thought to exist if the states' taxing power is based on either the relationship to a person (personal attachment) or a territory (territorial attachment). This thought has led to the formulation of the two famous income jurisdiction

[31] Richard A. Musgrave and Peggy B. Musgrave, Public Finance in Theory and Practice, 5th ed., McGraw-Hill, (1989),p.11

[32] Supra note 28, p. 133

[33] The 19th and 20th centuries' understanding of sovereignty has great influence in creating the modern concept of jurisdiction to tax. During this time, there was a strong claim that states' sovereignty contains two aspects: the power over a territory (enforcement jurisdiction) and the power over a particular set of subjects (political allegiance). Fundamental principles of taxation, in Addressing the Tax Challenges of the Digital Economy, OECD Publishing, Paris, (https://doi.org/10.1787/9789264218789-5-en.) , p. 33

principles: the residence and source principles.[34] Today, these principles are serving as the main criteria to create nexus between states' income tax powers and taxable persons, transactions, and objects. They are widely applied by tax treaties and domestic tax legislation.[35]

According to the residence principle, the state where a person resides shall have the right to tax the income of that person. The principle asserts that persons, including natural and artificial persons, shall pay tax in the state in which they establish their residence, regardless of the place where the income is derived.[36] Different criteria are used to determine whether or not a state is the place of residence of persons. For natural persons, nationality, physical presence, domicile, or related concepts are frequently applied to determine their residence status. For artificial persons (such as share or limited liability companies), places of registration (incorporation), or the seat of the management of the body or effective control is exercised are the common indicators of their residence. The residence principle grants taxing power to the state of residence based on the justification that persons shall share the public expenditure (costs) of the state whey they live. Taxpayers contribute to the public services, such as the maintenance of law and order, they receive from the state.[37]

Contrary to the residence principle, it is the place where the income is derived that matters for the source principle. The state where an income is derived shall have the right to tax the income, irrespective of the place where the persons reside.[38] Hence, non-residents of a state shall have the obligation to pay tax if they derive income in that state. The justification for source principle-based power of taxation is that a state that creates the opportunity to generate an income should be given the right to tax that income. The justification contains some elements of the benefit principle.[39]The deriving of

[34] Fundamental principles of taxation, p. 34
[35] States rely on either of destination or origin principles to determine the jurisdictional reaches of their indirect taxes, such as VAT.
[36] Angelo G.A. Faria, Source versus Residence Principle, in Parthasarathi Shome (editor), Tax Policy Handbook, International Monetary Fund, 1995, p. 216
[37] Source and Residence Taxation, p. 1, available at https://www.taxjustice.net/cms/upload/pdf/Source_and_residence_taxation_-_SEP-2005.pdf, last visited on Sept. 24, 2021
[38] Supra note 36, p. 216
[39] Ibid; Supra note 37

an income is presumed to occur in the state where the income-generating activity is exercised or conducted. For instance, an employment income is derived at the place where the employment service is exercised. 'Permanent establishment' is a well-known concept that is widely used by tax laws to determine whether or not non-resident artificial persons (bodies) derive income in source states. Generally speaking, it is defined as a fixed place of business that creates an income tax liability on non-resident bodies.[40]

In practice, most states apply a combination of residence and source principles. They establish taxing powers over; (1) the worldwide income of residents (i.e income derived in residence/home as well as foreign states) and (2) incomes of non-residents' that are derived from sources/activities within the territory of the state.[41] Since states do not have uniform jurisdictional rules, the same person or income could be subject to the taxing powers or imposition of taxes by two or more states. This creates the possibility of double taxation. For example, the same income may be taxed by one state based on the residence principle while another state based on the source principle. Alternatively, due to the various ways of definition of 'residence', the same person may be considered a resident person by two or more States.[42] This also leads to double taxation. These examples are not the only causes of double taxation. The different formulation of the meaning and components of the residence and source principles creates the problem in several ways. It is for this reason that tax treaties and domestic tax legislation provide different mechanisms for preventing the double taxation of income.[43]

Ethiopia employs a combination of residence and source principles to delimit the jurisdictional reach of its income tax power. According to the Income Tax Proclamation (2016), it has the power to levy income tax on:[44]

- Resident taxpayers with respect to their worldwide income:
- Non-residents with respect to their Ethiopian source income:

[40] As an example, see supra note 5, Article 4(2)(a)
[41] Taxation, UNCTAD Series on issues in international investment agreements, United Nations, United Nations Conference on Trade and Development, New York and Geneva, 2000, p.8
[42] Ibid, p.10
[43] For the international double taxation avoidance mechanisms, see tax treaties. For the unilateral (domestic) double taxation avoidance mechanisms, see supra note 5, Articles 45, 46
[44] Ibid, Article 7

An individual (natural person) is regarded as a resident taxpayer of Ethiopia if he/she complies with one of the following tests[45]

- The Domicile Test: An individual becomes a resident taxpayer if he/she is domiciled in Ethiopia. The Proclamation does tell us what domicile means. According to the Technical Notes prepared by the Ministry of Finance, "domicile" of an individual is the place where the individual has a permanent home.[46] This explanation is still not satisfactory. It does offer an answer to basic questions like what constitutes a permanent home. It is recommended to refer to the Civil Code of Ethiopia to fill the definitional gap.[47]
- The Citizenship test: This test has a narrow scope of application as it is concerned with those Ethiopian citizens that are consular, diplomatic, or similar officials posted abroad.
- The Physical Presence Test: Any individual that is present in Ethiopia, continuously or intermittently, for more than 183 days in one year, is regarded as a resident taxpayer of Ethiopia.

Concerning bodies (artificial taxpayers)[48], there are two alternative tests for their residence status. A taxpayer is presumed to be an Ethiopian resident if

- It is incorporated or established in Ethiopia (incorporation test): Business organizations are deemed to be incorporated in Ethiopia when they are formed under the commercial laws of the country. For other forms of body, the incorporation is made as per the pertinent applicable laws; for instance, cooperative societies are formed as per the rules contained in the cooperative society proclamation. (or)
- Its effective seat of management is in Ethiopia: The test for determining the effective seat of management is whether or not the top decision-makers of a body hold their meeting in Ethiopia.[49] For example, shareholders and the board of directors are the top decision-

[45] Federal Tax Administration Proclamation No. 983/2016, Article 5(2)
[46] Technical Notes of the Federal Income Tax Proclamation (No. 979/2016), Ministry of Finance, p. 27
[47]See Civil Code, 1960, Proc. No. 165/ 1960, Article 183
[48] According to Article 2(5) of the Federal Tax Administration Proclamation No. 983/2016, body includes company, partnership, public enterprise or public financial agency, or other body of persons whether formed in Ethiopia or elsewhere.
[49] Supra note 46, p. 28

making persons of companies. If they hold their meeting in Ethiopia, then the company shall be regarded as a resident of Ethiopia. On the other hand, the conduct of the day-to-day activities of a body, including lower-level management decisions, in Ethiopia does not make Ethiopia a state of residence. As will be discussed below, a body taxpayer may present in Ethiopia through a permanent establishment. This does not mean that the taxpayer is a resident of Ethiopia. Rather, it is regarded as a non-resident taxpayer.

Resident taxpayers are taxed on their worldwide income. That means, their income derived in and outside Ethiopia is under the taxing power or jurisdiction of Ethiopia. Worldwide income refers to an income derived anywhere in the world, including the state of residence.

Non-resident taxpayers are those taxpayers that do not satisfy the residence tests discussed above. If the status of an individual taxpayer does not pass one of the domicile, citizenship or physical presence tests, he/she is a non-resident taxpayer.[50] To give an example, Mohamed is a citizen of Ethiopia. He is working and living in the USA. Though his nationality is Ethiopian, he resides/ domiciles in the USA. Hence, he is not a resident taxpayer of Ethiopia. A body, which is not incorporated in Ethiopia or whose effective place of management is in a foreign country, is not a resident of Ethiopia. Non-resident taxpayers are liable to pay tax to Ethiopia only with respect to their Ethiopian source income. It is not the place where the income is paid that makes it either foreign or Ethiopian source income. The Income Tax Proclamation (2016) provides different and alternative tests for determining whether or not the income of a non-resident taxpayer is an Ethiopian source income.[51] For example, irrespective of the place where the income is paid to the non-resident, the following events make the income an Ethiopian source.

- The conduct of the income-generating activities, such as employment, business, sporting activities, and chance winnings, in Ethiopia
- The disposal or lease of assets, such as buildings, located in Ethiopia

[50] Supra note 5, Article 5(7)
[51] Ibid, Article 6

For a non-resident body, there is an additional and important requirement for the attribution of an income as Ethiopian source income. The non-resident body shall derive the income through its permanent establishment in Ethiopia.[52] A permanent establishment is a tax concept that is used to indicate the stable and ongoing presence of a foreign body in a given state. Regarding its historical origin, Michael Kobetsky noted:

> *The permanent establishment concept was developed in the middle of the nineteenth century in the German states to prevent double taxation among the Prussian municipalities. At that time, municipalities in the eastern part of Prussia claimed that a trade with a fixed place of business should be taxed in the municipality in which it was located, even though the owner of the business lived in another municipality….*[53]

The Income Tax Proclamation (No. 983/2016) defines a permanent establishment as consistent with the definition contained in the international tax laws, such as the OECD, UN Model, and bilateral tax treaties. The concept is generally defined as "a fixed place of business through which the business of a person is wholly or partly conducted".[54] The word 'fixed' is used to require a certain degree of permanence in the place of the business. Short-term operations do not constitute a permanent establishment. The nature of the place of business and its duration are further illustrated by some inclusions. For instance, a non-resident body is presumed to establish a permanent establishment in Ethiopia if it has a building or construction site that continues for more than 183 days.[55]

As indicated above, the different interpretations and combined use of the residence and source principles lead to double taxation of an income. A non-resident taxpayer may, with respect to the same income, be subject to tax in Ethiopia as well as in its home state. Being aware of this problem, the tax

[52]Ibid, Articles 4

[53] Michael Kobetsky, International Taxation of Permanent Establishments, Principles and Policy, Cambridge University Press, 2011, p.110

[54] Supra note 5, Article 4(1)

[55] Ibid, Article 4(2) (c)

treaties and Income Tax Proclamation of Ethiopia provide double tax avoidance mechanisms.[56]

Since Ethiopia is a federal state, the issue of double taxation could also arise among its regional states. A person that resides in one state may derive an income from his business located in another state. This and similar circumstances create the opportunity for two or more states to claim and exercise taxing power over the same income. The regional states should resolve the problem by incorporating proper income tax jurisdiction rules in their tax legislation. The existing regional income tax laws contain income tax jurisdiction rules that are similar to the rules contained in the Federal Income Tax Proclamation (No. 979/2016).[57]

Finally, it is worth mentioning that the advancement of digital technology further complicates the traditional concepts of residence and source principles. In today's electronically connected world, people can interact, do business, and derive income without a physical presence in source states. Digital technology/economy, such as e-commerce, has made it a reality that it is possible to derive income with a digital presence than a physical presence. States should consider the redefinition of the residence and source principles so broadly to include the digital presence of persons and transactions in their territory.

3.4 Income Tax Systems: Global, Schedular, and Mixed

Two theoretical models exist for designing income tax systems; the schedular and global income tax models (systems). In practice, many states design their tax systems in a combination of the features of both models.[58]

The global income tax model is one in which a single income tax is imposed on all incomes, irrespective of their nature and source. The taxable income and tax liability are assessed on the aggregate of all incomes minus deductible expenses if any. The model is advantageous based on equitable and, to some

[56] See, Tax treaties ratified by Ethiopia as well as the Federal Income Tax Proclamation (Supra note 5) Articles 45, 48; Income Tax Regulation (Supra note 23) Article 25

[57] See for example, The Amara National Regional state Income Tax proclamation, Proc., No.240/2016, Articles 4,5,6

[58] Howell H. Zee, Theory of Optimal Income Taxation, in Parthasarathi Shome (editor), Tax Policy Handbook, International Monetary Fund, 1995, p. 121

extent, administrative grounds. The model promotes tax equity by taxing persons on the aggregate of their income. It may also have an administrative advantage in the following situation. If the taxpayers have multiple sources of income, they need not prepare and file a separate tax return for each income. One tax return is enough.[59] Since the global income tax model imposes a single tax on the sum of taxable incomes of persons, it requires a strong tax administration with the capacity to identify and aggregate multiple incomes from different sources. This makes the administration of the model difficult. The United State introduced the global definition of income in 1862. This paved the way for the creation of the global income tax model. [60] The ideal (pure) global income tax model is not yet implemented. Even among those states that are regarded as having the model, there are special tax rules for some categories of income. The separate taxation of capital gain is an example of the non-existence of a single tax rule for all types of income.

The schedular income tax model imposes separate income taxes on different types of income. Incomes are separated by their sources, such as employment, business, etc, and subjected to different schedules (tax rules). It employs distinct rules of deduction and exemption or exclusion for each income. The tax rates, assessment, and collection mechanism may vary from schedule to schedule.[61] The main advantage of schedular income tax model is that its enforcement requires less administrative resources than the global income tax model. It does not involve the heavy task of income and expense aggregation. It is easily administered in countries with less developed tax administration. Since the model imposes income tax at the source of income, there is a good environment to collect tax through a withholding system. This reduces the number of taxpayers that are required to file tax returns. If there is a state policy to treat incomes differently, the schedular income tax model offers the appropriate income tax structure.For instance, a state may desire to provide special (lower) tax rules for capital income than the rest types of income. The model provides the structure for the special tax treatment.

The schedular income tax model has its downsides. An income may fall in two or more schedules. This creates overlapping of schedules.[62] A given type

[59]Ibid
[60] Supra note 19, p.232
[61] Supra note 12, pp. 472-473
[62] Supra note 58, p. 121

of income may fall into two or more schedules. The difference in the tax rules among the schedules induces taxpayers to engage in tax planning. They resort to reporting their income under a schedule that contains the lowest tax rate. The different treatment of incomes based on their type or source conflicts with the goal of equity. It is held that a tax shall be imposed based on the ability to pay of persons. The latter is expressed by an increase in the total economic capacity or income of the persons. The schedular model misses this element.[63] The emergence of schedular income tax systems traced back to the United Kingdom. In 1803, the country enacted a law that introduced schedular definition of income. This law laid down the foundation of the country's schedular income tax system to this day.[64]

In between the schedular and global income tax models, there is an intermediate, composite or mixed model that combines, to a greater or lesser extent, the features of the two theoretical models. The mixed model may impose a tax on many types of income on a global basis but still contain some schedular features. On the other hand, a predominately schedular model may have a separate and single schedule for the taxation of residual incomes. In practice, the existing income tax systems do not follow the pure either global or schedular model. The so-called global income tax systems contain some schedular elements and most existing [schedular] income tax systems lie on the spectrum between schedular and global.[65]

3.5 A Basic Introduction to the Income Tax System of Ethiopia

Income tax is an important fiscal policy tool in Ethiopia. It is among the major sources of revenue for the federal and regional governments. In the 2018/19 Fiscal Year, it contributed 43% (ETB 115.9 billion) of the total tax collected by the country. Bodies' profit tax (corporate income tax) and employment income tax made up nearly three-quarters of all the income tax revenue of the same fiscal year.[66]

The income tax system of Ethiopia consists of the country's income tax laws and their administration by the tax authorities at the federal and regional

[63] Supra note 12, pp. 473
[64] Supra note 19, p.232
[65] Supra note 12, pp. 474
[66] Tom Harris and Edris Seid, 2019/20 survey of the Ethiopian tax system, The Institute for Fiscal Studies, 2021, p.9

levels. The first publicly known and modern income tax law was issued in 1944.[67] This law has a distinctive place in the history of the Ethiopian income tax system. It introduced a schedular income tax system to the country, which continues to date. It imposed income taxes on employment and business, as separate sources of taxable income. It is believed that Ethiopia borrowed the schedular income tax model from Great Britain. In 1944, Ethiopia had a strong relationship with Great Britain.[68]

The following are key points to understand the key features of the Ethiopian income tax system

I. The Ethiopian income tax system exhibits the characteristics of schedular income tax system. There are distinct tax rules for the taxation of incomes earned from employment, rental of buildings, business, mining and petroleum operations, royalty, dividend, agriculture, etc. The main income tax system of the country (excluding the agricultural income tax system) contains four tax charging schedules: Schedules A, B, C, and D. Each Schedule has its tax base, tax rate, assessment, and collection methods. The existence of numerous schedules makes the income tax system one that is schedular.
II. Post-1991 Ethiopia is a federal state. The FDRE Constitution allocates the tax powers and sources among the federal and regional governments. Concerning income taxes, the two tiers of governments exercise either an exclusive or concurrent taxing power depending upon the constitutional provisions (Articles 96-99) under which the income in question falls. The federal government uses schedule A of the Income Tax Proclamation to impose and collect employment income tax from employees of its institutions and international organizations. The regional governments apply the same schedule to employees of their institutions and employers other than the federal institutions and international organizations. The federal and regional governments hold concurrent taxing powers over a business income tax that is imposed on private business organizations as per Schedule C of the income tax proclamations. If the business organization is owned by either the federal or regional governments, there

[67] Personal and Business Income Tax Proclamation, 1944, Proc. No. 60, Negarit Gazeta, 3rd year, No. 9
[68] Supra note 4, p. 1

will be no concurrent taxing power. The government that owns the organization has the exclusive right to levy and collect the business income tax from it. For example, the Commercial Bank of Ethiopia shall pay business income tax to the Federal Government. Those incomes that were assigned as per Article 99 of the Constitution fall under the jurisdiction of either the federal or regional governments depending upon the decision of the joint federal houses. For example, the joint houses decided the federal government levy income tax from interest paid by banks to money depositors. The interest income is taxed as per Article 56 (Schedule D) of the Income Tax Proclamation.

III. The existing income tax laws of Ethiopia are found primarily in proclamations, regulations, and directives. In terms of their content, it is difficult to make a distinction between the federal and regional income tax laws. Many of the laws do not reflect the assignment of taxing powers by the FDRE Constitution. The federal laws incorporate rules on those income taxes that are under the exclusive jurisdiction of the regional governments. For example, according to Article 97 (4) of the Constitution, the income taxation of individual traders (in the words of the income tax laws, Category C taxpayers) is the exclusive tax power of the regional government. However, the past, as well as present federal income tax laws, contain provisions that determine the assessment and collection methods of income tax from these taxpayers. On the other hand, the regional governments are in the habit of direct transplantation of the federal income tax laws. They simply copy and apply the federal laws to collect the regional income taxes. The regional income tax laws contain tax provisions that are originally enacted for federal income taxes. An example is dividend tax. In their content, there exists no difference between the federal and regional income tax laws. In the words of Taddese Lencho

> *The one area of taxation powers where the regional governments have shown some legislative muscle is in the agricultural income taxes, presumably because these taxes are the exclusive preserve of the regions.*[69]

[69]Taddese Lencho, Income Tax Assignment under the Ethiopian Constitution: Issues To Worry About, Mizan Law Review, Vol. 4 No.1, March 2010, p.43

The concerned authorities usually provide two justifications for the direct adaptation of the federal income taxes by the regional governments. First, there is a view that the regional governments do not have the required tax experts and drafters. The transplantation of the federal laws has been regarded as the appropriate solution to the legislative weaknesses of the regional governments. Second, some regional income tax laws regard the direct transplantation of the federal laws as a means of tax harmonization.[70] There has been a view that looks at the federal tax laws as model laws for the regional governments. Legally speaking, the FDRE constitution of Ethiopia does not contain tax harmonization clauses. There is no constitutional law that obliges the federal and regional governments to harmonize their tax laws. An examination should be made as to the issue of whether or not the transplantation of the federal laws is the appropriate way of (1) solving the legislative weaknesses of the regional governments and (2) tax harmonization.

IV. Taxpayers that derive incomes from two or more sources that fall under the same schedule are taxed on the aggregate of their incomes. This is called the income aggregation rule and it applies to Schedules A, B and C of the Income Tax Proclamation.[71] For example, a landlord rents two houses to two different tenants at 20,000 and 30,000 Birr respectively. The landlord is legally obligated to calculate and pay rental income tax on the total 50,000 Birr. The aggregation rule is important for two things. First, it is one of the means to ensure equity of the tax system. Second, it helps to prevent tax avoidance and erosion of the tax base. The income aggregation rule does not apply to Schedule D as there are separate taxable incomes and tax charging rules in the Schedule. For instance, dividends and income from lottery winnings cannot be aggregated and taxed under the same tax rate. They are subject to different tax rates. The aggregation rule even does not work for the same incomes falling under the same tax rule/rate. A person deriving dividends from two or more different companies shall not be taxed on the aggregate of the dividends. This is due to the application of the final withholding system on schedule D.[72]

[70] See, for example, Income Tax Proclamation of the Amhara National Regional State (No. 76/2002) Article 3
[71] Supra note 5, Article 8(2)
[72] Ibid, Article 64(2)

V. Under the existing Income Tax Proclamation (No. 979/2016), taxpayers are defined or classified in various ways for different purposes. Except for schedule A whereby the taxpayers (employees) are always natural (individual) persons, Schedules B, C and D's taxpayers could be either natural (individual) or artificial (body) persons. This classification of taxpayers is relevant to determining the applicable tax rates for schedules B and C. The two schedules apply progressive and proportional tax rates on individuals and bodies respectively.[73]

The classification of taxpayers into Category A, Category B, and Category C is the other important categorization of taxpayers. This classification is very relevant for Schedules B and C. By employing annual turnover and legal form (i.e, *body vs sole proprietorship*) as criteria, the Income Tax Proclamation defines the three categories of taxpayers as follows.[74]

- ✓ Category "A" taxpayers are bodies, irrespective of the amount of their annual turnover, and individuals (such as sole proprietors) with having an annual gross income of Birr 1,000,000 or more.
- ✓ Category 'B' taxpayers are individuals having an annual gross income of Birr 500,000 or more but less than 1,000,000.
- ✓ Category 'C' taxpayer individuals having an annual gross income of less than Birr 500,000

Category A and B taxpayers shall have the duty to keep books accounts and they are subject to the self-assessment rule. Category C taxpayers do not have the legal obligation to keep books of accounts. They are assessed based on a presumptive assessment method. The income tax laws set different deadlines for the payment of the annual income tax liability of the taxpayers.[75] For income tax jurisdiction rules and Schedule D tax rates, there is a classification of taxpayers into resident and non-resident taxpayers.[76]

3.6 Schedule A: Employment Income Tax

Employment income tax has different names in different tax systems. Depending upon the nature and structure of the income tax systems, it may be called Payroll Tax, Pay-As-You-Earn (PAYE), Pay-As-You-Go (PAYG) tax,

[73] Ibid, Articles 14, 19
[74] Ibid, Article 3
[75] Ibid, Article 49, 82, 83, 84
[76] Ibid, Article 7, Schedule D

Wage-Earners tax, etc. It is a common practice to employ a final withholding system to tax employment income. The employer is required to withhold the employment income tax from its employees. The tax is assessed on the gross income and there is little room for the application of deduction rules. Due to the application of the withholding system, employment income tax is easy-to-collect tax revenue. It claims little compliance and administrative costs. The tax is a high-yielding revenue collector in many countries.[77] It holds a significant share in tax revenues in general and income taxes in particular. The withholding scheme is an effective method for securing an uninterrupted and reliable revenue sources. By reducing tax evasion, it furnishes the government with uninterruptable money to fund its activities.[78]

On the other hand, the deduction of employees' expenses from their salaries/wages causes trouble for the withholding agents (employers) and complicates the income tax system.[79] If a deduction is allowed, there will be a difficulty of demarcating the line between employment-related expenses and other personal expenses. Given a large number of employees, it is inevitable that there will be many disputes over employment-related deductions. This will require tax authorities to spend a disproportionate amount of administrative resources. As a result, many income tax systems do not apply the regular expense deduction rules on employment income. Some systems deny deductions for employees while others allow a flat deduction. [80]

Income tax systems like Ethiopia apply an exemption rule concerning employment-related expenses. The Income Tax Proclamation (2016) contains some lists of employment-related payments that are exempted from tax. When an employment income tax is calculated, such payments are excluded from the computation of the taxable employment income.[81]

In the history of the Ethiopian income tax system, the 1944 income tax proclamation was the first law to come up with three Schedules. Schedule A

[77] Richard M. Bird and Milka Casanegra de Jantscher, The Pay-As-You-Earn Tax on Wages, in Tax Law Design and Drafting (volume 2; International Monetary Fund: 1998; Victor Thuronyi, ed.), p.

[78] Ataklti Weldeabzgi Tsegay, Tax Exemption through Letters: Issues of Legality and Equality, Bahir Dar University Journal of Law Vol.5, No.1 (2014), p. 132

[79] Supra note 12, pp. 488-489

[80] Ibid

[81] Supra note 5, Article 65(1)

was created for taxing individuals' income while Schedules B and C were for businesses' income. The 1949 and 1956 income tax laws followed the same suit in applying Schedule A for the taxation of personal incomes derived from employment and other sources in a non-business context. The scope of the schedule was narrowed down to employment income by the 1961 income tax proclamation.[82] To date, this schedule remains to be the exclusive schedule for taxation of income derived from employment.

3.6.1. The Taxable Units (Taxpayers) of the Schedule

An employment relationship is created by an agreement made between an employee and employer.[83]

When the employment relationship is seen in the context of income tax, the employee is the taxpayer that must pay employment income tax. The Income Tax Proclamation (No. 979/2016) defines an employee in the same way as the above. It states

> *"Employee" means an individual engaged, whether on a permanent or temporary basis, to perform services under the direction and control of another person, other than as an independent contractor, and includes a director or other holder of an office in the management of a body, and government appointees and elected persons holding public offices;*[84]

The definition holds that an employee is an individual that performs work under the control of the employer. There are inclusions in and exclusions from the definition of employee. Individuals that hold directorship or managerial positions, government appointees, and elected officials are regarded as employees. Managers of companies, judges and parliamentarians are

[82] Income Tax Law Proclamation No. 173 of 1961, Article 7

[83] According the labor law of Ethiopia, there are four components of the employment relationship. First, there is a duty of the employee to perform a work for the employer. Second, the work is performed under the authority and direction (control) of the employer. Third, the employer has the obligation to pay an amount of money to the employee in return for the performance of the work. Fourth, the relationship shall be established to perform lawful activities. The latter may have business or non-business purpose/objective. The duration of the employment may be short or not, definite or indefinite. Labor Proclamation, Proc. No. 1156/2019, Federal Negarit Gazette No. 89, 25th Year, No. 89, Article 4

[84] Supra note 5, Article 2(7)

examples of persons that are treated as an employee for the purpose of income tax. On the other hand, independent contractors are different from employees. The control over the performance of a work is the distinguishing criterion between the two categories. The existence or not of substantial control over the manner of performance of an activity is the requirement for the treatment of a worker as either employee or independent contractor. As stated above, employees perform work under the control of the employer. On the other hand, the Income Tax Proclamation (No. 979/2016) defines an independent contractor as

> *an individual engaged to perform services under an agreement by which the individual retains substantial authority to direct and control the manner in which the services are to be performed.*[85]

An independent contractor retains the control to determine the means of performance of the work. However, there is an obligation to deliver the result as per the agreement. The distinction between employees and independent contractors has considerable ramifications in schedular income tax system.[86] The applicable schedules, tax rates, assessment methods, accounting period, the scope of allowable deductions/exclusions, amount of tax liability and other closely related issues are not the same for the two groups. An independent contractor is considered self-employed and hence is subject to business income and indirect tax rules. The assessment, collection, and submission of the tax liabilities are effected by the contractor. Because independent contractor status reduces the compliance costs of clients, there is a general tendency among the latter to treat their workers as independent contractors rather than employees.[87] In the Ethiopian context, Schedule 'A' of the Income Tax Proclamation is designed to tax employees' income whereas the financial

[85] Ibid, Article 2(15)

[86] The employee-independent contractor classification has also important implications in employment and extra-contractual liability laws. Employment laws do not extend their scope of application to independent contractors. In contrast to employees, independent contractors are not entitled for employment rights. In extra-contractual liability, one of the sources of vicarious liability is employment relationship. Employers are vicariously liable for their employees, but not for independent contractors. See the Labor Proclamation, Proc. No. 1156/2019, Articles 3; Civil Code, Proc. No. 165/ 1960, Articles 2126- 2134

[87] Zerihun Asegid, The Use of Control Test in the Classification of Taxpayers into Employee and Independent Contractor: A Comparative Study on Workers of Higher Education Institutions, Mekelle University Law Journal Vol. 4 June 2016, p. 109

gains of independent contractors are primarily subject to Schedule 'C' of the Proclamation.

While making the distinction, the Income Tax Proclamation (No. 979/2016) does not specify the details of the control test. The general words of the Proclamation do not tell us the specific components and parameters of the control. What does mean by a performance of work? To what extent shall the employer exercise the control? What are the indicators of the control? Is it the place of the work or time of work or what? Does it mean what work to be done? or where to be done, or how to be done? or with whom to be done? Or any other? According to the Technical Note of the Income Tax Proclamation prepared by MOFED, the determination of whether an individual is an employee or independent contractor involves examining several factors, including whether the hirer has the legal right to control how the work is done and the degree of integration of the activities of the individual in the business of the hirer. In determining the degree of integration, regard is normally had to the following:

- Whether the individual is engaged continuously.
- Where the services are performed, in particular, whether they are performed at the hirer's place of business.
- Whether the hirer controls the timing and scheduling of the work.
- Whether the hirer provides the working tools, plant, and other relevant facilities necessary for the individual to perform his or her work.

In practice, the distinction between an employee and an independent contractor has been widely applied in higher education institutions.[88] The academic staffs of the institutions engage in teaching, research, and community services. These activities are multifaceted by their nature and could be disintegrated into further functions. For instance, teaching involves the delivery of education in regular and non-regular programs, such as distance, extension, and summer programs, preparations of a course syllabus, writing modules and textbooks, assessment of exams and research papers, advising students, and so on. The academic staff may provide such services to the very institution for which they work or to other institutions on a contractual basis. Through community services, the staff members provide

[88] Ibid, p. 123

short-term training and consultancy. For such services, special contracts are often signed between the staff and the institutions. As withholding agents, it is difficult for the higher education institutions to determine the applicable schedules for the various financial gains of the staff members. The identification of schedules for income earned from such activities has not been an easy task for the institutions. Some of them characterized the above as incomes sourced in employment and accordingly taxed as per Schedule 'A', while others characterized them as incomes that do fall in Schedule 'C'. The inconsistent application of the schedules has exposed the staff to unpredictable tax burdens and hence it remained a source of disagreement between them and the institutions. The problem needs to be resolved by enacting a proper interpretative directive of the control test.

On the other hand, employers are withholdings agents under Schedule A. They must withhold the employment income tax from the salary and other payments made to the employees and then submit the tax to the Tax Authority. The Income Tax Proclamation (No. 979/2016) defines an employer as 'a person who engages or remunerates an employee'.[89] The definition of employer is broader than that of an employee as it incorporates both natural (individual) and artificial (body) persons. The word 'remunerates' is used to cover those situations where one company may engage the employee but another (such as a sister) company actually pays the remuneration to the employee. In such circumstances, the duty to withhold employment income tax, as stated in Article 88 of the Income Tax Proclamation (No. 979/2016), falls on the sister company.

3.6.2. The Tax Base of the Schedule

Employment income tax is imposed on employment income. The definition and scope of employment income is another relevant issue under Schedule A. The Income Tax Proclamation (No. 979/2016) does not directly define what employment income means. Instead, it lists out those incomes that are regarded as employment income. The same Proclamation regards the following as an employment income.[90]

[89] Supra note 5, Article 2(8)
[90] Ibid, Article 12

- salary, wages, an allowance, bonus, commission, gratuity, or other remuneration received by an employee in respect of a past, current, or future employment;
- the value of fringe benefits received by an employee in respect of a past, current, or future employment. Fringe benefits are
- Payments made up on termination of an employment contract. These include payments instead of unutilized annual leave, severance payments, and compensations for unlawful termination by the employer.

The common feature of the above lists of income is that all of them arise from the employment relationship. In connection to the concept of employment income, we need to realize the following relevant issues. First, the basic criterion to characterize a given payment as an employment income is the existence of a connection between the income and employment. As stated in the above provision, the income shall be received 'in respect' of employment. The employment relationship should be the main reason for the payment. Contrary to this, any payment made in non-employment context does not fall within the scope of employment income. For example, a pure gift, such as a wedding present given by an employer to an employee, would not be employment income.[91] Second, the taxable employment income includes fringe benefits. The latter are nowhere defined in the income tax laws. In general terms, fringe benefits refer to extra benefits that are derived by the employee from the employment.[92] The benefits are different from the remuneration (salary or wage) of the employee and they may be given either in cash or non-cash forms. The main examples of fringe benefits are health insurance, employer-provided housing, the use of the employer's car for personal purpose, and the provision of discounted goods to employees. The taxation of fringe benefits is justified on equity and tax base widening grounds.

Employees earning the same amount of income, but in different forms, should be subject to the same tax liability. For example, it is against horizontal equity to impose a tax on an employee that receives a 10,000 birr wage and exempt another employee that receives an in-kind employment benefit worth 10,000

[91] Supra note 46, p.42
[92] Supra note 12, p 492

Birr. The non-taxation of fringe benefits affects the tax base. It narrows the tax base as employment contracts usually offer fringe benefits to employees. In addition, it could motivate taxpayers to evade tax liability by shifting their remuneration, such as salary and wages, into fringe benefits.

One of the defects of the pre-2016 income tax laws was that they did not contain detailed provisions concerning the types and valuation rules of fringe benefits. Due to the legal gap, it was not possible to impose employment income tax on such benefits. The Income Tax Regulation (No. 410/2017) specifies those taxable fringe benefits in Ethiopia.[93] They include debt waiver, household personnel, housing, discounted interest loans, and meals. The monetary value of in-kind fringe benefits should be estimated per the applicable valuation rules. Accordingly, the 'cost to the employer' and 'market value' methods are applied to determine the monetary amount of meals and housing accommodation respectively.[94]

Third, the determination of whether or not a given employment income is taxable or not requires an understanding of the structure and scope of schedule 'A' of the Ethiopian income tax system. When the taxability of a given benefit under schedule A becomes an issue, we need to begin our inquiry from the concept of employment income. If the benefit fulfills the definitional requirements of employment income as stated in Article 12 of the Income Tax Proclamation, then we can conclude that that benefit falls within the scope of Schedule A. However, this does not necessarily mean that that benefit is taxable. The employment income should not be an exempt income. An employment income that is identified as an exempt income is not subject to employment income tax. For example, a monthly employment income of up to 600 Birr is exempt from tax.[95] Those employees that receive a salary of less than 600 Birr per month do not pay employment income tax. For those employees that receive a salary above 600 Birr, the first 600 Birr is exempt from tax. Let's assume that the salary of an employee is 7000 Birr. Accounting for the 600 Birr exemption, the taxable employment income is 6400 Birr.

[93] Supra note 23, Article 8
[94] Ibid, Articles 11(1), 13
[95] Supra note 5, Article 12(2), 11

The other exemptions are found in Articles 65 and 54 of the Income Tax Proclamation (2016) and Regulation (2017) respectively. Within the limits set by the applicable directives, payments made to cover the medical expenses of the employees, transportation allowance, hardship allowance, and per diems are exempted from employment tax. An employment income received by foreign diplomats is not taxable in Ethiopia. Compensation for employment injury is not subject to employment income tax.[96]

Due to the misunderstanding of the concept of taxable employment income, there have been many instances whereby different forms of benefits, particularly house allowances, are claimed to be exempted from tax. For example, in the case between Workneh Belay et al vs Awi Zone Revenue Department,[97] the taxpayers were public prosecutors of the Amhara National Regional State. In addition to the basic salary, they received housing allowances from their employer: the regional government. They brought legal action before the lower courts when an employment income tax was imposed on the housing allowance. They argued that the regional income tax laws do not explicitly state that housing allowances are taxable. On the other hand, the respondent regional state argued that the regional tax laws do not explicitly exempt housing allowance from taxes. Except for the Woreda Court, the remaining courts, including The Federal Supreme Court Cassation Division, decided in favor of the taxation of housing allowances. One can conclude from this decision that tax law favors the inclusion of income absent a specific exclusion.

Fourth and as stated in the introduction part of this section, the Income Tax Proclamation (No. 979/2016) rejects the application of a deduction rule for schedule A. Unlike Schedules B and C of the Proclamation, the determination of the amount of taxable employment income does not involve the deduction of expenses from the salary and other payments made by the employer.[98] The employee is not entitled to a deduction of any expenditure incurred in deriving the employment income. Instead of deduction of expenses, there is an

[96] Ibid, Articles 65(1) (a), (F), (i); Vienna Convention on Diplomatic Relations,1961, Article 34; Labor Proclamation (Proc. No. 1156/2019, Article 112(1)
[97] Federal Supreme Court Cassation Division , File No. 196753, May 25, 2013 E.C
[98] Supra note 5, Article 10(3)

exemption of some employment-related payments.[99] The latter do not constitute part of the gross employment income

Fifth, employment income includes income received with respect to past, present, or future employment.[100] In the ordinary course of things, an employment income is paid to present employment. It is a common practice in Ethiopia to pay a monthly salary for the employment rendered in the same month. But, the Income Tax Proclamation (No. 979/2016) widens the timing of employment income to other arrangements: past and future employment. It may be the case that the employment contract may provide for deferred compensation in the sense that the employment income or portion of it will be paid at a later date. To illustrate, for the employment service rendered in the 12 months of 2014 E.C, the employment income may be paid in September 2015 E.C. On the payment date, the employee receives back payment for past employment. The Proclamation states that an income received with respect to past employment is regarded as an employment income. On the other hand, the employee may receive employment income in advance for work to be done in the future. This is the case of advance payment for future employment. The same proclamation regards such payment as employment income.

3.6.3. The Income Brackets, Tax Rates, and Computation Methods

One of the reasons for the enactment of the 2016 Income Tax Proclamation was the need to revise the income tax brackets. The repealed income tax Proclamation of 2002 was effective for 14 years without amendment of the brackets. The brackets are thought to be inconsistent with the changed economic circumstances, particularly the real value of money, in the country. The Income Tax Proclamation of 2016 came up with revised income tax brackets in consideration of the current real value of money (Birr).[101] The exempt threshold was increased from 150 to 600 Birr. There is no tax for the first 600 Birr employment income of employees. It is exempted from tax. All employees, whether their income is less or greater than 600 Birr, do not pay

[99] Ibid, Articles 12(2), 65
[100] Ibid, Articles 12(1)
[101] Interview with Wasihun Abate, Director of Legal Services, Ministry of Finance, Gebi Lelimat Magazine, Special Issue, 2009 E.C

tax on such amount. The monthly employment income that is subject to the maximum tax rate (35%) was changed from 5000 to 10,900 Birr.

Employment Income (per month) Birr	**Employment Income Tax Rate**
0 –600	0%
601-1,650	10%
1,651-3,200	15%
3,201-5,250	20%
5,251-7,800	25%
7,801-10,900	30%
Over 10,900	35%

Source: Federal Income Tax Proclamation ((No. 979/2016)), Article 11

As shown in the above table, marginal tax rates are set by reference to the monthly employment income of employees. They range from 0% (which means no tax is imposed) to 35%. In computing the payable employment income tax, the taxable employment income shall be sliced into the different income brackets and taxed at the respective tax rates. Let's assume that the monthly salary of the employee is 2000 Birr. The first 600 Birr is exempted from tax. The taxable employment income is 1400 Birr. Out of the total, the 1050 Birr, which falls in the 601-1650 bracket, is taxed at 10%. The remaining 350 Birr is taxed at 15%. The total tax liability is equal to 157.5 Birr (105 + 52.5).

If the employee works for multiple employers, the tax liability is assessed on the aggregate of the employment income.[102] For instance, Mr. Abebe started working in X Company since October 01, 2014 E.C for a salary of 10,000 Birr. He was also hired by Y Company to work on a part-time basis since January 01, 2014 E.C for 7000 Birr. The employment income tax for and post-January shall be calculated on the aggregated salary, which is 17000 Birr, not separately for each salary. The exemption amount of 600 Birr is not applied to each income source/salary. The result is that the amount of tax on the aggregated income is greater than the tax on its parts.

[102] Supra note 5, Articles 8(2), 88(2)

When advance payment, back payments, severance fees, compensation, and other similar benefits are received from single employment, it is important to apportion the income/benefits to the months it covers. Let's assume that the employee received a total back payment of 120,000 Birr for the service rendered in the past 12 months. The employment income tax shall be calculated by prorating the 120,000 Birr over 12 months period. The back payment is presumed to be derived in the months when the employment is exercised. When the 120,000 Birr is divided into 12 months, the monthly employment income becomes 10,000 Birr. Based on the progression method, the employment income tax for the monthly salary (10,000 Birr) is calculated as follows.

- 10,000 Birr – 600= 9400 (taxable income)
- 1050 Birr x 10% = 105 Birr (the tax on the income that falls on the first taxable income bracket)
- 1550 Birr x 15% = 232.50 Birr (the tax on the income that falls on the second taxable income bracket)
- 2050 Birr x 20% = 410 Birr (the tax on the income that falls on the third taxable income bracket)
- 2550 Birr x 25% = 637.50 Birr (the tax on the income that falls on the fourth taxable income bracket)
- 2200 Birr x 30% = 660 Birr (the tax on the income that falls on the fifth taxable income bracket)
- Monthly employment income tax= 105 Birr + 232.50 Birr + 410 Birr + 637.50 Birr + 660 Birr = 2045 Birr
- Total employment income tax on the back payment= 2045 x 12= 24,540 Birr

3.6.4. The Declaration and Payment of Employment Income Tax

Tax declarations and payment are two closely interrelated matters. A tax declaration, which is also called a tax return, means a disclosure of tax information in an approved form and a manner provided by tax laws or tax administration.[103] The declaration may be filed either physically or electronically, depending upon the specific situation of tax systems.[104] It is

[103] Supra note 45, Articles 79, 80
[104] Ibid, Article 80, 82

through tax declaration that taxpayers report the amount of gross income, deductions, losses, refunds, tax payable, and related issues to the tax authorities. The payment of tax is effected following the filing of tax declarations. In Ethiopia, failure to declare and pay tax within the time set by the applicable tax laws results in administrative and criminal penalties.[105]

Employment income tax is due when the employee receives employment income.[106] The word 'receive' is interpreted widely to include not only the actual receipt of the employment income but also includes those cases of constructive receipt, which are illustrated in Article 2(19) of the Proclamation. For example, an employee is treated as having constructively received the income once it is made available for collection. For a constructive receipt to happen, the employee should be able to collect the income at any time and without substantial preconditions. If an employer deposits the income (salary) in the bank account of the employee, the tax law regards that the employee has received it. The employee's actual withdrawal of the salary from the bank account does not have any role here. The employee is considered as having received the income because the withdrawal of the money has become under his/her control. So, employment income is realized when either an actual or constructive receipt is taken place.

Since the Ethiopian income tax system adopts a monthly accounting period for Schedule A, employment income is taxed in the calendar month in which it is received. In some foreign tax systems, employment income is taxed on annual basis. That is to say, the employment income is assessed on the annual employment earnings of the employee. An employee may receive different amounts of employment income within a year. If the employment income varies on a monthly basis, the employee faces higher tax liability under the monthly accounting period than the annual accounting period.[107]

The withholding system is the principal tax assessment and collection tool of Schedule A. Even if employment income tax is paid from the pocket of the employee, the employer has to withhold the tax from the payment made to the

[105] Ibid, Articles 104, 105, 125
[106] Supra note 5, Article 10
[107] Supra note 66, p. 11

employee. As a withholding agent, the employer must assess, collect, declare and pay (submit) the tax to the tax authority.[108]

The employment income tax liability shall always fall on the employee as the latter is the one that derives the taxable income. The employer is not allowed to pay the tax from its pocket. The employer's payment of the tax on behalf of the employee will bring a different tax consequence. The Income Tax Proclamation makes it clear that an employment income tax paid by the employer is regarded as an employment income of the employee.[109] The income tax shall be calculated on the aggregate of the tax paid by the employer plus the income of the employee. To illustrate the provision, assume that the monthly salary of the employee is 5000 Birr. The employment tax on the salary is 697.50 Birr. Instead of withholding from the salary, the employer paid the tax from his pocket. The law considers the 697.50 payment as an income of the employee and the taxable employment income becomes 5697.50 (5000 + 697.50). The employment income tax on the 5697.5 Birr is 859.37 Birr. The difference between 859.37 and 697.5, which is 161.87 Birr, shall be paid by the employee. (Note that the tax authority has already received 697.5 Birr from the employer)

In two exceptional cases, employment income tax is subjected to self-assessment. First, some employers are exempted from withholding duty by law. The Vienna Convention provides that diplomatic organizations (embassies and consulates) have no duty to withhold tax from their non-tax exempt workers, such as administrative staff and private servants.[110] The specific examples are secretariats, record officers, drivers, and guards. These employees have a self-withholding obligation. They are duty-bound to assess and collect the employment income tax by them. Second, an employee may derive employment incomes from two or more employments. In this case of multiple employment, the Income Tax Proclamation provides two scenarios. If one of the employers is aware of the multiple employment, it shall withhold the tax based on the aggregated employment income. If the employer is not aware of the multiple employments and the tax is not withheld based on the

[108] Supra note 5, Article 88
[109] Ibid, Article 12(3)
[110] Vienna Convention on Diplomatic Relations, 1961, Article 34

aggregated employment income, the employee shall have the duty of self-assessment.[111]

3.7 Schedule B: Income Tax on Rental of Buildings

There is no uniform approach for taxing income from the rental of buildings around the world. The Income Tax Act of India contains a separate section, which is titled 'Income from house property', to tax rental income earned from residential, commercial, or factory buildings and land attached to the building (such as a parking lot attached to the building). The tax is computed under Section 22 of the country's Income Tax Act.[112] The South Africa Income Tax Act does not set up a separate section (schedule) for income from the rental of buildings. Such income is added to other taxable incomes and the income tax is calculated on the total taxable income of the taxpayer.[113] Ethiopia is an example of a country that sets up a separate tax schedule for the rental of income from buildings. In the history of the Ethiopian income tax system, Schedule B had been created in 1944 for taxing income from business activities. [114] The scope of the schedule was narrowed down to the taxation of income derived from the rent of lands and buildings used other than for agricultural produce, and cattle breeding purposes in 1956. From 1975 to 1993, the schedule was removed by law and absent from the income tax structures[115]. In 1993, the schedule was re-introduced with a narrowed scope of application on income derived from 'rental of buildings'.

By its nature, renting buildings is a business activity as it involves an economic activity conducted for financial gain. The Income Tax Proclamation (No. 979/2016) defines business in terms of some activities, excluding 'rental of buildings'.[116] The exclusion is made to delimit the scope of Schedule B and C of the Proclamation. The existing tax policy documents and laws of Ethiopia do not specify the justifications for the separate treatment of rental

[111] Supra note 5, Articles 83(2), 88(2)
[112] Akhileshwar Pathak and Savan Godiawala, Business Taxation, 2nd Edition, McGraw Hill Education, 2013, p. 20
[113] Tax on Rental Income, available at https://www.sars.gov.za/types-of-tax/personal-income-tax/tax-on-rental-income/, last accessed on Dec. 15, 2021
[114] Personal and Business Income Tax Proclamation, 1944, Proc. No. 60, Negarit Gazeta, 3rd year, No. 9, Schedule B
[115] Taddese Lencho, Towards Legislative History of Modern Taxes in Ethiopia (1941-2008), Journal of Ethiopian Law, Vol. XXV No. 2, 2012, p.156
[116] Supra note 5, Article 2(2)

income from buildings under Schedule B. It is not clear why income from the rental of buildings is not regarded as a business income and is taxed under the schedule governing business income tax. Some argued that the separate treatment of income from the rental of buildings was not a product of serious policy deliberation. The decision to tax income from the rental of buildings under schedule B seemed to happen by accident.[117]

The liability to pay rental income tax happens when the taxpayer 'derives' the taxable rental income. If the taxpayer does not derive the income, then there will be no legal obligation to pay the tax. This leads us to the important key concept of income taxation: realization event. Rental income becomes taxable when the taxpayer 'derived' income from the rental of buildings. If the taxpayer follows the accrual tax accounting method, the word 'derived' means 'receivable' or the arising of the right to receive an income. If the taxpayer adopts a cash basis tax accounting, 'derived' is defined as 'received'.[118]

Accrual and cash-based accounting are the two common methods that accountants use to prepare financial statements of businesses. They are concerned with the timing of when incomes and expenses are recorded in the financial statements or book of accounts of taxpayers. In accrual-based accounting, an income is recorded when a product or service is delivered to a customer with the expectation that money will be paid in the future. Expenses of goods and services are recorded despite no cash being paid out yet for those expenses. In cash-based accounting, an income is recorded only when cash is received. Expenses are only recorded when cash is paid out.[119] With the view to easing tax compliance, Category B taxpayers, individual taxpayers whose annual gross income is 500,000 Birr but less than 1,000,000 Birr, are required to report their incomes and expenses on a cash basis. They may voluntarily account on an accrual basis provided that they comply with the requirements set under financial reporting standards.[120] Except for this, there are no provisions in the income tax laws (proclamation and regulation) that tell us which taxpayer shall report on an accrual basis and which on a cash basis. It is

[117] Supra note 4, p. 367
[118] Supra note 5, Articles 2(5), 2(19)
[119] Accrual Accounting vs. Cash Basis Accounting: What's the Difference?, available at https://www.investopedia.com/ask/answers/09/accrual-accounting.asp., last accessed on Jan. 12, 2022
[120] Supra note 5,Article 33(1); Supra note 23, Article 58(2)

also not made clear when incomes and expenses are recorded in the books of accounts of taxpayers. The repealed Income Tax Proclamation was by far better than the current laws. It contained provisions that explain the concepts of accrual and cash bases'. It stipulated that companies shall account on an accrual basis while other taxpayers may account on either of the two methods.[121]

3.6.5. The Taxable Units (Taxpayers) of the Schedule

The identification of the taxpayers of Schedule B is relevant to knowing the persons that are liable for the payment of rental income tax. Rental income tax is imposed on 'a person renting out a building or buildings who has taxable rental income for the year.[122] The tax obligation is imposed on the person that (1) leased the building to the lessee, and (2) received the rental income for the year. The taxpayer, which is the person liable to pay the rental income tax, fulfills the two criteria. It is important to notice that the taxpayer may be the owner of the building or other persons, such as a sub-lessor.[123]

The person that rents the building may be a body or an individual person. A body is defined as a "company, partnership, public enterprise or public financial agency, or other body of persons whether formed in Ethiopia or elsewhere.[124] The treatment of partnership as a body is a distinct feature of the Ethiopian income tax system. In many foreign income tax systems, partnerships are not taxable entities. Instead, they are treated as conduit entities. This implies that the tax liability flows through the partnerships to the partners. The tax effects fall on the members or partners. It is the members, not the partnership, that have the legal obligation to pay tax. In Ethiopia, the reverse is regulated. It is the duty of the partnership, which is qualified as a body and taxable entity, to pay income tax in either Schedule B or C of the Income Tax Proclamation. In addition, the members (partners) would be obliged to pay dividend tax if they receive income from the partnership.

[121] Income Tax Proclamation (proc. 286/2002), Article 58, 59, 60
[122] Supra note 5, Article 13(1)
[123] Ibid, Article 16
[124] Supra note 45, Article 2(5)

There are significant tax effects of the classification of taxpayers into a body and individual persons under Schedule B.[125] Body is always treated as Category A taxpayer. It shall comply with the duties of books of accounts, accounting methods, and tax payment period applicable for the category. The tax rate set for a body is different from that of individuals.[126]

3.6.6. The Tax Base of the Schedule

Rental income tax is imposed on the taxable rental income of taxpayers that is derived from the rental of building/s.[127] Taxable rental income is the tax base of Schedule B and it is defined as

> *gross amount of income derived by the taxpayer from the rental of a building for the year reduced by the total amount of deductions allowed to the taxpayer for the year.*[128]

Unlike employment income tax, rental income tax is imposed on the net rental income of the taxpayer. The net rental income is the difference between the amounts of annual gross rental income and deductible expenses. Rental income tax shall be paid after the allowable expenses are deducted from the gross rental income. So, the rental income tax base is a net concept.[129]

Assume the taxpayer earned a total of 100,000 Birr rental income in a given year. To earn this income, the taxpayer incurred 30,000 Birr as an expense. The taxable rental income is 70,000 Birr. On the other hand, if the allowable deduction exceeds the gross income, the taxpayer derives no income, instead, there is a loss. By the operation of loss carry forward, the taxpayer is entitled to offset the loss from future income.[130]

Gross rental income refers to the total rental income of the taxpayer without exempt income and deduction of expenses.[131] Without being restricted to the following incomes, the gross rental income includes[132]:

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[125] The effects also apply for Schedule C.
[126] Supra note 5, Articles 82, 84
[127] Supra note 5, Article 13(1)
[128] Ibid, Article 15
[129] Supra note 46, p. 45
[130] Supra note 23, Article 24
[131] Supra note 5, Articles 15(4-7), 65

- All amounts[133] derived by the taxpayer during the year under the lease agreement, including any lease premium[134] or similar amount;
- All payments made by the lessee during the year on behalf of the lessor according to the lease agreement.[135]
- The amount of any bond, security, or similar amount that, during the year, the taxpayer is entitled to retain as a result of damage to the building and that has not been used by the taxpayer in repairing the damage to the building[136]
- The fair market value[137] of any renovation or improvement made under the lease agreement to the building when the cost was borne by the lessee in addition to the rent payable to the taxpayer.
- If a taxpayer leases a furnished building, any amount attributable to the lease of the furniture or equipment.

As noted, the deduction of expenses is allowed to arrive at the taxable rental income. Depending upon the category of the taxpayer, the Income Tax Proclamation ((No. 979/2016) provides two types of deduction rules in schedule B. For those taxpayers that shall have the duty to keep books of accounts (Category A and B taxpayers)[138], Article 15(7) of the Proclamation laid down the deduction principle which states

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[132] Ibid, Article 15(2)

[133] 'Amount' includes non-cash benefits that are derived by the taxpayer as well. See Ibid, Article 2(1). For example, instead of paying the rent in money, the lessee may provide a good or service to the lessor that has a monetary value equal to the rental amount. The good or service shall be valued and included in the taxable rental income the lessor.

[134] A lease premium is a non-refundable lump sum payment made by the lessee to the lessor of the building upon the formation of the lease agreement. A distinction should be made between a lease premium and the rent payable under the lease contract. The premium is paid as consideration for the grant of the lease, not for the use or enjoyment of the building.

[135] The lease agreement may oblige the lessee to cover utilities costs of the building, such as electricity, water, waste disposal, and sewage. Since such expenses are covered on behalf of the lessor, they shall be added to the rental income.

[136] "A lease agreement may require the lessee to pay a bond as security against any damage to the leased building. If the agreement provides that the lessor can retain the whole of the bond at the end of the lease, Article 15(2)(c) includes the amount of the bond in the lessor's rental income in the tax year in which the bond is retained. This will usually be the year that the lease terminates." Supra note 46, p. 48

[137] Supra note 45, Article 3

[138] Supra note 5, Articles 3, 82(1,2,4)

> *…deduction shall be allowed for any expenditures to the extent necessarily incurred by the taxpayer in deriving rental income and paid during the year.*

There is no restriction as to the amount and type of the expenditure (to be deducted) as far as the expenditure was necessary to derive the rental income. Based on the "Necessity' requirement of the law, we can conclude that not all expenses are deductible, only those expenses that are incurred to derive the rental income are deductible. The taxpayer is not allowed to get a deduction for personal expenses, in other words, expenses that are nothing to do with the rental income are not deductible. For instance, a school fee for the children of the taxpayer is an example of a personal expense that the tax law denies deduction. The costs of acquisition, renewal, improvement, and reconstruction of the leased building/s are deductible expenses. The Proclamation provides some illustrative examples of allowable deductions as follows.[139]

- the cost of the lease of land on which the building is situated;
- The cost of furniture and equipment (for furnished buildings)
- Interest and insurance premiums (for insured buildings)
- Fees and charges, but not taxes[140], levied by the government in respect of the land or building leased. (The main example of these costs is municipality charge)

For Category A and B taxpayers, books of accounts (records) are used as the main data source to determine the amount of gross income and deductible expenses. The Income Tax Proclamation requires these taxpayers to maintain records of the derived rental income, fees and charges, acquisition and improvement costs of the buildings, and other costs incurred to derive the rental income.[141] Since rental income tax is paid annually, it is important to calculate the annual gross income. If the lease contract provides a lease payment on a monthly basis, the taxpayer shall convert the monthly rental income into annual rental (gross) income. The next step is the deduction of

[139] Supra note 5, Article 15(7)
[140] Taxes are not considered as expenses for tax purpose and hence they are not deductible. It is against the revenue raising purpose of taxation to deduct one type of tax as an expense of another type of tax. This does not mean that there is no credit or deduction if the same income is taxed more than once, as in the case of double taxation.
[141] Supra note 5, Article 82(4)

expenses from the annual rental income to arrive at the taxable rental income. For the purpose of Schedule B (and C as well), expenses (expenditures) are classified into ordinary and capital expenses. Ordinary expenses, such as insurance premium, land lease fee, municipality charges, and utility costs, are directly deducted from the gross annual rental income of the tax year. Capital expenses, such as costs incurred for the acquisition, repair, and maintenance of the leased building/s, furniture and equipment, are subject to depreciation rules.

Before applying the depreciation rules, it is essential first to understand the basic concept of depreciation. In taxation, depreciation is a cost (expense) recovery mechanism of capital assets that are used for deriving taxable income. It is used to allocate the cost of the asset over the supposed useful life of the asset. Since capital assets are used to derive income for a longer time, their costs should also be allocated for many years (or at least for more than one year). The depreciation rules allow both the taxpayers and tax administration to know the amount/portion of capital expenses to be deducted in each tax year. The straight-line method is the most common way, including in Ethiopia, of calculating depreciation. What makes this method a straight line is that the amount of depreciation in every tax year remains the same or uniform. According to this method, the annual depreciation is calculated as follows.[142]

Annual Depreciation= depreciation base[143] x depreciation rate

Let us assume the following hypothetical case. A taxpayer purchased machinery to be used for its business at the cost of 8 million Birr. The applicable income tax law provides that the taxpayer shall deduct 10% of the cost of machinery in each tax year. The taxpayer is allowed to deduct 800,000 Birr in one tax year (i.e, 8 million x 10%). It will take a total of 10 years to fully deduct the 8 million Birr cost. This is what depreciation means and how it works.

As indicated above, capital expenses are not deducted at once from the gross rental income of the year. They are apportioned to many years as per the

[142] See also supra note 23, Articles 37(1), 38(1)
[143] The depreciation base may be either the cost of the asset or net-book value of the asset. For their difference, see supra note 5, Articles 68, 69

depreciation method. According to Ethiopia's income tax laws, buildings are defined as part of structural improvement and depreciated at the rate of 5%.[144] This means that the total capital cost would be deducted within 20 years. Hence, the depreciation rule allows us to know the amount of deductible capital expense in each tax year. If we deduct 5% of the total cost each year, the total cost would be recouped/ deducted from the gross income in 20 years. For instance, the taxpayer bought the leased building at 5 million Birr. For every tax year, the taxpayer is entitled to an annual depreciation (deduction) of 5% of the 5 million Birr: 25,000 Birr.

The total annual expense of the taxpayer is a sum of ordinary expenses and capital expenses for the year. The annual taxable rental income is derived by deducting the annual expense from the annual gross income of the taxpayer. If the result is positive (the gross income exceeds the expense), there is net taxable income and this income shall be taxed as per the applicable tax rates. If the result is negative (the expense exceeds the gross income), there is a loss and this loss will be deducted from future rental income as per the loss carry-forward rule.[145] If the result is zero (the gross income is equal to the expense), the taxpayer neither derives an income nor incurs a loss. No tax will be paid in this case.

For taxpayers that do not have the legal obligation to keep books of accounts (Category C taxpayers)[146], the Proclamation introduces a special rule that allows both the taxpayer and tax administration to know the amount of allowed expenses in the absence of books of accounts.[147] Category C taxpayers are presumed to be micro and small businesses with a difficulty in keeping books of accounts and deriving a small amount of income. The taxation of the taxpayers based on books of accounts brings high compliance and administrative costs. As a result, the Income Tax Proclamation does not obligate the taxpayers to keep books of accounts. Their annual income tax liability is determined based on a special income tax assessment method called

[144]The normal depreciation rules apply on Category A taxpayers. For Category B taxpayers, the Income Tax Proclamation introduced simplified depreciation rule for their costs of depreciable assets. The costs are deductible at once. See supra note 5, Articles 15(7)(C), 33(2); Supra note 23, Article 23, 39-41

[145] Ibid (Income Tax Regulation), Article 24

[146] Supra note 5, Articles 3, 82(3)

[147] Ibid, Article 15(5)

presumptive tax.[148] For Category C taxpayers falling under Schedule B, the following expenses are deductible from the annual gross rental income.[149]

- any fees and charges, but not tax, levied by the government in respect of the land or building leased and paid by the taxpayer during the year. Since land belongs to the state, landlords (lessors) pay land lease payments to the government. Municipalities also impose different charges on owners of buildings. So, the land lease and municipality charges are directly deducted from the annual gross rental income of the lessors.
- an amount equal to fifty percent (50%) of the gross rental income derived by the taxpayer for the year as an allowance for the repair, maintenance, and depreciation of the building, furniture, and equipment. This rule is introduced to assess the amount of allowable/deductible expenses other than fees and charges deducted above. 50% of the annual gross rental income is presumed to be the acquisition and maintenance costs of the building, furniture, equipment, and utility costs….of the taxpayer. In some practical cases, lessors are required to submit a copy of the lease agreement to the tax administration. The agreement is used to calculate the annual gross rental income, and the deductible expenses (50% of the gross rental income) of the taxpayers.

The annual gross rental income is determined based on the tax authorities' estimate of the Category C taxpayers' income. The lease agreement may be used as a reference for annual gross rental income. Fees and charges paid to the government and 50% of the annual gross income constitute the annual allowable expenses of the taxpayers. Depreciation and loss carry forward rules do not apply here.

Finally, in connection with the tax base of Schedule B, the definition of 'buildings' is worthy of consideration. Rental income tax is imposed on the income derived from the lease of a building. Renting a building is the source of taxable rental income under the Schedule. But what is the definition of a building? What would be the income tax consequences of leasing a building,

[148] Supra note 5, Article 49; Supra note 23, Article 49
[149] Ibid (Federal Income Tax Proclamation), Article 15(5)

land, and other properties? The Income Tax Proclamation does not provide an answer to any of these questions. For example, it does not define what building means. According to the Building Proclamation of Ethiopia, a building refers to a permanent or temporary construction used for the purpose of dwelling, office, factory, or any other purpose. Some argue that this definition should be used to understand the concept of 'building' in Schedule B of the Income Tax Proclamation.[150] An income derived from the rental of movable and immovable properties, other than buildings, will fall outside the scope of Schedule B. These properties include machinery, and intangible properties. If renting out the properties (other than buildings) is the main (business) activity of a person, Schedule C will apply to tax income derived from such operations. The other alternative is to apply Article 58 of the Income Tax Proclamation (2016). If a property is leased 'casually', the income derived from the casual rent is not taxed under Schedule B or C, but under Article 58. As is further discussed later on, the lack of precise definition for the word 'casual' creates overlapping problems between Article 58 and the preceding schedules.

3.6.7. The Income Tax Brackets, Rates, and Computation Methods

In Schedule B (as well as C), the income tax brackets and rates are set in consideration of the classification of taxpayers into bodies and individuals. For bodies, there is no tax bracket at all. Irrespective of the amount of their taxable income for the year, they are taxed at the flat tax rate of 30%.[151]

For individuals, there are 7 income tax brackets that reflect the differences in the amount of their annual taxable rental income. Unlike Schedule A which sets the tax bracket on monthly basis, the tax brackets of Schedule B are fixed on an annual basis, 0 -7,200 Birr being the first bracket. In terms of the amount, there is no difference between the two schedules. The monthly 0-600 Birr tax bracket of schedule A is equal to the annual 0 -7,200 Birr tax bracket of schedule B. The remaining tax brackets reflect the different amount of taxable incomes. On the other hand, 7 marginal tax rates are assigned for the tax brackets; starting from 0% to 35%. The individual taxpayers pay no tax on

[150]Belete Addis, Characterization of Taxable Units and Tax Bases under the Income Tax Schedules of Schedule 'A' and 'B' of the Federal Income Tax Proclamation of Ethiopia: A Commentary, Bahir Dar University Journal of Law Vol.8, No.1 (December 2017) p. 60
[151] Supra note 5, Article 14

their income that falls under the first tax bracket (0 -7,200 Birr). They shall pay different amounts of tax on their incomes that fall under the remaining tax brackets; from lower to higher taxes on the second and subsequent tax brackets.

Taxable Rental Income (per year) Birr	**Rental Income Tax Rate**
0 -7,200	0%
7,201-19,800	10%
19,801-38,400	15%
38,401-63,000	20%
63,001-93,600	25%
93,601-130,800	30%
Over 130,800	35%

Source: Federal Income Tax Proclamation ((No. 979/2016)), Article 15

For Category A and B taxpayers, which could be either bodies or individuals, the computation of their annual rental income tax liability is illustrated by the following hypothetical example.

Given:

- The acquisition cost of building= 2 million Birr
- Municipality Fee paid to the government (annual)= 1500 Birr
- Land Lease paid to the government (annual) = 1000 Birr
- Water Bill (annual) = 1000 Birr
- Monthly rent income= 10,000 Birr

Required: Rental Income Tax for the Year

Solution:

- Gross Income of the year= 120,000 Birr (10,000 Birr x 12)
- Deductible Expense for the year= 103,500 Birr [Ordinary expenses (1500+1000+1,000) + Capital (100,000: i.e 5% of 2 million as depreciation)]
- Taxable Income=

- If the taxpayer is a body= 16,500 Birr (120,000- 103,500)
- If the taxpayer is an individual= 9000 Birr (120,000- 103,500-7200)

- Rental Income Tax=
  - If the taxpayer is a body= 4950 Birr (16,500 x 30%)
  - If the taxpayer is an individual=930 Birr (9,300 x 10%)

3.6.8. Declaration and Payment of Rental Income Tax

Unlike the case of Schedule A, self-assessment is the principal assessment method for Schedule B. Except for limited cases[152] whereby lessees could be required to withhold rental income tax, it is the duty of the lessor (taxpayer) to assess, declare and pay the rental income tax to the government. The Income Tax Proclamation (No. 979/2016) makes it clear that tax declarations shall be filed to the tax authority within[153]

- 4 months from the end of the tax year (for Category A taxpayers)
- 2 months from the end of the tax year (for Category 'B' taxpayers)
- 1 month (Hamle) from the end of each fiscal year of the government (for Category 'C' taxpayers)

If Category A or B taxpayer is an individual (natural) person, the tax year begins on Hamle 1 and ends on Sene 30.[154] For Category A taxpayers, the tax declaration shall be made within Hamle 1 to Xiqimt 30 while for Category B within Hamle 01- Nehassie 30. If Category A or B taxpayer is a body, the law allows the taxpayer to adopt its tax (accounting) year that may begin and end at different times than the above. For example, a company may set its accounting year in accordance with a Gregorian calendar. The tax year begins and ends on January 1 and December 31 respectively. Since Category C taxpayers are individuals and are not allowed to set their tax year, the tax declaration shall always be filed within the month of Hamle. For instance, a tax declaration for 2014 E.C (Hamle 01, 2013 to Sene 2014 E.C), must be filed within Hamle 01 to 30, 2014 E.C

[152] Ibid, Article 92
[153] Ibid, Articles 83(4)(6)
[154] The tax authority may grant the individual taxpayer to adopt a different period. Ibid, Article 2(21)(a)

For Category A and B taxpayers, it is mandatory to accompany tax declaration with documents. The taxpayers shall submit records showing income and expenses, including the book value of the building.[155] The tax declaration of Category C taxpayers is made on the form provided by the tax administration. It needs not to be supported with documents, such as income statements, as the taxpayers do not have the legal obligation to keep books of accounts.[156]

A tax declaration is always required whether or not the taxpayer's annual gross income exceeds the deductible expenses. Even if the taxpayer experiences a loss, a tax declaration must be filed within the time set by the law. The duty to pay tax is due only when the gross rental income exceeds the expenses or when there is taxable rental income. Unless the declaration is amended or rejected by the tax authority for different reasons[157], the taxpayer shall pay the amount of tax specified in the declaration. The rental income tax shall be paid within the time set for the tax declaration.[158] The taxpayer shall pay the tax within the due date (period) of the tax declaration. For example, a category C taxpayer shall pay the tax within the 30 days of Hamle. Like the case of tax declaration, there are legal consequences for failure to pay the required amount of tax within the prescribed time. The non-compliant taxpayer shall face, in addition to the payment of tax due, interest, administrative and criminal penalties.[159] The tax authority is empowered to take different measures, such as seizure and sale of properties, to recover unpaid taxes.[160]

Finally, attention should be given to the following issues that are relevant to Schedule B.

- Subleasing: It may happen that a lessee may sub-lease the building to another person called, sub-lessee. In this case, the lessee becomes a sub-lessor and the tax implication is governed under Article 16 of the Income Tax Proclamation (Sub-leasing). The sub-lessor is liable to pay tax on the

[155] Ibid, Articles 82(4), 83(5)
[156] Ibid, Articles 82(3)
[157] For example, Supra note 45, Article 28
[158] Supra note 5, Article 84(2)(4)
[159] Supra note 45, Articles 37, 105, 109, 110, 125
[160] Ibid, Articles 38-48

net rental income received from the sub-lessee. The following are deducted from the rental income of the sub-lessor.

- the total rental income paid by the sub-lessor to the lessor and
- the total expenses necessarily incurred by the sub-lessor to derive rental income.

Look at the following simple example. Abubeker constructed a 3-storey building and leased it to Hana at 50,000 Birr per month. Then, Hana sub-leased the building to another person, called Hagos, at 80,000 Birr per month. In this example, the Income Tax Proclamation regards Abubeker as a lessor and Hana as a sub-lessor. Hana derives and shall pay tax on a rental income of 30,000 Birr (i.e, 80,000 - 50,000).

- Lease of Business: In contrast to subleasing of a leased building, leasing an existing business, with all its equipment including buildings, does not attract income tax under Schedule B. The income from such leasing will be taxed under Schedule C of the Income Tax Proclamation.[161] For instance, a person that operates a supermarket may lease it to another person under a lease contract. The income from the lease of the supermarket is taxed under Schedule C, not B.
- The Applicability of Income Aggregation Rule under Schedule B : If a person leases two or more buildings, the rental income tax liability of the person shall be calculated on the aggregate of the rental income of the buildings. It is against the law to calculate the tax separately for each building.[162] For a person that derives income from different sources, one falling under schedule B and the other under another schedule, the aggregation rule does not apply. Two examples could be given here. It is a common practice for hotels to provide catering and room services for their customers. In the light of the schedular income tax system of Ethiopia, the hotels' income from the renting of rooms shall be separated from other incomes of the hotels, and shall be taxed under Schedule B. Real estate companies engage in the construction and sale and lease of buildings. The incomes from the sale and lease of buildings are not taxed under the same Schedule. The former falls under schedule C while the latter under Schedule B.

[161] Supra note 23, Article 22
[162] Supra note 5, Article 8(2)

Summary

For tax purposes, income can be defined as an economic benefit. It is capable of being expressed or measured in terms of money. Non-economic benefit is not considered income since it does not have a monetary value. An income tax is imposed for different purposes. It generates revenue for the states to cover their expenditures. It is also commended for income and wealth distribution. The residence and source principles are the two commonly applied principles that establish the income tax jurisdiction of states. They create nexus between states' income tax powers on the one hand and taxable incomes on the other hand. In practice, most states, including Ethiopia, apply a combination of residence and source principles. Income tax systems may be designed based on either schedular or global income tax models (systems). The global income tax model is one in which a single income tax is imposed on all incomes, irrespective of their nature and source. The schedular income tax model imposes separate income taxes on different types of income. But, in between the two models, there is an intermediate model that combines, to a greater or lesser extent, the features of the two theoretical models.

Ethiopia has a schedular income tax system. The country's income tax system consists of the schedules A, B, C, and D of the Income Tax Proclamation and the agricultural income tax regime. The existing income tax laws of Ethiopia are found primarily in proclamations, regulations, and directives. In terms of their content, it is difficult to make a distinction between the federal and regional income tax laws. Many of the laws do not reflect the assignment of taxing powers by the FDRE Constitution. Schedule A is used to impose a tax on income derived from employment. Under this Schedule, the employees and employers are the taxpayers and withholding agents respectively. The tax rates range from 0% (which means no tax is imposed) to 35%. There is a monthly accounting period for Schedule A. Hence, the employment income shall be taxed in the calendar month in which it is received. The scope of application of Schedule B is limited to income derived from the rental of buildings. The taxpayers of schedule B are those persons that derived rental income from the lease of buildings. Rental income tax is imposed on the net rental income of the taxpayers. The tax shall be paid after the allowable expenses are deducted from the gross rental income. In Schedule B (as well as C), the income tax brackets and rates are set in consideration of the

classification of taxpayers into bodies and individuals. Irrespective of the amount of their taxable income for the year, bodies are taxed at the flat tax rate of 30%. For individuals, there are different income tax brackets and rates. Unlike the case of Schedule A, the tax brackets, tax rates, and tax liabilities of Schedule B are set or determined on annual basis. Self-assessment is the principal assessment method for Schedule B.

Review Questions

1. How income is defined in the economics, accounting, and legal (income tax law) professions?
2. What are the causes and prevention mechanisms of double taxation?
3. Compare and contrast the global, schedular, and mixed-income tax systems. Which system do you recommend for Ethiopia? Why?
4. Which areas or provisions of Ethiopia's income tax laws, particularly the income tax proclamations and regulations, aimed at promoting tax equity?
5. What are the defining criteria and the objectives for the classification of taxpayers into Category A, B, and C under Ethiopia's income tax laws?
6. Why do you think that Ethiopia adopted a monthly accounting period for employment income while an annual accounting period for rental of buildings and business income taxes?
7. Discuss whether or not the monthly tax accounting period puts employees under a heavier income tax burden than schedules B and C taxpayers.
8. Ujulu is a lecturer/employee at X University in Ethiopia. He agreed with the university to prepare a reference book and receive 200,000 Birr as a payment. Based on the income tax laws of Ethiopia, is such payment taxable or exempt income? shall it be treated as an employment income or royalty or any other type of income? Why?
9. Which fringe benefits are taxable in Ethiopia and which ones are not? What are the challenges of taxing fringe benefits in the country?
10. Do you support the exclusion of income from the rental of buildings from the definition of business income and its taxation under a different schedule (schedule B)? Why? What would be the possible pros and cons if the schedule B were removed and income from the rental of buildings taxed under Schedule C?

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Chapter Four

The Law of Income Tax in Ethiopia: Part II

Introduction

Ethiopian income tax laws are broad in scope and content. Discussing them in a single chapter could make the chapter bulky. It affects readers' interest and attention. To avoid this problem, the income tax laws are discussed in two different but related chapters. This chapter is a continuation of the previous chapter. It will focus on the remaining two schedules of the Ethiopian income tax system: schedules C and D. It will explain and examine the taxable unit, tax base, income brackets, tax rates, assessment, and collection methods of the schedules.

4.1 Schedule C: Business Income Tax

Business income receives special attention in both schedular and global income tax systems. The characterization of an income as 'business income' is important for the schedular systems to determine which schedule applies to tax it. Even if global income tax systems define income 'globally' for tax purposes, they contain special tax accounting rules that apply to business income.[1] The business entities' complex nature, structure, income, expenses, accounting periods, and similar issues call for the adoption of special income tax rules for business income.

Historically, the taxation of income from businesses was first introduced in Ethiopia by the 1944 Income tax Proclamation. The Proclamation created Schedule B to impose fixed and presumptive taxes on different types of businesses.[2] It was the income tax decree of 1956 that brought the taxation of businesses to Schedule C.[3] Now, the Schedule contains more provisions than the remaining schedules of the Income Tax Proclamation. There are detailed rules concerning gross income, deductible expenses, and tax accounting methods.

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[1] Lee Burns and Richard Krever, Taxation of Income from Business and Investment, in Victor Thuronyi (ed.), Tax Law Design and Drafting, volume 2, International Monetary Fund: 1998, p. 570

[2]Personal and Business Income Tax Proclamation, 1944, Proc. No. 60, Negarit Gazeta, 3rd year, No. 9, Schedule B

[3]The Income Tax Decree of 1956, Decree No. 19 of 1956, Article 4

Schedule C consists of the general and special parts. The general part contains the common provisions (Articles 18-35, and 45-50) and applies to all taxpayers that engage in business activities. The special part governs the income taxation of a specific category of taxpayers- persons engaged in mining and petroleum operations (contractors and licensees). It covers Articles from 36 to 44. The general part applies to the contractors and licensees concerning those tax matters that are not regulated by the special part. More will be discussed later on.

The obligation to pay business income tax is created when the taxpayer derives the business income. The word 'derive' is interpreted as either 'the arising of the right to receive or 'received' depending upon the accrual or cash-based accounting followed by the taxpayer. For more, refer to the discussion made with respect to the same issue under the introduction part of Schedule B.

4.1.1 The Taxable Unit (The Taxpayers) of Schedule

Business income tax is imposed on a person conducting a business.[4] The person may be either a natural (individual) or artificial (body) person. As we have seen in the previous section, a body is defined by the Tax Administration Proclamation in a manner of including companies, partnerships, public enterprises, and other forms of bodies.[5] Although cooperative societies have their own legal personality and are regarded as a body, they are exempted from paying income tax under Schedule C. The exemption is made not, by the Income Tax Proclamation, but by the Cooperative Society Proclamation. The purpose of the exemption is to encourage cooperative societies.[6]

The tax effects on a Schedule C body taxpayer are similar to Schedule B-body taxpayer. Schedule C contains one distinct rule with regard to Micro Enterprises. Even if the enterprises fulfill the definitional elements of body,

[4]Federal Income Tax Proclamation (No. 979/2016), Article 18(1)
[5]Federal Tax Administration Proclamation No. 983/2016, Article 2(6)
[6]The Cooperative Societies Proclamation requires members of the cooperative societies to pay dividend tax. (Cooperative Societies Proclamation, No. 985/2016, Article 43 (1) (a)). The members are subject to Article 55 of the Income Tax Proclamation. The case of Cooperative societies demonstrates that in Ethiopia taxes are regulated by, not only tax laws, but also non-tax laws. For a complete understanding of Ethiopian tax system, one needs to be familiar with those non-tax legal instruments that contain tax measures.

they pay business income tax as per the tax rates of individual taxpayers.[7] Encouraging the enterprises seems to be the reason behind it.

In order to qualify as a taxpayer of schedule C, a person must conduct a business. Business is defined as any industrial, commercial, professional, or vocational activity conducted for profit.[8] The duration of the business activity does not affect its qualification as a business for income tax purposes. The activity may be conducted for a short or long period. Industrial activity refers to the processing of raw materials and manufacturing intermediate or finished goods. The manufacturing sector falls under this category. Commercial activity includes any legal activity conducted for financial gain. Trading in goods and services is one example. Activities that are not regarded as commerce by the Commercial Code of Ethiopia could be treated as commercial activity as far as they are undertaken with a profit motive. A professional activity involves the application of skill, which is based on theoretical knowledge usually acquired through higher or specialized education. Professionals are defined as those persons who earn their living from performing an activity that requires a certain level of education or specialization. They include advocates, medical practitioners, pharmacists, chartered accountants, engineers, surveyors, teachers etc. Like a professional activity, a vocational activity also involves the application of skill. But, attending higher or specialized education is not required. The acquisition of a vocational skill may be through specialized training. The conduct of a builder, electrician, or plumber, is an example of vocational activity.[9] An income from a professional or vocational activity is taxed under schedule C if the person who performs the service acted as an independent contractor rather than as an employee. If the person renders the service under employment relationships, then the income will be regarded as employment income and taxed under schedule A. The exclusion of employment from the definition of business needs to be understood in this context.

The Income Tax Proclamation refers to the Commercial Code of Ethiopia to recognize the trading activities as a business for the purpose of the Income Tax Proclamation. It does not follow that activities that are treated as trade by the Commercial Code are taxed under Schedule C. Some of the activities may fall

[7] Supra note 4, Article 19(2)
[8] Ibid, Article 2(2)
[9] Technical Notes of the Federal Income Tax Proclamation (No. 979/2016), Ministry of Finance, p. 3

under other schedules or laws. For example, though agriculture is regarded as trade by the code, the income from such activity is taxed under the Agricultural Income Tax Proclamation. The Income Tax Proclamation regards any activity, other than rental of buildings, undertaken by share or private limited companies as a business.[10] It is logical to assume that the word 'any activity' refers to an activity undertaken for profit. There is no room for such companies to engage in non-profit activities and non-profit activities to fall under Schedule C. Rental of buildings is excluded from the scope of Schedule C for the obvious reason that it is subject to Schedule B of the Income Tax Proclamation.

4.1.2 Tax Base of the Schedule

Schedule C applies to income from business activities. The Income Tax Proclamation provides that an income tax is imposed on a person that derives income from the conduct of a business.[11] This implies that a business income (or an income that is derived from business activity) is the tax base of Schedule C. The source of the income must be 'business', as defined by the Income Tax Proclamation and discussed earlier.

Like the case of Schedule B, the tax in Schedule C is not imposed on the gross business income of the person. Rather, it is imposed on the taxable business income, which is the difference between the gross business income and deductible expenses of the person.[12] The gross income refers to the total revenue or gain derived by the person (taxpayer) during the year from the conduct of a business. It may be derived either in cash or non-cash (such as in-kind) form. Gross business income does not include exempt income, as specified by the tax laws. Article 65 of the Income Tax Proclamation and related laws cover exempt incomes. For example, the income of a non-profit organization that is derived from the performance of its core function is exempt income. If the same organization derives an income from the conduct of a business, such income is treated as a business income and taxed under Schedule C. In Ethiopia, many religious institutions operate religious goods stores. They sell goods like spiritual books, rosaries, and cassock crosses. These goods are part and parcel of the religious services of the institutions. The income derived from the sale of such goods is an exempt income. On the other hand, some of

[10] Supra note 4, Article 2(2)
[11] Ibid, Article 18(1)
[12] Ibid, Article 20

the institutions own and operate secular schools. The income derived from the educational service is not an exempt income. It is taxable as per Schedule C.

The following are examples of income that should be included in the gross income.

- Gross proceeds from the disposal of trading stock: Trading stock is any property that the taxpayer manufactures or acquires to manufacture, sell or exchange in the ordinary course of business.[13] Such property could be movable or immovable, tangible or intangible. Examples of trading stock are raw materials used in a manufacturing process, semi-finished and finished goods, and goods purchased for resale or exchange. To give more specific examples, cereal (barley malt, rice, or maize), hops, water, and yeast are raw materials or trading stocks for a taxpayer that operates a beer factory. If the taxpayer sells one of the raw materials for whatever reason, the income from the sale shall be included in the gross business income. Beer is also a trading stock and hence its sale is a source of business income. If the taxpayer engages in the import and sale of automobiles, the automobiles are the trading stock of the business.
- Gross fees for the provision of services (other than employment income): This category of income is derived from the rendition of services, such as advocacy, and consultancy. Employment is excluded because it is taxed under Schedule A.
- A gain on disposal[14] of a business asset (other than trading stock[15]) made by the taxpayer during the tax year. A business asset is "an asset held or used in the conduct of a business wholly or partly to derive business income".[16] The definition is so broad that it includes both capital and revenue assets. For example, haircutting equipment is a business asset for taxpayers engaged in barber services. When business assets are disposed of, the taxpayer may derive either a gain or loss. A gain is derived when the revenue from the disposal of the asset exceeds the netbook value of the asset. If the netbook value exceeds the gain, then there is a loss. As illustrated in the below example, the net book value of an asset is the

[13] Ibid, Article 2(24)
[14]For the definition of disposal, see Ibid, Article 67(1)
[15]Trading stock is excluded here because it is already included in the gross income under Article 21(1)(a) of the Income Tax Proclamation.
[16] Ibid (Federal Income Tax Proclamation), Article 2(24)

original cost of the asset reduced by depreciation deductions allowed in respect of the asset.[17] The inclusion of the gain to a business income is subject to the following conditions.

- ✓ If the disposed business asset is depreciable, but not subject to capital gain tax under Article 59 of the Income Tax Proclamation, the gain is regarded as business income.[18] The amount of the gain is assessed by deducting the net book value of the asset from the amount (consideration) derived from the disposal of the asset. For instance, a taxpayer bought a vehicle for his hotel business at 1 million Birr. After using it for two years, the taxpayer sold the vehicle for 800,000 Birr. The taxpayer was allowed a total of 300,000 Birr (15% of 1 million Birr per year) as a depreciation deduction for the vehicle.[19] The amount of the netbook value is 700,000 Birr (1 million- 300,000). The consideration from the disposal of the vehicle is 800,000. The gain, which is regarded as a business income, is 100,000 Birr (800,000- 700,000). Let us further assume the same taxpayer but in a different context. Instead of the vehicle, the taxpayer purchased 4 computers for the hotel at 100,000 Birr (25,000 Birr per computer). He was allowed 40,000 Birr as depreciation deductions for two years (20% of the 100,000 Birr per year). Then, he sold the computers for 80,000 Birr. The netbook value of the computers becomes 60,000 Birr (i.e 100,000- 40,000). The gain (business income) on the sale of the computers is 20,000 Birr (i.e 80,000- 60,000).
- ✓ If the disposed business asset is both a depreciable asset under Schedule C and an investment asset under Article 59 of the Income Tax Proclamation, the recaptured depreciation is regarded as business income and taxable under Schedule C, and the remaining gain as a capital gain and taxable under Article 59. Buildings, shares, and bonds are taxable investment assets under Article 59. On the other hand, under schedule C, the depreciation rules apply to tangible movable assets, buildings, and business intangibles, such as

[17]For the difference between (original) cost of the asset and net-book value of asset, see Ibid, Articles 68 and 69

[18]Ibid, Article 21(3)

[19] For a discussion on the depreciation concept, refer to section 3.7.2 (The Tax Base of Schedule B) of chapter three.

copyright, and patent. The rules do not apply to shares and bonds as they are not depreciable assets. This implies that buildings are the only property that is both a depreciable asset under Schedule C and an investment asset under Article 59. A building, which has been in use to derive business income and at the same time whose cost was being recovered through depreciation rules, may be disposed of (sold or exchanged) above its cost. The gain from the disposal shall be apportioned into capital gain and business income. Consider the following example. An individual purchased a commercial building for 2 million Birr. He operated a hotel business using the building for 2 years. During these years, he was allowed a deduction of 200,000 Birr (5% of 2 million Birr per year) as the depreciation cost of the building. Then, he disposed of (sold) the same building for 3 million Birr. The disposal of the building brings the following tax outcomes.

- The consideration for the disposal= 3 million
- The netbook value of the building= 1.8 million (2 million - 200,000)
- The gain on disposal of the building= 1.2 million (3 million – 1.8 million)

- The portion of the income that is treated as business income (recaptured depreciation) and taxable under Schedule C= 200,000 (to the extent of the allowed depreciation)
- The portion of the income that is treated as capital gain and taxable under Article 59= 1 million (above the cost/allowed depreciation, which means the difference between the gain on the disposal and recaptured depreciation)

The main rationale for the treatment of recaptured depreciation as business income and the imposition of tax on it is that the taxpayer has got the right to deduct the capital expense (cost) under the capital gain tax rules (Article 59). It is not justified to allow the taxpayer another deduction of expense for the same asset under the business income tax rules. Hence, the cost of the building that had been recovered in the form of depreciation must be recaptured and treated as an income and taxable under Schedule C.

Once the gross income is determined, the next step is assessing the type and amount of the deductible expenses. There are more detailed provisions of

deductions in Schedule C than any other schedules of the Income Tax Proclamation. In addition to the basic rule/principle of deduction, we find examples of positive limb (allowable) deductions, negative limb (prohibited) deductions, and limitations on those deductible expenditures. As provided by the Income Tax Proclamation, it is the underlying rule that any expenditure is deductible to the *extent necessarily* [emphasis added] in deriving, securing, and maintaining amounts included in business income.[20] There are two important components of the rule. First, the existence of a sufficient connection between the expenditure and the derivation of business income is the main criterion to qualify for a deduction. Expenditure incurred for deriving an income other than business income, such as exempt income, is not allowed as a deduction under Schedule C.[21] Second, a given expenditure may be incurred to drive both business and non-business income at the same time. The 'extent' criterion is required to address such cases. A deduction is allowed with respect to that part of the expenditure relating to the derivation of business income. The portion of the expenditure that is used to derive the non-business income is not deductible. The identification of the portion of deductible and non-deductible expenses is to be made by the apportionment rule of the Income Tax Proclamation.[22]

The Positive limb deductions include the following.[23]

- Cost of trading stock: As noted above, an income from the disposal of trading stock is regarded as business income. On the other hand, the cost incurred in connection with the trading stock is a deductible expense. Since business income tax is assessed and paid on annual basis, it is important to figure out the annual cost (expense) of the trading stock for the tax year in which the tax is paid. [24]
- Costs of capital assets (including intangible properties): Capital assets are owned by taxpayers for longer use. Conventionally and for tax

[20] Supra note 4, Article 22(1)(a)
[21] Supra note 9, p.61
[22] Supra note 4, Article 76
[23] Ibid, Articles 22(1)(b-d), 23
[24]The Income Tax Proclamation ((No. 979/2016)) does not provide the specific method that shall be used to determine the amount of the annual cost of trading stock. It generally states that the amount to be determined in accordance with the financial reporting standards. The repealed Income Tax Proclamation of 2002 was very specific and clear on the issue. It proclaimed that the cost of trading stock disposed of during a tax period is determined on the basis of the average cost method. (Income Tax Proclamation, Proc. No 286/2002, Article 22)

purposes, the assets are thought to be used for more than one tax year. Since the assets have a useful life above one year, the costs incurred in connection with the assets should be allocated in more than one year. The depreciation rules are included in the tax laws to do this job.[25] The main purpose of such rules is to allocate capital expenditures (the costs of capital assets) to several tax years, as inferred from the depreciation rates set for each category of assets by the applicable laws. A reference to Articles 25 and 33(2) of the Income Tax Proclamation (No. 979/2016) and Articles 36-41 of the Income Tax Regulation (No. 410/2017) should be made to know the category of depreciable assets, the depreciation rates, and other related matters.

- A loss on disposal of a business asset (other than trading stock): The loss refers to the amount of cost (net book value) of the asset above or in excess of the consideration (gross gain) derived at the time of disposal of the asset.[26]
- Interest for loans: Taxpayers may borrow money to run their businesses. One of the effects of the borrowing is a payment of interest to the lenders. The Income Tax Proclamation allows the deduction of interest if the loan is used to derive business income. To prevent tax evasion (as a result of a taxpayer's claim of artificial interest as a deductible expense), the Income Tax Proclamation and Regulation sets relevant criteria.[27]

  Charitable donations: The deductibility of donations has nothing to do with deriving business income. The Income Tax Proclamation includes donations in the list of deductible expenses to promote socially desirable behavior. Hence, the deduction of donation is justified on social grounds. The following shall be fulfilled to legally deduct donations:[28] (1) the donation shall be made to an Ethiopian entity defined or recognized by the Charities and Societies Proclamation (No.621/2009), (2) the donation shall be made in response to development or an emergency call made/issued by the Government, (3) the amount of allowable (deductible) donation shall not exceed 10% of

[25]In accounting, the term depreciation is used for tangible capital assets while amortization for intangible assets. The Income Tax Proclamation does not recognize such division as it applies the term depreciation for both categories of assets.

[26] Supra note 4, Article 22(3)

[27] Ibid, Article 23(2); Income Tax Regulation (No. 410/2017),Article 28

[28] Ibid (Federal Income Tax Proclamation), Article 24

the taxable income of the taxpayer for the year. If the taxpayer donates more than 10% of its annual taxable income, the amount of donation in excess of the 10% of the taxable income will not be deductible. In principle, taxable income is determined after the deduction of expenses from the gross income of the taxpayer. Without determining the amount of gross income and deductible expenses, we cannot know the amount of taxable income. The logical flow is first to determine the amount of gross income, then deductible expenses, and finally taxable income. So, the question is how do know the amount of the 10% taxable income without first settling the issue of deductible expenses (donation in our case). To determine the deductibility of a donation as an expense, it is not logical to put a certain percentage of taxable income as a precondition. It is like putting a cart before the horse. This problem of the Proclamation needs to be resolved as follows. The criteria "10% of taxable income" should be understood to refer to the amount of income derived after deducting the gross income from the expenses other than the donation in question. Hence, all the remaining expenses of the taxpayer should be added and then reduced from the gross income. The resultant amount should be regarded as a taxable income without considering the charitable donation. Then, the deductibility of the donation needs to be determined by comparing it with the taxable income. Let's assume that the taxpayer generates a gross income of 3 million Birr. To generate this income, the taxpayer incurred an expense of 1 million Birr (a cumulative of cost of trading stock, salary, utility bills, and depreciation). In addition, it donated 100,000 Birr to an Ethiopian charitable organization. To determine the issue of whether the donation is deductible or not, we need to deduct the 1 million birr expenses from the 3 million Birr gross revenue. The result is 2 million Birr. The next step is determining whether or not the 100,000 birr donation exceeds 10% of the 2 million Birr taxable income. The donation is deductible because it does not exceed the 10% threshold (which is 200,000 Birr).

- Expenses not over the limits set by the Income Tax Proclamation. For instance, an employer, who is also a schedule C taxpayer, has the right to deduct pension contribution, not in excess of 15% of the monthly employment income of his employee. A deduction is also available

with respect to representation expenditures of an employee without exceeding 10% of the employment income of the employee.[29]

- Other expenses that are recognized by the Income Tax Regulation. [30]

As one of the manifestations of the specificity of Schedule C, we do find some lists of non-deductible expenses under Article 27 of the Income Tax Proclamation. There are different justifications for their non-deductibility. There are denials of deductions on public policy grounds. For Example, fines, and penalties are not deductible because they are intended to serve compensatory or penalty objectives. Some of them are denied the deduction because they are not incurred to derive business income.[31] In some cases like transactions taking place between related persons, the law prohibits deduction to prevent tax avoidance.[32] There are expenses, which are allowed as deductions to a certain extent, to serve social objectives. An expense above the limited level is not deductible. The case of charitable donation could be taken as an example.

Capital expenditures are deductible as per depreciation rules of the Income Tax Proclamation. They are not deductible by other means. Dividends generated by the business are profits or incomes, not expenses. Dividends are not deductible expenses. Insured losses are not deductible because they will be compensated by the insurance providers. [33]

4.1.3 The Income Tax Brackets, Rates and Computation Methods

Schedule C employs similar income tax brackets and rates to that of Schedule B. The only difference lies in the applicable tax rate on Micro Enterprises. Though the enterprises satisfy the definitional criteria of a body, their taxable income is taxed per the tax rates of individual taxpayers.[34]

The computation methods of gross income, deductible expenses, taxable income, and business income tax in Schedules B and C are similar. The classification of taxpayers into categories A, B, and C plays an important role in

[29] Ibid, Article 27(1)(C),(i)
[30] Supra note 27 (Income Tax Regulation), Articles 29-35
[31] See, for example, Supra note 4, Articles 27(1)(j)(k)(l))
[32] Ibid, Article 27(1)(m)
[33] Ibid, Article 27(1)(a)(d)(e)
[34] Ibid, Article 19(3)

determining the computation methods. Category A and B taxpayers are required to keep books of accounts. Hence, the numerical data that are relevant to determine their tax liability are derived from their books of accounts.

When gross income is calculated, it is necessary to aggregate all business income that falls under Schedule C. Exempt income, if any, is excluded. When expenses are calculated, it is mandatory to apply depreciation rules for capital expenditures or assets.[35] Non-capital expenditures, such as administrative costs, and utility bills, are wholly deducted from the gross income of the tax year. If the amount of deductible expenditures exceeds the amount of gross business income, the taxpayer experiences a loss. Loss carry forwards apply to allow the taxpayer to deduct the loss from future income. This right is not given without restriction. The deduction of current loss from future income is temporally limited. Tax loss carry forwards extend for the maximum of the next five tax years. A loss incurred in one tax year cannot be carried forward for more than five tax years. The five-year loss carry forward period applies to a loss incurred in one tax year. If the taxpayer incurs another loss in a different tax year, another five-year loss carry forward period applies to this loss as well. But, the taxpayer is not permitted to carry forward if he/she incurs further losses for the third or more times. Such losses will not be deductible from the future income of the taxpayer.[36] Look at the following example to understand the application of the loss carry forward rules.

	2013 E.C	2014 E.C	2015 E.C
Gross Income	2 Million	2 Million	3 Million
Expense	3 Million	1.8 Million	2 Million

In 2013 E.C, the taxpayer incurred a loss of 1 Million Birr. The Proclamation allows the taxpayer to carry forward to and deduct the 1 Million Birr loss from the incomes (to be) generated in the next five tax years (2014-2018 E.C). In the given example, the taxpayer is allowed to deduct 200,000 Birr in 2014 E.C while the remaining 800,000 Birr in 2015 E.C. The reason why the

[35] For Category B taxpayer, the Income Tax Proclamation introduced a simplified deduction rule for their costs of depreciable assets. See Ibid, Article 33(2)
[36] Ibid, Article 26

loss is deducted in two tax years is that the income derived in 2014 E.C (200, 000 Birr) is not sufficient to fully offset the total loss of the taxpayer (1 million Birr).

For taxpayers that report on an accrual basis, it may happen that an income that is included and recorded as taxable income may not be actually collected. For example, the taxpayer may sell his goods on credit and the buyer may fail to pay the price of the goods as per their agreement. In this case, the sale is recorded as income (since the accrual method requires the taxpayer to include it in the income before the actual receipt), but the taxpayer did not actually receive it. Using the example above, the taxpayer may be entitled to a deduction for the bad debt or irrecoverable debt. The Income Tax Proclamation allows the taxpayer to deduct the bad debt from his record when the conditions laid down under Article 30 are fulfilled. If the debtor pays the bad debt at a later time, the bad debt so paid is reported as an income per Article 73 of the Proclamation. Bad debt provisions are found only in Schedule C. Taxpayers of other schedules, even if they account as per an accrual basis, cannot have the right to deduct bad debts.

As noted previously, the taxable business income is the amount of gross income minus the deductible expenses for the tax year. For instance, if the gross income and deductible expenses are 10 and 7 million birr respectively, the taxable income is 3 million birr. If the taxpayer is a body, the taxable income is taxed at a tax rate of 30%. If the taxpayer is an individual or a micro-enterprise, then the taxable income is taxed according to the marginal tax rates stated in Article 19 of the Income Tax Proclamation.

For Category C taxpayers, a presumptive tax assessment is used to determine the amount of gross income, deductible expenses, taxable income, and the business income tax. Depreciation rules, loss carry forward, and bad debt rules do not apply to the Category C taxpayers. Based on the legislative delegation made by the Income Tax Proclamation, the Income Tax Regulation provides that Category C taxpayers shall pay business income tax in accordance with schedules prepared as per turnover-based and indicator-based standard assessment methods. [37] These methods are not new to Ethiopia. They have been in practice for decades. The implementation of the two presumptive methods

[37] Ibid, Article 49; Supra note 27 (Income Tax Regulation), Articles 49, 60

has been made based on directives issued by the Ministry of Finance and its regional counterparts (regional Finance Bureaus). The Estimation of Daily Sales directive is an infamous directive. The income tax liability of the majority of Category C taxpayers is determined as per the estimation of daily sales method. This method has been criticized for the subjective and unfair assessment of income taxes of Category C taxpayers. Tax officers go to every business premises and make estimations of daily sales or turnover. The estimated daily turnover is converted to annual turnover. This is done by multiplying the daily turnover by the number of working days (in a year) assigned for the business sector in which the taxpayer is engaged. The tax authorities have already set the average number of days for different business sectors. Many taxpayers complain that estimations of daily sales are excessive and subjective. The subjective nature of estimated assessments produces lots of disparities in the tax liabilities among the taxpayers.[38]

4.1.4 Declaration and Payment of Business Income Tax

Schedules B and C also share commonalities with respect to the timing and manner of declaration and payment of income tax. In both schedules, the classification of taxpayers into categories A, B, and C determines when and how to declare and pay tax to the tax administration. The discussion made under schedule B is relevant for this section as well. In principle, the assessment, declaration, and payment of business income tax are made by the taxpayers. The duty of tax declaration is made in a form approved by the tax administration.[39] For category A and B taxpayers, there is an additional obligation of accompanying the declaration by balance sheet and profit and loss statement.[40] The taxpayers declare their tax liability after determining the amount of gross income, deductible expenses, and the final tax dues. Hence, self-assessment is an integral and implied part of the tax declaration. Ancillary to the self-assessment, a withholding tax method may be applied in limited circumstances. A non-final business income tax may be withheld by the Customs Authority or payer of income. The tax withheld in advance will be credited or deducted from the annual (total) business income tax liability of the taxpayer.[41]

[38]For more on the features and problems of the presumptive income tax assessment methods, see Zerihun Asegid, Standard Assessment of Small Businesses in Addis Ababa City; Legal and Practical Problems in Focus, Business Law Series, Vol. 6, Addis Ababa University, 2013

[39]Supra note 5, Article 21

[40] Supra note 4, Article 83(5), 84

[41]Ibid, Articles 85, 92, 98

4.1.5 Taxation of the Extractive Industries: Mining and Petroleum Income Tax

4.1.5.1 Introduction

The oil and mining sectors are usually called the extractive industries as they involve the extraction of raw materials from the earth followed by the processing and selling of the products to the end consumers.[42] Oil, coal, gold, iron, and copper are examples of raw materials. The sectors require huge capital and advanced technologies. Their impact on economic growth is enormous. They are an important wealth-creating instrument for countries like Saudi Arabia, Nigeria, and Russia. The countries derive a huge amount of foreign currency (from the export of the resources) and revenue (in the form of tax and royalties). On the other hand, the sectors are linked with some serious problems. Conflict, environmental pollution, and workplace health hazards are the common downsides of the sectors.[43] In Ethiopia, the mining sector produces and supplies to market a variety of mineral commodities, such as gold, salt, limestone, marbles, and other precious stones. The oil sector is still in the exploration phase. Even though Ethiopia is rich in natural resources, the extractive industries, including the oil and mining sectors, accounted for less than 1 percent of GDP, 1 percent of government revenue, and 14 percent of exports: these industries were only able to create 4,000 formal jobs in 2018.[44]

As indicated above, the extractive industries require advanced technology and massive initial capital, particularly at the exploration and processing stages of the raw materials. In taxing the industries, some issues are worthy of special attention. First, multi-national companies are the ones that usually satisfy the above requirements and engage in the sectors. Transfer pricing[45] by the companies is a major challenge for tax administrations. Strong transfer pricing rules and enforcement are required to overcome the problem. Second, owing to the large initial capital incurred for the extraction and processing of raw

[42] Claudine Sigam and Leonardo Garcia, Extractive Industries: Optimizing Value Retention in Host Countries UNCTAD, Geneva, 2012, p.3

[43] Ted Schrecker et. al, How extractive industries affect health: Political economy underpinnings and pathways, Health and Place Journal, Vo. 52, 2018, pp. 140-142

[44] https://uneca.org/storys/ethiopia%E2%80%99s-mining-sector-has-potential-stimulate-economic-growth-poverty-reduction-says, last accessed on Nov. 14, 2021

[45] For a discussion on the transfer pricing concept, see the transfer pricing section of chapter 12 (The Law of International Taxation) of this textbook.

materials, it is important to design appropriate deduction rules that consider the special expenses of the industries on the one hand and the need to prevent erosion of tax base on the other hand.[46]

Since the beginning of the modern tax system of Ethiopia, mining, and petroleum operations had been covered by the main income tax laws. The operations were subject to a separate income tax regime between 1986 to 2016. The first petroleum income tax proclamation was introduced in 1986 while the mining income tax proclamation in 1993. The introduction of autonomous income tax regimes for both sectors was rationalized by the need to encourage the sectors than to raise more revenue. They provided more generous tax benefits than the other main income tax laws.[47] The Income Tax Proclamation of 2016 ended the separate income tax regimes of mining and petroleum operations.

The federal and regional governments of Ethiopia have two fiscal roles concerning natural resources, such as mining and petroleum. As sovereign bodies, they hold the power to levy and collect taxes on incomes and activities associated with such resources. The FDRE Constitution states that it is the joint power of the federal government and regional states to levy and collect income tax on all petroleum and large-scale mining operations. Persons engaged in these operations have to pay income tax on such operations to the federal government and regional states. The regional states have the exclusive right to levy and collect income tax on small-scale mining operations.[48]

As owners of the natural resources, the federal government and regional states have the property right to levy and collect royalties on the natural resources (mining and petroleum). The sharing of the royalties to the federal government and regional states follows the tax sharing pattern discussed above: royalties on all petroleum and large scale mining are the joint income of the federal government and regional states while royalties on non-large scale mining go to the regional states.[49]

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[46] David C.L. Nellor, Taxation of Mineral and Petroleum Resources, in Parthasarathi Shome (editor), Tax Policy Handbook, International Monetary Fund, 1995, p. 238

[47] Taddese Lencho, Towards Legislative History of Modern Taxes in Ethiopia (1941-2008), Journal of Ethiopian Law, Vol. XXV No. 2, 2012, pp. 125-126

[48] FDRE Constitution, No. 1/1995, Articles 97(8), 98(3)

[49] Ibid

4.1.5.2 Taxation of Mining and Petroleum Operations under the Federal Income Tax Proclamation (No. 979/2016)

This section of the Income Tax Proclamation, which covers Articles 36-44, provides some rules with respect to licensees and contractors. The latter are persons (taxpayers) that contract with the government to engage in mining and petroleum operations respectively.[50]

Licensees and contractors are required to pay income tax when they derive income from their operations. Similar to other businesses, they pay tax on their net income. As before, to arrive at taxable income, it is necessary to deduct expenses from gross income.

The Income Tax Proclamation (No. 979/2016) provides rules on two types of capital expenditure by licensees and contractors: development expenditure and exploration expenditure. With respect to other types of capital and non-capital expenditure, the general part of Schedule C as well as other parts of the Proclamation will apply. For example, depreciation deductions generated by depreciable assets (tangible movable and immovable assets)are not treated as either development or exploration expenditures; they are deducted in accordance with the normal depreciation rules of the Proclamation.[51] The same is true for the deductibility of administrative expenses.

Development expenditures are defined as intangible capital expenditures that are incurred in connection with activities that are authorized under a mining license or petroleum agreement. These include social infrastructure expenditures and expenditures incurred acquiring an interest in a mining right or petroleum agreement, and mining or petroleum information.[52] Exploration expenditures refer to expenditures incurred in connection with exploration operations, including exploration information and social infrastructure expenditures that are incurred in related exploration.[53] Like development expenditures, exploration expenditures are confined to intangible expenditures; depreciable assets are expressly excluded from its scope. Exploration

[50] See Supra note 4, Article 36(1,11,15, 16, 18)
[51]Ibid, Article 25; Supra note 27 (Income Tax Regulation), Article 39
[52]Ibid (Federal Income Tax Proclamation), Article 36(4, 5, 19)
[53]Ibid, Article 36(6)

expenditures are deducted at once from the annual gross income of the licensee or contractor.[54]

After the deduction of expenses from the gross income, the net income (profit) will be taxed at the rate of 25%.[55] The tax rates specified in Article 19 of the Proclamation will not have an application to contractors and licensees. As an exception to Article 51 of the Income Tax Proclamation that imposes 15% of income tax on non-residents that renders technical services, a non-resident sub-contractor that provides service to a licensee shall pay an income tax, which is equal to 10% of the payment received from the licensee. The licensee must withhold the tax from the payments made to the subcontractor. Payments made by contractors to subcontractors are exempt from income tax. [56]

4.2 Schedule D: Other Income Taxes

Initially, Schedule D was created in 1967 to bring the autonomous agricultural income tax regime to the main income tax system. [57] It was not introduced to tax the income that we now refer to as 'other incomes'. The previously separate agricultural income tax rules became part of the main income tax system (Schedule D) from 1967 to 1976. In 1976, the Schedule was removed from the main income tax system and re-introduced in 1978 to impose income tax on royalties, income from technical services, income from games of chance, and dividend income. Since 1978, the Schedule has remained effective and has included other taxable income. For example, capital gains, interest on bank deposits, income from the casual rental of property, and windfall profits were incorporated into the schedule in 1994, 2001, 2002, and 2010 respectively.[58] The taxation of other income was introduced by the current Income Tax Proclamation in 2016.

Schedule D is distinguished from the remaining schedules in many aspects. There is no general and single source of income/income that represents the schedule. The schedule is a larger umbrella that covers distinct and independent

[54]Ibid, Article 39(1)
[55]Ibid, Article 37(3)
[56]Ibid, Article 37(4), 65(1)(q)
[57]Taddese Lencho, The Ethiopian Income Tax System: Policy, Design and Practice, A Dissertation Submitted in partial fulfillment of the requirements for the degree of Doctor of Philosophy, University of Alabama, 2014, p.422
[58] Ibid, p.424

sub-schedules. While Schedules A, B, and C are represented by employment, rentals of buildings, and business incomes respectively, Schedule D represents miscellaneous types of income. Most of the incomes are traditionally called passive income. Unlike an active income, passive income is a type of income whereby the taxpayer does not engage significantly to derive the income. The taxpayer has no active participation in the activity that serves as the source of the income. The income is derived based on the regular activity of other people. For example, companies make profits based on the activities (works) done by their employees than the shareholders. The dividend paid to the shareholders is an example of passive income. Interest on loans and royalties on intellectual property are the other examples of passive income.[59] The incomes are subject to different sub-schedules (tax rules). The nature of taxable income, tax rates, assessment, and collection methods are not the same across the sub-schedules. For example, while a deduction is allowed with respect to taxation of capital gain, undistributed, and repatriated profits, there is no deduction for the other incomes. It is the gross income that is subject to the tax. Dividends and interest are examples.

Unlike Schedules A, B, and C, Schedule D contains flat tax rates and no distinction is made between body and individual taxpayers for the purpose of the tax rate. The tax rates are not the same for the miscellaneous incomes. There exist different tax rates for the miscellaneous incomes. In some cases, the classification of the taxpayer into resident and non-resident status determines the applicable tax rates. Article 51 is formulated for the taxation of income earned by non-resident taxpayers with no permanent establishment. The minimum tax rate in the Schedule is 5%. It applies to incomes like royalties. The maximum tax rate is 30% and it applies to capital gains derived from the disposal of shares and bonds. Since each sub-schedule has its tax rate, income aggregation rules do not apply to Schedule D. For instance, dividends and income from lottery winnings cannot be aggregated and taxed under the same tax rate. More importantly, the same incomes falling under the same sub-schedule are not taxed on their aggregate. A person deriving dividends from two or more different companies shall not be taxed on the aggregate dividends. Assume that Kidane bought 100 and 200 shares from X and Y companies. In

[59] Richard J. Vann International Aspects of Income Tax, in Victor Thuronyi (ed.),Tax Law Design and Drafting, volume 2, International Monetary Fund: 1998, P. 706

2014 E.C, he received dividends of 30,000 and 50,000 Birr from the two companies respectively. The dividend tax is not calculated on the aggregate of 80,000 Birr. Rather, it shall be computed separately, on each payment. Even if both payments are subject to the same tax rate, they are not taxed together. This is due to the application of a final withholding system on schedule D. The tax imposed on each payment of income under schedule D is a final tax. It is not levied as an advance tax, which will be credited from future total tax liability.[60]

There is no either a monthly or annual tax year under Schedule D. The tax liability is due whenever a payment of income is made to the taxpayers described in the Schedule. Self-assessment applies with respect to taxation of income from casual rents (Article 58), capital gains (Article 59), windfall profits (Article 60), undistributed profits of bodies (Article 61) repatriated profits (Article 62), and other incomes (Article 63).[61] The tax assessment, declaration, and payment shall be made by the taxpayers themselves. For example, Halima constructed a building intended for commercial purposes at the cost of 20 million Birr. Later, she sold the same building for 30 million Birr. It is not the duty of the buyer to assess and collect the capital gain tax due on the disposal of the building. As a taxpayer subject to the self-assessment rule, Halima shall compute and pay the capital gain tax to the government. The remaining types of incomes are taxed based on final withholding rules. The payers of the taxable income shall withhold the tax from the payment they made to the taxpayers and submit the same tax to the government. To illustrate, companies shall withhold an income tax on the dividends they pay to their shareholders.

If an income that is taxable under Schedule D is also subject to tax under one of the other Schedules (A,B, or C), then the income will be taxed under the latter and not under schedule D.[62] This rule is designed to apply for those situations in which either Schedule A or B or C taxpayers derive schedule D income in connection with their core functions/ businesses. For instance, commercial banks derive business income from different sources and are taxed under Schedule C. They derive interest income from lending money. This income is not taxed under schedule D. It is taxed under schedule C because it is part of the

[60] Supra note 4, Articles 64(2), 98
[61] In some cases, the tax may be withheld by the payer of income in accordance with Article 89 of the Income Tax Proclamation ((No. 979/2016))
[62]Supra note 4, Article 61(1)(a)

core business/activity of the banks. Employers may allocate shares, as fringe benefits, to their employees. The dividends derived from the shares are regarded as employment income/fringe benefit and taxed under Schedule A, not Article 55.[63]

4.2.1 Taxation of Income of Non-residents

Non-residents pay income tax on their income derived in Ethiopia. It is not a pre-requisite for the non-resident taxpayers to be present in Ethiopia through a permanent establishment. Unlike the previous income tax proclamations whereby the presence of permanent establishment was a must criterion, the current proclamation extends the tax jurisdiction of Ethiopia to non-resident taxpayers without a permanent establishment in the country.[64] This type of tax is called non-resident tax.

The taxable unit (taxpayer) of non-resident tax is a non-resident taxpayer without a permanent establishment in Ethiopia. Any taxpayer that is not a resident of Ethiopia is regarded as a non-resident taxpayer.[65] If the taxpayer is not a resident taxpayer, then they are treated as a non-resident taxpayer. For the purpose of application of non-resident tax, being non-resident is not sufficient. The taxpayer must derive the taxable income without establishing a permanent establishment in the country. If the income is derived through a permanent establishment, the tax is imposed per other rules. For example, if the income is a dividend, Article 55 of the Income Tax Proclamation will apply.

The tax base of the non-resident tax is the gross income derived from limited sources of income. The tax is imposed on dividends, interest, royalties, management fees, technical fees, or insurance premiums.[66] There is no deduction of expenses. The tax base is not subject to the same tax rate. Depending upon the type of income, a different tax rate applies.[67]

[63]Supra note 27 (Income Tax Regulation), Article 17
[64]Supra note 4, Article 51
[65]Ibid, Article 51
[66]For the definitions of dividend, interest, management fee, royalty, and technical fee, see Articles 2(6), 2(16), 2(17), 2(20) and 2(23) of Federal Income Tax Proclamation (No. 979/2016). Insurance premium is not defined by the Proclamation. A reference to insurance laws or literature needs to be made.
[67]Supra note 4, Article 51

- 5% for an insurance premium or royalty
- 10% for a dividend or interest
- 15 % for management or technical fee

The duty to pay non-resident tax arises when the non-resident taxpayer derives one of the above incomes. Articles 2(5) and 2(19) are relevant to understanding the meaning of the word 'derive'. The non-resident tax is assessed and submitted to the tax administration by the payer of income, which may be either a resident person or a non-resident person with a permanent establishment in Ethiopia. Non-resident tax is subject to a withholding system.[68] This withholding mechanism is justified because the taxpayer has no permanent establishment in Ethiopia. The withheld tax is paid to the tax administration within 30 days after the end of the month in which the income was paid.[69] For instance, if the non-resident taxpayer derived the income on October 12, then the payer of the income is required to submit the tax to the tax administration within one of the 30 days of November. Failure to withhold the tax brings personal liability on the payer of income.[70] The payer will be subjected to the tax collection and recovery provisions of the tax administration proclamation. Finally, we need to note that the withheld tax will not be offset from the annual tax liabilities of the taxpayer. If the taxpayer derived two or more dividends within a year, the tax is assessed and paid separately for each payment.

4.2.2 Taxation of Non-Resident Entertainers

Entertainers are those persons or groups of persons whose work is to please or amuse their audience. Entertainers include but are not limited to, musicians, dancers, comedians, sportsmen, sports teams, musical groups, and theatre troupes. When non-resident entertainers derive income from their entertainment performance in Ethiopia, they are required to pay an income tax that is equal to 10% of the gross income derived from the performance. In the case where the entertainer's income is received by another person, the same tax liability rests on that person.[71]

[68] Ibid, Article 89
[69] Ibid, Article 97
[70] Ibid, Article 97(3)
[71] Ibid, Article 53

For example, an entertainment company brought foreign (non-resident) musicians and organized a music festival in Ethiopia. The company sold out entrance tickets and collected a fee (income) from the gatherers. The income Tax Proclamation makes it very clear that the fees collected by the company are subject to tax under Article 53. No deduction is allowed with respect to the fees. The law aims at preventing tax avoidance in circumstances whereby the fee (income) is not directly paid to the entertainer, but someone else.

Since the musicians are non-residents, the Proclamation applies a final withholding mechanism on the fees/gross income of the entertainers. The duty to withhold the tax is imposed on the person that makes the payment to the entertainer/s. However, this person shall be either a resident of Ethiopia or a non-resident with a permanent establishment in Ethiopia.[72] If not, there will be no duty of withholding the tax from the entertainer. The person that makes the payment to the entertainer, in other words, the withholding agent, shall submit the withheld income tax to the tax authority within 30 days after the end of the month in which the income was paid to the entertainer.[73]

The scope of Article 53 of the Proclamation extends to Ethiopian sourced income of non-resident entertainers. It does not extend to resident entertainers of Ethiopia. There are many Ethiopian entertainers, such as musicians, artists, comedians, and footballers that make money from their performances in Ethiopia. The Proclamation does not contain a separate and explicit provision for the income taxation of resident entertainers. It is by way of interpretation of the scope of the existing schedules that we can find a place for them. On the one hand, it may be held that the entertainers should be treated as employees and then placed under schedule A. If this argument holds sway, the entertainers are taxed in the same way as employees. The other line of argument is to treat the entertainers as independent contractors and to apply Schedule C to tax their income.

4.2.3 Taxation of Royalties

The definition of a royalty is important to determine the scope of application of Article 54 of the Income Tax Proclamation (No. 979/2016). In its ordinary meaning, royalty refers to either of the following types of income. First, it may

[72] Ibid, Article 89(2)
[73] Ibid, Article 97

represent an income received by a person for the use of his/her intellectual property rights, such as copyright and patent by (or sale of the same rights to) another person. Second, a royalty is used to mean a payment made for the right granted for the extraction of natural resources, such as minerals, oil, and gases. The owner of such resources grants others the right to extract the resources upon payment of the royalty. Article 54 of the Proclamation is concerned with the income taxation of holders of intellectual property rights, not royalty received for use of natural resources. This is evidenced by the proclamations' definition of royalty that restricts itself to incomes derived from the exploitation of intellectual property rights.[74] An income derived by artists and authors from the sale of music albums and books respectively is an example of income tax is taxed under this section.

Both residents and non-residents with a permanent establishment in Ethiopia are liable for an income tax at the rate of 5% on the gross amount of the royalty. That is to say, their tax liability is equal to 5% of the royalty they derived from the use or sale of their intellectual property rights. There is no deduction for expenses as the tax is imposed on the gross income (royalty).

If the royalty is paid by residents or non-residents with a permanent establishment in Ethiopia, then the tax is assessed and submitted to the tax authority per the withholding system. The payers of the royalty must withhold the tax.[75] If the payer of royalty is a non-resident without a permanent establishment in Ethiopia, the duty to pay income tax on the royalty is confined to residents and the latter shall have the duty of self-assessment. The tax shall be calculated and submitted to the tax authority by the residents (receivers of the royalty).[76]

As a common problem of schedular income tax system, the taxation of royalty may overlap with the taxation of employment income under the Income Tax Proclamation. In Ethiopia, university employees engage in and derive income from the writing of textbooks or modules. Due to the high tax rates of schedule A and the room for overlapping between royalty and employment income, there are universities (withholding agents) that treat income from the writing of the textbooks as royalty and assess the income tax at the rate of 5%. Some

[74] Ibid, Article 2(20)
[75] Ibid, Article 90
[76] Ibid, Article 93(3)(a)

universities regard the income from the royalty as employment income and calculate the tax under schedule A.[77] The inconsistent characterization of the taxable incomes is not good for the tax system. It poses fairness and certainty challenges. Hence, the line that demarcates royalty from employment income needs to be properly delineated.

4.2.4 Taxation of Dividends

Scholars advance various approaches on the type of income tax system that should be applied to legal entities, such as companies, and their shareholders.[78] According to the proponents of the classical (disintegrated) tax system, the entities and their shareholders shall be treated as separate taxable persons and taxed separately. The system imposes two income taxes;

- First, when the entities make profits, a tax on the profit of the entities applies, which is also called as corporate income tax
- Second, when profits are distributed to shareholders, the income tax generated is called dividend tax.

The classical tax system supports the separate taxation of dividends in the same way as other investment income, such as interest. However, the system is criticized for creating double taxation. The criticism holds that the system taxes the same income twice; first at the entity level and second at the shareholder level. Even though there are calls for the elimination of the system, many countries have adopted it for several reasons, including the need to raise more revenue. The USA and Ethiopia are examples of countries that fall under the classical tax system camp. On the other hand, we find the integrated (imputation) tax system that advocates for the taxation of the entities only, not the shareholders. The tax paid at the entities' level is presumed as a tax paid by the shareholders. Hence, the system allows tax credits to shareholders in case they pay tax on their dividends. This is the approach in countries like Australia.[79]

[77]Supra note 57, p.442
[78]Felipe Rodrigo Conejeros Saavedra, Tax system: integrated or disintegrated?, Inter-American Center for Tax Administrations, available at https://www.ciat.org/ciatblog-sistema-tributario-integrado-o-desintegrado/?lang=en, last accessed on Nov. 25, 2021
[79] https://taxfoundation.org/corporate-integration-tax-reform/, last accessed on Nov. 25, 2021

Bodies, such as companies, make different types of distributions[80] to their shareholders. The distributions may be paid out of the profit of the body and in some cases out of no profits at all (from the capital of the body). [81] With the tax systems that impose a separate tax on dividends, the issue of which distribution shall be regarded as a dividend and which one not (as a return of capital) is a source of controversy. The need to limit tax liability on the one hand and the need to raise more revenue, on the other hand, are the competing interests that fuel the problem. Entities and shareholders may try to characterize a dividend as a return of capital or distribution paid out of the capital of the bodies. In a bid to prevent the tax base from erosion, the tax systems go further to characterize some of the distributions as dividends even though the bodies label the distributions otherwise. Loans and distribution of in-kind properties, excessive compensation, and stocks (shares) to shareholders are among the various modes of distribution that are subject to income taxation in many tax systems.[82] The effective income taxation of dividends requires a legal framework that addresses the taxability of constructive dividends, inter-corporate dividends, capital dividends, stock dividends, the redemption of shares, and distributions made during liquidation.

As noted above, Ethiopia follows the classical system. Until 1978, the country had applied the integrated tax system that limited the imposition of the income tax to the profit of the business organization. There was no tax at the shareholders' level. The Income Tax Amendment Proclamation of 1978 introduced the classical system and extended the income tax reach to dividends paid to shareholders. The Proclamation levied a withholding income tax on dividends at the rate of 25%. A reduction of the tax rate was made by the successive income tax laws. [83]

[80] Distributions are payments made by a company to its shareholders in connection with their ownership rights or investment over the company.

[81] Graeme S. Cooper and Richard K. Gordon, Taxation of Legal Persons and their Owners, in Victor Thuronyi (ed.),Tax Law Design and Drafting, volume 2, International Monetary Fund: 1998, p. 846

[82] Taddese Lencho and Hana Arayaselassie, Dividend over Dividends: The Recent Controversies over the Meaning and Scope of Dividends and Lessons from the Comparative Experience, in Taddese Lencho and Kyle Logue (editors), The Ethiopian Tax System: Some Contemporary Issues and Problems, Ethiopian Business Law Series, Vol. VI, 2014, pp.166-169

[83] Ibid, p.147

The Income Tax Proclamation of 2016 defines a dividend as a distribution of profits by a body to its members.[84] This means that a distribution which is a return of capital is not regarded as a dividend. The Proclamation tries to treat some forms of distributions as dividends and bring them to the tax net. These include:

- An amount of capital dividend (Return of capital) above its nominal value:[85] For example, Mr X owns 100 shares in ABC Company. Each share has a nominal value of 1000 Birr. With the view of reducing its capital, the Company lowers the nominal value of each share to 800 Birr and repays 200 Birr per share to Mr.X. In this case, no dividend is subject to tax. Let us assume that instead of 200 Birr the company repays 300 Birr per share to X. Even though the actual reduction of the par value of each share is 300, the Company reduces the nominal value of each share by only 200 Birr. The Proclamation considers the 100 Birr difference as a dividend on each share.
- An amount of redemption of membership interest (shares) in excess of its nominal value[86]:
- An amount, returned to the member on cancellation or liquidation of body, in excess of its nominal value[87]
- Constructive or disguised dividends that are made to the member or a related person of the member under the pretext of "real" transactions.[88]For example, a company entered into a loan contract with one of its shareholders whereby the company agreed to borrow a certain payment of money from the shareholder and to pay interest on the loan. When the substance or enforcement of the contract is examined, it is a simulated or fake arrangement made between the two parties for the payment of a dividend in the form of loan repayment. In most cases, the dividend allocated to the shareholder is disguised as and paid in the form of interest for loan debt. Since the tax rate applicable to interest is lower than that of

[84]Income Tax Proclamation (No. 286/2002), Article 2(6). The Federal Tax Administration Proclamation defines member as a person with membership interest in the body including a shareholder in a company or a partner in a partnership. It also defines membership interest as an ownership interest in the body including a share in a company or an interest in a partnership. Supra note 5, Article 2(20, 21)
[85]Supra note 4, Article 2(6)(a)
[86]Ibid, Article 2(6)(b)
[87]Ibid, Article 2(6)(b)
[88]Ibid, Article 2(6)(c)

dividends, the shareholder will pay a lower amount of tax. This is one instance of a constructive dividend. By examining the true nature of transactions declared by taxpayers, the tax administration has the responsibility to combat similar tax avoidance arrangements.

Unlike the repealed (2002) Income Tax Proclamation that limited the payment of dividends to share and private limited companies, the Income Tax Proclamation of 2016 broadens the scope of dividend payers to bodies in general.[89] In addition to share and private limited companies, profits distributed by partnerships, public enterprises, cooperative societies, and other similar forms to their members are regarded as dividends and subject to income tax.

Before the enactment of the Income Tax Proclamation of 2016, there had been a controversy between the tax authority and taxpayers over the timing for the establishment of the duty to pay dividend tax. Taxpayers were of the view that the duty is created only if their companies make a formal declaration of dividends. According to this view, undeclared dividends should not be subject to tax. On the other hand, the tax authority took different actions, such as the issuance of a directive that aimed at collecting taxes even from undeclared dividends. The controversy that happened due to the absence of an adequate definition of dividend in the then income tax laws, particularly the Income Tax Proclamation of 2002. Being aware of this problem, the Income Tax Proclamation of 2016 came up with an explicit provision that targets the taxation of undistributed profit or, in other words, undeclared dividends.[90]

Under the Income Tax Proclamation of 2016, The duty to pay an income tax on dividends becomes effective when a person, such as a shareholder of a company, derived a dividend.[91] For the purpose of Schedule D in general and dividend tax in particular, 'derived' has the meaning of received' and the latter is broadly defined to include not only the direct transfer of the dividend to the personal account of the taxpayer but also the disposal of the dividend by a third party for the benefit of the taxpayer.[92]

[89]Income Tax Proclamation (No. 286/2002), Article 34(1); Supra note 4 Article 2(6)
[90]Ibid (Federal Income Tax Proclamation), Article 61
[91]Ibid, Article 55
[92]Ibid, Articles 55, 2(5)(b), 2(19)

Not everyone that derives a dividend is required to pay the tax. The Proclamation makes further qualifications. To establish the legal duty to pay tax under Article 55, the person that derives the dividend shall be either of the following.

- Resident of Ethiopia
- Non-Resident with a permanent establishment in Ethiopia. If the non-resident who derives the dividend does not have a permanent establishment in Ethiopia, Article 51 applies.

The Income Tax Proclamation (No. 979/2016) explicitly states that it is the gross amount of the dividend that is subject to the income tax. This implies that the taxpayer that derives the dividend is not allowed for any deduction of expenses.[93] The amount of the income tax is equal to 10% of the gross dividend derived by the taxpayer. The person that makes payment of dividend to the taxpayer must withhold the income tax and account to the tax authority within the time set by the Proclamation.[94]

4.2.5 Taxation of Interest

When introduced for the first time in 2001, a withholding tax on interest was imposed on depositors of money in banks. The tax rate was 5% of the interest. The scope of taxable interest income was still limited to the interest derived by bank depositors and the tax rate remained 5% until the Income Tax Proclamation of 2002 was repealed in 2016. Other types of interest (income), such as interest paid to lenders, did not attract the tax.[95]

Under the Income Tax Proclamation of 2016, interest is defined broadly as;

> *a periodic or lump sum amount, however described as consideration for the use of money or being given*
> *time to pay, and includes a discount, premium, or other functionally equivalent amount;*[96]

[93] It has to be recalled that bodies pay business income tax under schedule C and they are not allowed to deduct dividends as deductible expenses. Dividends are paid from the profit of the bodies.
[94] See supra note 4, Articles 89(1), 90(2), 93(3), 97
[95] Income Tax (Amendment) Proclamation (No. 227/2001), Article 2(3); Income Tax Proclamation (No. 286/2002), Article 36
[96] Supra note 4, Article 2(16)

According to the broad definition employed by the Proclamation, interest is an amount or economic benefit derived in response to the use of money or for being given time to pay. Irrespective of the identity of the payer or receiver of the interest, the following are regarded as interest

- Interest paid on deposits
- Interest paid on debentures by companies
- Interest paid on loans[97]
- Discounts and premiums that are paid for the use of money[98]
- Other functionally equivalent payments[99]

The periodicity of payment of interest is not relevant for the purpose of the tax. The interest may be paid periodically, at a regular interval, or all at once as a lump sum. The tax is due whenever interest is derived by a person.

There are two types of taxpayers, which derive the interest, under this section of the Proclamation; resident taxpayers and non-resident taxpayers with a permanent establishment in Ethiopia.[100] The resident taxpayer is taxed on its worldwide interest income while the non-resident is taxed on its Ethiopian source interest income. Both are taxed when they derive, which means receive, interest. The definitions of resident and non-resident taxpayers, derive and received, are addressed elsewhere in this chapter. As in the case of dividends, there is no deduction for interest. The taxpayers are taxed without deduction of any expense.

[97]The loan may be made either in a business or non-business context. If the lender is a financial institution whose core job is lending money, the interest is taxed under schedule C. See Ibid, Article 64(1)(a)

[98]The Technical Notes of Ministry of Finance provides the following example. "A bill of exchange may be issued at a discount on its face value with the full amount of the face value payable on maturity of the bill. A 90-day bill with a face value of 100 Birr may be issued for 90 Birr. This means that the issuer of the bill receives 90 Birr on issue and pays 100 Birr on maturity. The difference of 10 Birr is referred to as discount, but is economically the equivalent of interest. A premium is really additional interest and may be payable by a borrower with a low credit rating to compensate for the greater risk involved with the loan." (Supra note 9, p. 14)

[99]The Technical Notes gives "amount payable for the time value of money under a derivative financial instrument or a payment of defaulted interest by a guarantor" as example for it. (Ibid, p. 14)

[100]Supra note 4, Article 56. It is to be noted that interest derived by non-residents with no permanent establishment is taxed under Article 51 of the same Proclamation.

Regarding the tax rates, the Proclamation provides the lower tax rate of 5% for interest derived from savings (deposit of money) with financial institutions, such as banks, that are residents of Ethiopia. The rationale for setting a lower 5% tax rate seems to encourage the saving of money with financial institutions. Saving is one form of investment. An unintended consequence of this approach is that the low tax rate incentivizes taxpayers to report income from other sources like interest income. For example, to avoid the payment of dividend tax at the rate of 10%, it is common for companies and their shareholders to enter into a fictitious loan contract whereby the companies become borrowers while the shareholders as lenders. The earnings of the shareholders that would otherwise be declared dividends are instead reported as an interest to take advantage of the 5% tax rate. Hence, the taxation of interest is a prime target of income shifting by taxpayers. For all other types of interest, the tax rate is 10% of the interest. Under this category, interests derived from depositing money with foreign financial institutions, debentures of companies, and loans are taxed at 10%.[101]

The tax under this section is a final tax, which means there is no credit at the end of the tax year and it is subject to a withholding system. The declaration and payment of the tax are made in accordance with Articles 90(3) and 93(3) of the Income Tax Proclamation (No. 979/2016).

4.2.6 Taxation of Income from Games of Chance

Income from games of chance is an example of non-recurrent income. The deriving of the income is based on an uncertain event of chance. Like employment and similar incomes, it is not possible to derive the income on regular basis.

In Ethiopia, the income taxation of games of chance was first introduced by the Income Tax (Amendment) Proclamation of 1978 and the tax rate was 10%.[102] Unlike the Income Tax Proclamation of 2002, the Income Tax Proclamation of 2016 contains a provision that defines a game of chance. It states that a game of chance is a ‘game whose outcome depends primarily on chance rather than the

[101]Ibid, Article 56. If the payer of the interest is either a schedule B or C taxpayer and the interest is incurred in deriving a taxable income, then it is entitled to deduct it as an expense. Refer, Ibid, Articles 15(7)(d), 23,
[102]Supra note 57, p. 452

skill of the participant, including a lottery or tombola.'[103] Though skill (or knowledge) may have some role, it is chance that plays a significant role in determining the outcome of the game. Lottery (tombola, instant lottery, promotional lottery…), bingo, sports betting, and casino are among the popular types of games of chance. [104]

In contrast to a game of chance, a game of skill depends much more on skill than chance (luck). For example, the result of a chess competition depends much on the skills of the players than their luck. An income that is derived from participation in a game of skill does not fall within the scope of the tax rules governing income taxation of games of chances.

Governments earn income from the organizers and winners of games of chance in tax and non-tax forms, such as license fees. To engage in the business of games of chance in Ethiopia, a permit must be obtained from the National Lottery Administration. The permit is issued and renewed upon payment of a fee.[105] According to a newly enacted directive, the permit fee for sports betting is 500,000 Birr and the renewal fee is 100,000 Birr.[106] In addition, the person that operates the gaming business and the winner of the game must pay the required taxes under Schedule C and Article 57 of the Income Tax Proclamation (2016) respectively.

For the purpose of taxation of income from games of chance, the taxpayer is any person, either resident or non-resident of Ethiopia, and the income shall be derived from a game of chance exercised in Ethiopia. That means, it is Ethiopian sourced income.

Persons, who pay money or any other economic benefit to the winners of games of chances, are required to withhold 15% of income tax from the payment. The tax is imposed on the gross income and hence there is no application of a

[103]Supra note 4, Article 57(4)
[104]What are games of chance? Definition and Examples, available at https://marketbusinessnews.com/financial-glossary/games-chance/, last accessed on Nov. 29, 2021
[105]A Proclamation for the Re-Establishment of the National Lottery Administration, No. 535/2007, Articles 13, 18
[106] Sport Betting lottery Directive (No. 172/2021),

deduction rule. There is no obligation to pay tax when the income from the winning is less than 1000 Birr.[107]

Nowadays, games of chances, especially sports betting, are becoming professional careers and a regular source of income for some individuals. There are professional gamblers that make money from the games for their living. In some foreign tax laws, a distinction is made between professional and amateur (casual) gamblers. For example, in the USA, the professional gamblers are distinguished from the amateur ones by the following standard of the country's Supreme Court:

> *"If one's gambling activity is pursued full time, in good faith, and with regularity, to the production of income for a livelihood, and is not a mere hobby, it is a trade or business."*[108]

The consequence is that professional gamblers are treated as business persons and taxed in accordance with business income tax rules.[109] The income tax laws of Ethiopia are not explicit about this situation. We do not find provisions or cases that specifically deal with the income tax implications of professional vs. amateur gamblers. This does not mean that there is no way to address the issue. In the case where an income falls and is taxable under Schedule D and one of the remaining Schedules (A, B, and C), the Income Tax Proclamation gives priority to the taxation of the income under the latter schedules.[110] This implies that there is a legal room for taxing professional gamblers under Schedule C.

When the income is derived in non-cash forms, such as houses, cars, and mobile phones, the valuation rules of the Income Tax Proclamation are applied to estimate the monetary value of the income and assess the income tax.[111]

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[107]Supra note 4, Article 57

[108]Commissioner of Internal Revenue vs Groetzinger, No. 86-1226, U.S. Supreme Court, (1987), cited in Alistair M. Nevius, Tax issues for professional gamblers, availablehttps://www.journalofaccountancy.com/issues/2016/oct/taxes-for-gamblers.html, last accessed on Nov. 29, 2021

[109]Alistair M. Nevius, Tax issues for professional gamblers, available https://www.journalofaccountancy.com/issues/2016/oct/taxes-for-gamblers.html, last accessed on Nov. 29, 2021

[110]Supra note 4, Article 64(1)(a)

[111]Ibid, Article 75

The tax under this section is final and it is subject to a withholding system. The declaration and payment of the tax shall be made in accordance with the applicable tax rules.[112]

4.2.7 Taxation of Income from Casual Rentals

When an income is derived from the casual rental of either a movable or immovable asset in Ethiopia, it is taxed under Article 58 of the Income Tax Proclamation of 2016. The taxpayer may be either resident or non-resident of Ethiopia. However, the income shall be an Ethiopian-source income (as the asset is located in Ethiopia)

The meaning of the word 'casual' is important not only to understand within the scope of Article 35, but also to avoid characterization problems with Schedules B and C. If the rental is carried out casually, Article 58 will be applied. If the rental is carried out on regular basis, the income derived from the rent will be taxed under either Schedule B (if the property is a building) or C (if the property is other than a building). The Income Tax Proclamation of 2016 does not contain a provision that defines the 'casual' rental of an asset. The Income Tax Regulation of 2017 tries to define the term in a non-satisfactory manner. Instead of defining what 'casual rental' means, the Regulation engages in telling us what 'casual rental' does not mean. Causal rental is explained as the opposite of the 'regular business of rental' of movable or immovable assets.[113]

> *"…income derived from casual rental of asset" means gross income derived by a person who is not engaged in the regular business of rental of movable or immovable asset.*

To make things more complicated, the Amharic version of the Regulation contains phrases (underlined) that could be interpreted in different ways.

> *አልፎ አልፎ ሀብትን በማከራየት የሚገኝ ገቢ ማለት በንግድ ስራ ላይ በመደበኛነት ያልተሰማራ ሰው የሚንቀሳቀሱ ወይም የማይንቀሳቀሱ ንብረቶችን አልፎ አልፎ በማከራየት የሚያገኘው ጠቅላላ ገቢ ነው።*

[112] Ibid, Articles 64(2), 91, 93(3) and 97. In relation to income derived from winning of sport betting, the tax shall be paid to the national lottery Administration at the end of every month. Sport Betting lottery Directive, No. 172/2021

[113] Supra note 27 (Income Tax Regulation), Article 50

The problem with the above definitions is that they lack accuracy and consistency. Like the repealed income tax laws of 2002, the regulation does not tell us what is 'causal' or 'regular'. We do not know the duration of the casual rental. Moreover, there is an inconsistency between the English and Amharic versions in the use of the word 'regular'. While the English version relates the word with rental activity, the Amharic version ties it with business activity (Schedule C). This legal gap is a common problem of the repealed income tax laws of 2002 and the current income tax laws of 2016/17.

In practice, due to the absence of an accurate and clear definition of the two words, there has been and continues to be much confusion as to the scope of Article 58 vis-à-vis schedules B and C. There is no common understanding among and between the tax administration and taxpayers concerning the meaning of the above terms and the types of incomes subject to Article 58. Rentals of guest houses, private cars, and tents for special occasions like weddings are among the contested sources of income that could fall under the above article.

The word 'annual' in Article 58(1) may lead to a conclusion that the taxpayer that derived income from casual rent must pay on its annual income and have a tax year, like Schedule B and C taxpayers. Such a conclusion would be wrong for the following reason. Tax on income from causal rent is governed by self-assessment, not the withholding rule. For Schedule D incomes that are subject to self-assessment, the Income Tax Proclamation provides a general rule on the time for tax declaration and payment. The Proclamation requires the taxpayers to file a tax declaration 'within two months after the date of the transaction giving rise to the income'.[114] Renting a property on other than a regular basis is the transaction that gives rise to casual rental income. It appears that the two months tax declaration period commences just after the completion of the casual rent (lease) period. This means that the taxpayer must make a separate tax declaration for each casual rent (lease) contract.

An income that is derived from the rental of industrial, commercial, or scientific equipment may be characterized as both a royalty[115] and income taxable under Article 58. In this situation, the Proclamation treats the income as royalty and

[114]Supra note 4, Article 83(7)
[115]Ibid, Article 2(20(d)

prioritizes its taxation under either Article 51 or 54 (depending upon the nature of the taxpayer's residence).

4.2.8 Taxation of Gains on Disposal of Certain Investment Asset

The Income Tax Proclamation deals with the taxation of the gain realized from the disposal of some investment assets. In the tax literature and foreign tax systems, this is referred to as taxation of capital gain. The meaning of gain derived from the disposal of investment (capital) asset and its distinction with other forms of income, such as business income, and the justifications for treating it under separate tax rules are some of the interesting issues in a tax system that deserve attention.

Capital gain refers to an increase in the value of an investment asset when the asset is disposed of. When an asset is sold for a higher price than the original purchase price, there will be a realization of gain and the seller must pay tax on the gain. If the asset is sold for a price lower than its purchase price or acquisition cost, there will be a capital loss and no tax will be due. Tax laws may allow the offset of a capital loss from future capital gain.

Realization events and periodicity (recurrence) are the two important factors that distinguish capital gain from other forms of income. Capital gain is derived when there is a disposal of a capital asset or transfer of ownership of a capital asset from the taxpayer to someone else in different ways, such as by sale, exchange, or gift. The disposal of a capital assets is a triggering event for not only the deriving of capital gain but also the existence of a duty to pay capital gain tax.

Other incomes like business income, interest, dividends, and royalty are derived from the use of capital assets. For example, a business income is derived when a person generates profit from the conduct of a business, using its capital assets. Except for a few cases[116], disposal of an asset is not a precondition. Disposal of capital gain is a one-off transaction. As a result, a capital gain is not a periodic income. It is derived by the owner only once for each investment asset that is sold, exchanged, or gifted. This is different from the case of other incomes like business income that are derived on regular basis from continuous economic activities, with one notable exception worth noting. If trading in capital goods is

[116] Ibid, Article 21(1)(b)

the regular activity of a person, the income from such activity is often regarded as a business income and taxed in accordance with business income tax rules.[117] The sale of buildings by real estate companies is a typical example of this unique situation.

The separate taxation of capital gains is widely practiced not only in schedular income tax systems but also in those predominately global income tax systems. The tax systems subject the capital gains either to different tax rates or exempt them from tax entirely. Capital assets appreciate (or depreciate) in value over time. Ideally, the best way and time to tax capital assets is whenever they increase in value. However, the implementation of this approach is difficult and complicates the tax system. It is burdensome for the tax administration to make an assessment of the increased value of the asset at the end of a prescribed period and impose a tax on it. Additionally, the owner of the asset may not have the cash to pay the tax liability whenever the asset accrues in value. To resolve this problem, the disposal of the capital asset is chosen as a realization event for capital gain and capital gain tax. This unique realization event requires the incorporation of different tax rules, which in effect brings the separate taxation of capital gain.[118]

The taxation of capital gains is not without criticism. The assessment of capital gain tax requires the maintenance of proper records on the costs and prices of the assets. The tax administration is expected to make sure that the tax is imposed on the correct value of the assets. The maintenance of records and implementation of valuation rules create administrative burdens. [119]

Under the Income Tax Proclamation of 2016, the capital gain tax is not levied on the disposal of all types of investment (capital) assets. For instance, the disposal of vehicles and machinery does not trigger the tax. The Proclamation limits the application of the tax to the following taxable assets.[120]

[117] John R. King, Taxation of Capital Gains, in Parthasarathi Shome (editor), Tax Policy Handbook, International Monetary Fund, 1995, p. 156
[118] Ibid, p. 156
[119]Juanita D. Amatong, Taxation of Capital Gains in Developing Countries, international Monetary Fund, p. 361
[120]Supra note 4, Article 59(1)

- Immovable assets[121]: There are two articles of the Income Tax Proclamation that may be called upon for the meaning and types of immovable assets for the purpose of capital gain tax. The first is Article 59(7) and the other one is Article 2(13). The former holds that gain derived from the disposal of a building, which is held and wholly used as a private residence for 2 years before its disposal[122], is not treated as an immovable asset for the purpose of capital gain tax. The problem with this article is that it does not tell us which assets are regarded as immovable assets. The latter article regards mining and petroleum rights, and mining and petroleum information as immovable assets. A gain from the disposal of such rights and information could be taxed under this section. Since the Income Tax Proclamation does not provide either an adequate definition or a comprehensive list of the types of immovable assets, a reference to the property laws of Ethiopia needs to be made. According to the Civil Code, immovable property/asset consists of land, buildings, and their intrinsic elements.[123] The current Ethiopian Constitution treats land as a common property of the state (people) and prohibits its disposal by way of sale or exchange.[124] Since persons do not have ownership rights over land, it is unlikely that there is a capital gain tax on land in Ethiopia. Buildings and their intrinsic elements are the main and common examples of immovable assets that can be owned and disposed of by private individuals. There is no doubt that their disposal triggers the capital gain tax.
- Shares and Bonds: The Income Tax Proclamation does not give us adequate information as to the meaning and types of shares and bonds. To fill this gap, a reference needs to be made to both the tax literature and other relevant laws, such as the Commercial Code of Ethiopia.

[121]It has to be noted that the repealed Income Tax Proclamation did not extend capital gain tax broadly to immovable assets. It restricted its application to buildings (held for business, factory, or office) and shares. See Income Tax Proclamation (2002), Article 37

[122] A similar exemption of the same building from tax is also made by the VAT and ToT laws of Ethiopia. See Value Added Tax Proclamation (No.285/2002), Article 8(2)(a), as amended by Value Added Tax (Amendment) Proclamation (No. 609/2008), Article 2(5); Turnover Tax Proclamation (No.308/2002), Article 7(1)(a)

[123]Civil Code, 1960, Proc. No. 165/ 1960, Articles 1130-1139

[124]Supra note 48, Article 40(3)

As noted above, persons that derive gain from the disposal of the taxable assets are subject to the capital gains tax. When the asset is disposed of by way of gift, it is the donee, not the donor that is regarded as the taxpayer.[125]

If trading by immovable assets, shares, and bonds is the core activity of a person, the gain from the disposal of such assets is treated as business income and taxed under Schedule C.[126]The main example of such a scenario is the construction and sale of buildings by real estate companies.

The tax base for capital gain tax is the gain derived from the disposal of the taxable assets. Like the case of taxable rental and business income, it is not the gross gain that is subject to the tax. The taxable capital gain is the net gain in excess of the costs of the assets.[127] To determine the amount of the taxable gain, it is necessary to calculate the amount of the consideration (gross gain) derived from the disposal of the asset and the cost of the asset at the time of disposal.[128]

For example, a person bought a building at 1 million Birr and sold later it for 1.5 million Birr. Here, the 1 million Birr represents the cost of the building and the 1.5 million Birr represents the sales proceeds/consideration received at the time of disposal (sale) of the building. The taxable gain is the difference between the two amounts, which is 0.5 million Birr. If before its disposal the building was used to derive a business income, which is taxable under Schedule C and a depreciation deduction was made, the computation of the taxable capital gain involves further issues and steps.[129] Let's assume that the person was able to deduct 200,000 Birr as the depreciation cost of the building in the course of assessment and payment of its business income tax liability under Schedule C. In this case, the net book value of the building must be reduced to 800,000 Birr. The gain becomes 700,000 Birr.

[125]Supra note 27 (Income Tax Regulation), Article 53
[126]Supra note 4, Article 64(1)(a)
[127]Ibid, Article 59 (3)
[128]The proclamation contains detailed rules regarding the acquisition and disposal of taxable assets under Articles 66-72. Hence, it is important to refer these articles while determining the amount of the consideration (gross gain) and cost of taxable assets at the time of their disposal.
[129]Supra note 4, Article 21(4), 59(6)

The result is:

- Business income taxable under Schedule C (the recaptured depreciation)= 200,000 Birr.
- Capital gain taxable under Article 59= 500,000 Birr.

The cost of the asset may exceed the consideration derived from its disposal. In this case, the taxpayer realizes a capital loss. The taxpayer is entitled to recover the current loss from a future gain in accordance with the loss carry forward rules of the Proclamation.[130] The Proclamation prohibits the deduction of a loss incurred in connection with a particular asset, such as a building, from the gain derived from the disposal of another asset, such as a share or bond. If the loss is reported from a transaction of disposal of a taxable asset taking place between related persons, it is prohibited to apply loss carry forward. But, unlike the time limit put for loss carry forward of schedule C[131], a loss under this section can be continued forward for the indefinite future, until the loss is fully offset.

The Proclamation provides two types of tax rates for the taxable assets.[132] A gain derived from the disposal of an immovable asset is taxed at the rate of 15% while the gain derived from the disposal of either a share or bond is at 30%. The capital gain tax is assessed by the taxpayer and it must be declared and paid to the tax authority within two months after the disposal of the asset.[133]

4.2.9 Taxation of Windfall Profit

The taxation of windfall profit was brought to the income tax system of Ethiopia by the Income Tax (Amendment) Proclamation of 2010. The Proclamation delegated the then Minister of Finance and Economic Development to issue a directive and impose windfall profit tax whenever it deemed necessary. Based on this power, the Minister issued a directive that aimed at the taxation of windfall profits generated by banks in 2010. In this year, the National Bank of Ethiopia took an overnight measure of devaluation

[130]Ibid, Article 59(4)
[131]Ibid, Article 26(3, 4)
[132]Ibid, Article 59(2)
[133]Ibid, Articles 69, 83(7)

of the Ethiopian currency against the US Dollar by around 16.7%.[134] The sudden measure of the National Bank created an unexpected opportunity for commercial banks and other financial institutions to generate a significant amount of profit from their holding of foreign currency at the time of devaluation. The windfall profit of the banks/institutions was taxed at the rate of 75%. [135] The main reason for generating such profit was the sudden decision of the government. The excessively high tax rate was imposed due to the unearned nature of the profit.

The Income Tax Proclamation of 2016 defines 'windfall profit' as any unearned, unexpected, or other non-recurring gains.[136] The essential characteristic of windfall profit is that it is an unexpected gain derived from the occurrence of lucky circumstances. The person that derives the gain has little or no expectation or control over the circumstances.[137] The demand, supply, and prices of goods and services may be suddenly changed due to unforeseen circumstances or decisions of the government. The change could create a huge amount of money for some people. Practically, in the international oil market, unexpected supply shortages have led to a sharp increase in oil prices. Some countries have imposed windfall profit tax on those oil companies that generated profits from the unexpected surge in the prices.

Since windfall profit is generated from unforeseen circumstances, it is impossible to describe in advance in the tax laws the source of the tax base, the tax rate, and similar matters. In the Income Tax Proclamation, these issues are not specified. These details of the tax are left to be decided by a directive to be issued by the Minister of Finance. Until the writing up of this paper, there has been only one case of the imposition of windfall profit tax in Ethiopia. That is the 2010 tax that targeted the windfall profit derived by the banking sector due to the overnight devaluation of Ethiopia's currency by the National Bank of Ethiopia.

[134]Ethiopian birr devalued, IMF welcomes move, Reuters News, available at https://www.reuters.com/article/ozabs-ethiopia-currency-20100901-idAFJOE6800SX20100901, last accessed on Dec. 3, 2021

[135]Supra note 57, p. 508

[136]Supra note 4, Article 60(4)

[137] Broadly and conceptually speaking, income from chance winning could be taken as windfall profits. But, the income tax system of Ethiopia treats these incomes differently and taxes them at a separate tax rate.

4.2.10 Taxation of Undistributed Profit

The tax implication of retained (undeclared or undistributed) profit of companies was a source of dispute between taxpayers and the tax authority during the era of the Income Tax Proclamation of 2002. Taxpayers were in a view that the dividend tax became due only when the companies have actually paid the profit (dividend) to shareholders. The then Ethiopia Revenue and Customs Authority (ERCA) argued that the companies should withhold the dividend tax whether or not the dividend was retained or declared (distributed) to the shareholders. According to the decision of MoFED, which gave the final verdict on the controversy, a profit that was neither reinvested in any investment, including raising the capital of the companies, nor distributed to shareholders should be taxable.[138] The inadequate provisions of the Income Tax Proclamation of 2002 should be blamed for this problem.

The Income Tax Proclamation of 2016 preferred to resolve the controversy by introducing an explicit and separate provision relating to the taxation of undistributed profit. If the profit of a body is not distributed to its members or reinvested in the body or other investments, it is taxed at the rate of 10%. [139] The tax applies to not just the undistributed profit of companies, but bodies in general. On the other hand, if the profit is distributed, Article 55 will apply.

Even if the Proclamation does not make it very specific, the tax on the undistributed profit is paid from the account of the body. Hence, the taxpayer under this section is the body itself, not the members. The tax shall be declared and paid by the body (taxpayer) that retained the profit. But, these and other remaining details are left to be specified in a directive to be issued by the Minister of Finance.

4.2.11 Taxation of Repatriated Profit

The separate taxation of repatriated profit under Schedule D needs to be analyzed bearing the important feature of Schedule C in mind. According to the schedular structure of the Ethiopian income tax system, an income (profit)

[138] Controversial Dividend Tax Finally Settled, Addis Fortune, available at https://addisfortune.net/articles/controversial-dividend-tax-finally-settled/, last accessed on Dec. 03, 2021

[139] Supra note 4, Article 61

derived from the conduct of business is taxable under Schedule C. If the taxpayer that derived the business income is a body, the tax liability is assessed at the rate of 30%. Schedule C applies to the business income of both resident and non-resident body taxpayers of Ethiopia.

Article 62 of the Income Tax Proclamation (2016) provides that there is a 10% tax on the repatriated profit of a permanent establishment of a non-resident body conducting business in Ethiopia. The income (profit) is derived from the conduct of business in Ethiopia. The essential criterion that establishes tax liability under this article is the repatriation of the income out of Ethiopia by the non-resident body. Even if Article 62 does not state it explicitly, the non-repatriated profit should be treated and taxed under Schedule C of the Proclamation because it is derived from business activity.

The purpose of Article 62 seems to reduce the chance of tax evasion by non-resident taxpayers through the repatriation of business profits out of Ethiopia. Since the taxpayers are non-residents of Ethiopia, the probability of sending profits back to their home or another state is high.[140]

Repatriation of profit could also be made by resident taxpayers for various reasons. For example, it is common for the business community in Ethiopia to create bank accounts in Ethiopia and abroad. If the law aims at closing off the way for tax evasion, it is necessary to extend the applicability of repatriated profit tax on resident taxpayers.

Repatriated profit is taxed on annual basis, in reference to the tax year of the body. For each tax year, the amount of the taxable repatriated profit of the body is calculated in accordance with the formula set by the Income Tax Regulation (2017).[141]

In the case where a given income is taxable under Schedule D and other schedules as well, Article 64(1)(a) of the Proclamation gives priority to the taxation of the income under the other schedules. If we extend this general rule of Schedule D to Article 62, the repatriated profit, which is a business income,

[140] Repatriation of profits and other payments is one of the investment guarantees of Ethiopia. Foreign investors are allowed to repatriate or remit profits of their investment out of Ethiopia. Investment Proclamation, No. 769/2012, Article 26

[141] Supra note 27 (Income Tax Regulation) , Article 51

shall be taxed under Schedule C. But, this makes Article 62 non-functional and totally inapplicable provision as repatriated business profit is the only taxable income that falls under Article 62. Hence, it is necessary to clarify the scope of applicability of the general rule vis-à-vis Article 62 of the Proclamation.

4.2.12 Taxation of Other Income

Under the repealed Income Tax Proclamation of 2002, income was defined broadly as an economic benefit derived from *whatever* source (Emphasis added).[142] Unfortunately, income from whatever source was not taxable due to a lack of tax charging rules (schedules). The rules were designed to tax income from particular and limited sources (employment, rental of building, business, and the exhaustive sources of income of schedule D). Income that was not designated in one of the charging rules was escaping tax.

The taxation of other income is a new feature of the Income Tax Proclamation of 2016. Thanks to Article 63 of the Proclamation, there is now a rule for the taxation of a residual category of income. According to the Article,

> *A person who derives any income that is not taxable under Schedule A, B, C, or the other Articles of this Schedule shall be liable for income tax at the rate of 15% on the gross amount of the income.*

This Article brings more sources of income to the income tax system. Doing so helps to achieve two important objectives. First, it broadens the tax base and raises more revenue for the government. Second, it enhances the equitability of the tax system. Persons deriving income from whatever source are liable to pay tax.

There are two requirements for an income to be a taxable income under Article 63. First, it shall not be a type of income that falls under one of the existing charging rules. That is to say, it must be different from employment income, income from rental of buildings, business income, and schedule D incomes (e.g, royalty, dividend, interest…). Second, it should not be an exempt income. If income is one of those that are exempted by the Income Tax Proclamation and other laws, it will not be taxed at all. An example of income that could be taxable under Article 63 may include a reward given for whistleblowers of tax

[142] Income Tax Proclamation, (No. 286/ 2002), Article 2(10)

evasion pursuant to Article 134 of the Tax Administration Proclamation (No. 983/2016).

Since the tax is imposed on the gross income, there will be no deduction of expenses. It is the duty of the person that derives the other income to declare and pay the income/tax within two months after the date of the transaction that gives rise to the income.[143] For example, in the case of whistleblowers, the tax declaration shall be filed within two months after the grant of a reward by the tax authority.

Summary

This chapter has dealt with Schedule C and D of the Income Tax Proclamation. Schedule C governs the taxation of income derived from business activities, including mining and petroleum operations. The Schedule contains more provisions than the remaining schedules of the Income Tax Proclamation. There are detailed rules concerning gross income, deductible expenses, and tax accounting methods. Like rental income tax, business income tax is imposed on the net income or profit of the taxpayers. The tax shall be calculated after the allowable expenses are deducted from the gross business income (turnover). The tax brackets, tax rates, and tax liabilities of Schedule C are set or determined on annual basis. The income tax brackets and rates are set in consideration of the classification of taxpayers into bodies and individuals. Irrespective of the amount of their taxable income for the year, bodies are taxed at the flat tax rate of 30%. For individuals, there are different income tax brackets and rates. Even if micro enterprises fulfill the definitional elements of a body, they pay business income tax as per the tax rates of individual taxpayers. Self-assessment is the principal assessment method. Ancillary to the self-assessment, a withholding tax method may be applied in limited circumstances. Licensees and contractors are required to pay tax on their net income. The special part of Schedule C provides deduction rules for licensees and contractors concerning development and exploration expenditures. In addition, it sets 25% as the applicable tax rate for both licensees and contractors.

Schedule D is a larger umbrella that covers distinct and independent sub-schedules. The nature of taxable income, tax rates, assessment, and collection

[143]Supra note 4, Article 83(7)

methods are not the same across the sub-schedules. For example, while a deduction is allowed with respect to taxation of capital gain, undistributed, and repatriated profits, there is no deduction for the other incomes. Schedule D contains flat tax rates and no distinction is made between body and individual taxpayers for the purpose of the tax rate. The tax rates are not the same for the miscellaneous incomes. In some cases, the classification of a taxpayer into resident and non-resident status determines the applicable tax rates. There is no either a monthly or annual tax year under Schedule D. The tax liability is due whenever the payment of income is made to the taxpayers described in the Schedule. Self-assessment applies to the taxation of income from casual rents, capital gains, windfall profits, undistributed profits of bodies, repatriated profits, and other incomes. The remaining types of incomes are taxed based on final withholding rules.

Review Questions

1. How the income tax treatment of partnerships in Ethiopia differs from that of some foreign income tax systems?

2. Compare and contrast the deductible and nondeductible expenses under Schedules B and C of Ethiopia's income tax laws.

3. Discuss whether or not Ethiopia has an adequate legal framework and institutional readiness to levy and collect business income tax from digital companies, such as Facebook, Alibaba, YouTube, and Amazon.

4. What types of losses could occur in business activities? Which losses are deductible and which ones are not deductible in Ethiopia?

5. Explain the concept of "related persons" and discuss its place and roles under the Ethiopian income tax system, particularly in the income tax proclamations and regulations.

6. What are the meaning and purpose of the 'cost of the asset' and 'net-book value of the asset' concepts concerning depreciation?

7. What are the essential characteristics of Schedule D vis-à-vis other schedules of the Income Tax Proclamation?

8. Why do think that some countries, including Ethiopia, tax business income and capital gain under different schedules or rules?

9. What types of income do you know that are practically being taxed as per Article 63 of the Income Tax Proclamation?

10. In which areas or parts of the income tax schedules that self-assessment and withholding tax methods apply?

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Chapter Five

The Law Value Added Tax in Ethiopia

Introduction

The preceding chapters have discussed the topics of taxation and tax law, the Ethiopian tax system, and direct taxes. Here after you will be dealing with one group of taxes namely the consumption or indirect taxes. Indirect taxes or consumption taxes are those taxes whose burden is not on the one who pays the taxes. They are a type of taxes that are imposed on the final consumers. Among the types of consumption taxes are Value-added Tax, Turnover Tax, Retail Sales Tax, manufacturer's Sales Tax, and Wholesaler's Sales Tax. Each has its own advantage and disadvantages. This chapter will focus on Value-added Tax which is the prevalent form of Consumption tax in our today's world.

The chapter will explore the concept of consumption taxes, the meaning, and nature of these types of taxes, the rationale for adopting them, the disadvantages of these taxes, and their classification. The second section will discuss the Value Added Tax of Ethiopia. Under this section we will discuss the meaning of VAT and its difference from other consumption taxes, its history and how it became popular its disadvantages, the methods of calculating it, the concepts of good versus Traditional VAT, the features of Ethiopian VAT, the scope of VAT under Ethiopian law, the exemptions and zero ratings, the VAT rate and their application, origin and destination principles of VAT, taxpayer control mechanisms and VAT assessment, payment, refund and carry forward rules.

5.1 Understanding Consumption Taxes in General

5.1.1 Defining Consumption Taxes

According to OECD, consumption taxes are those types of general taxes imposed on goods and services, consisting of value-added tax (VAT) and its equivalent in several jurisdictions (goods and services tax, or GST), sales taxes, and other general taxes on goods and services such as Turn over tax; and taxes on specific goods and services, consisting primarily of excise taxes, customs and import duties, and taxes on specific services such as insurance premiums and financial services.[1]

[1]OECD, Consumption Tax Trends, OECD Publishing. http://dx.doi.org/10.1787/ctt-2014.

A tax on individuals that is measured by their level of consumption rather than their income is usually referred to as cash-flow or consumption-based income tax. Most taxes on consumption are indirect taxes. These taxes are collected by suppliers of taxable goods and services to be paid to the tax official and are expected to be borne by final consumers of those goods and services.[2] The indirect tax on consumption may take the form of a single-stage tax such as the excise tax or a multistage tax such as a value-added tax or goods and services tax.

The most well-known advocator of consumption-based taxation was Thomas Hobbes. In his view, people should pay tax based on what they consume (withdraw from society's limited resources) rather than on what they earn in income (contribute to those resources through their labor). Both receive protection from the government.[3]One of the arguments raised by Supporters of consumption-based taxes is that income-based taxes discourage savings by double taxing it whereas consumption taxes encourage saving since these kinds of taxes are only imposed purely on consumption.[4]

5.1.2 The rationale for consumption taxes

A handful of writers have been advocating for consumption-based taxes for several justifications. In fact, none of these perceived advantages are free of criticism since all of them are contended. For instance, Junko Kato promotes Consumption-based tax because its base is less mobile and because it is a more efficient and reliable base than income, especially highly mobile capital income;[5] Ben Terra and Julie Kajus regarded consumption tax as a less volatile and more stable revenue source as it is less susceptible to punctuations in the economic cycle.[6] Professor Andrews and Bradford argue that a consumption-

[2] Alan Schenk and Oliver Oladman, Value Added Tax, A Comparative Approach, Cambridge Tax law Series, New York, 2007, P. 9

[3]Thomas Hobbes, Leviathan 184 (Dutton ed. 1914). Thomas Hobbes is one of the prominent founders of modern political philosophy. He is well-known for his political than economic theory, but he does touch upon taxation in many of his works, including his most famous, Leviathan. Hobbes believed that tax should not be equated to a man's wealth, but to the debt he owed the state for his defense and the maintenance of the rule of law. He also advocated for the provision of public support for those unable to earn a living by their labor.

[4] Richard Good, Government Finance in Developing Countries, Brookings Instit. 1984, pp. 141–142

[5]Junko Kato, Regressive Taxation and the Welfare State: Path Dependence and Policy Diffusion, Cambridge University Press, Cambridge, 2003, 36–37

[6]Ben Terra and Julie Kajus, IBFD, A Guide to the European VAT Directives, 2011, 7.6.1–7.6.2.

type tax is simpler to implement and results in a fairer tax and one that more efficiently distributes the tax burdens.[7] Alvin C. Warren also shares the same view that Consumption is a fairer and more reliable measure of welfare than income.[8]

Harry Grubert and Richard Krever Promote Consumption-based taxes for their relative neutrality in relation to savings and investment decisions.[9]Goldberg also shared a similar view about the importance of consumption tax of eliminating undesirable disincentives for saving and investing.[10] He claims that consumption tax fosters capital formation and technological advancement and innovation by encouraging saving and investing.[11] He added that consumption tax would allow the economy to achieve greater productivity (i.e., it would grow the economic pie) by leaving savings untaxed.[12] Jonathon Gruber also praises consumption taxes for their neutrality which he claims will help enhance investment, efficiency and economic growth.[13]

5.1.3 Types of Consumption Taxes

Consumption taxes, sometimes known as indirect taxes, can be either single-stage taxes applicable only at one stage from the production through to the distribution stages like excise tax, manufacturers' sales tax, wholesalers' sales tax, and retailers' sales tax, or all of the stages like the Value Added Tax and turn over tax.[14] These taxes are in general classified as(1)multi-stage turnover taxes;(2) single-stage taxes at the retail, wholesale, or manufacturing level;(3)hybrid retail/wholesale taxes; (4) specific single-stage sales taxes (excise tax) and(5)value-added taxes carried to the retail, wholesale, or manufacturing level.

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[7] W. Andrews, A Consumption-Type or Cash Flow Personal Income Tax, 87 Harvard Law Review, 1113, 1974, see also Bradford, "An Uncluttered Income Tax," p. 9

[8] Alvin C. Warren, 'Fairness and a Consumption-Type or Cash Flow Personal Income Tax', Harvard Law Review 88(5), 1975

[9]Harry Grubert and Richard Krever, 'VAT and Financial Services: Competing Perspectives on What Should Be Taxed?', Tax Law Review 65(2), 2012, PP. 199–204.

[10] Daniel S. Goldberg, The Death of the Income Tax, A Progressive Consumption Tax and the path to Fiscal Reform, Oxford University Press, 2013, P. 143

[11] Ibid

[12] Ibid

[13]Jonathon Gruber, Public Finance and Public Policy, 3rd ed., Worth Publishers, New York, 2011), PP. 754–56.

[14] American Treasury Department Report, Tax Reform For Fairness, Simplicity, and Economic Growth, Volume 3,1984, P. 29

A retail sales tax also called an ad valorem tax, imposes a tax on the final sale of commodities and services by the retailer to ultimate consumers.[15] Those final sales at the retail stage represent personal consumption expenditures made by individuals.[16] A retail sales tax is also alternatively called the "general sales tax" to indicate the uniform nature of the tax rate.[17] In the case of a retail (general) sales tax, sales made at a pre-retail stage are not subject to taxation.[18]

a. Single Stage General taxes at Wholesale or Manufacturing level

Manufacturing or wholesalers sales taxes are single-stage taxes imposed on the producer or wholesaler or the last wholesaler who sells his goods to the retailer. Unlike the turnover tax or the value-added tax which are imposed throughout the retail level, the manufacturers and the wholesales sales tax are imposed only at a single stage. These taxes are different from the specific single-stage tax of the excise tax because excise tax is imposed only at a particular level – on elected items at a manufacturing or wholesaling level. The excise, manufacturing, and wholesalers' sales tax are single-stage indirect taxes. The manufacturer's and wholesaler's sales taxes are applied only to a limited number of taxpayers since they exclude retailers who cover a large number of firms.[19] However, the manufacturer's and wholesaler's sales taxes are preferred by developing countries because they are more easily manageable for administrative and enforcement purposes.[20]However, the manufacturer's sales tax and the wholesaler's sales tax are regarded as disadvantageous when compared to retail sales tax and turnover tax because they create economic distortions and lack neutrality of consumption and production.[21]These two types of taxes create distortions because of their narrow base of taxing business inputs or capital. They will have differing effects on the distribution of income since they use different tax bases at different rates.

[15]Daniel S. Goldberg, The Aches and Pains of Transition to a Consumption Tax: Can We Get There from Here? 26 VAT. Tax Rev. 2007, PP. 447–492
[16] Ibid
[17] Ibid
[18] Ibid
[19] US Department of treasury, Tax Reform for fairness Simplicity and Economic Growth, Value Added Tax, P. 33
[20] Ibid
[21]Ibid

b. Single Stage Retailer's Sales Tax

A single-stage retailer's sales tax, also called an ad-valorem tax, is a tax that imposes a tax on the final sale of goods and services at the retail level when the retailer sells goods and services to final consumers.[22] It is a tax that is applied to the sales of goods and services by registered businesses to consumers and unregistered entities.[23] When a retailer's sales tax is imposed at a uniform rate, it would be referred to as a general sales tax, and when it is imposed at differentiated rates (including a zero rate) on different commodities, it is known as a specific sales tax or an excise tax.[24]When a retailer's sales tax is applied, all the sales made on earlier stages preceding the retail stage are free of taxation. Retail sales tax is preferred over the turnover tax as it avoids cascading effects and distortions.

c. Specific Single Stage Sales Tax (Excise Tax)

Excise tax is a specific single-stage sales tax that is imposed on purposefully selected commodities. Broadly defined, all selective taxes on goods, services, and motor vehicles can be considered part of excise systems.[25]The distinguishing features of excise tax include its selective nature, discriminatory intent, and the application of quantitative measurement to determine tax liability.[26]While an excise shares similarities with the RST, MST, and WSST as all are imposed only at a single stage. There are, however, notable differences. First, excise tax is different from other consumption taxes such as the VAT, RST, manufacturer's sales tax wholesaler's sales tax, and turnover tax because of its specificity; the other indirect taxes are commonly imposed on all goods and services. Second, excise tax also is different from other consumption taxes in terms of purpose. Unlike other consumption taxes, the purpose of excise taxes is more than just revenue raising; its purposes include discouraging consumption,[27]

[22] Daniel S. Goldberg, Supra Note at 10
[23]Ibid
[24] Ibid
[25] Sijbren Cnossen, Theory and Practice of Excise Taxation, Oxford University Press, 2005, P. 2
[26] Ibid
[27] Ibid

d. Turnover (Multi-stage cascading) Tax

Turnover tax is a multi-stage sales tax that is applied to the full value of goods or services every time it changes hands in the process of production and distribution.[28]The difference between the value-added tax and the turnover tax is that the turnover tax lack an input credit. Turnover tax is a multistage general sales tax without credits. It is also sometimes referred to as a cascade tax to indicate its cascading or a tax-on-tax effect.[29] Tax cascading results whenever a commodity or service is taxed more than once as it passes through various stages of the production-distribution chain from the manufacturing to the retail stages.[30]The cascading nature of the turnover tax is the reason that makes it undesirable all over the world since it leads to more rigorous economic distortions by taxing transactions preceding the consumption level.[31] By contrast, a retail sales tax is not burdened with this cascading problem.

When turnover tax is applied, the amount of tax to be borne by any particular final commodity depends upon the number of intermediate stages of production which preceded it.[32]Turnover tax exposes the economy to distortions in the patterns of relative goods prices as final products differ in the number of stages of their vertical integration.[33]

e. Value Added Tax

A value-added tax is defined as a multi-stage tax imposed on the value added to goods and services as they proceed through various stages of production and distribution and to services as they are rendered‖ which is eventually borne by the final consumer but collected at each stage of production and contribution

[28] George E. Lent, et. al, The Value Added Tax in Developing Countries, IMF working Paper, 1973, PP. 318-379
[29] Jane Frecknall, The Theory Principles and Management of Taxation, An Introduction, Oxford University Press, 2017, P. 97
[30] Howell H. Zee, Tax Cascading Concept and Measurement, In Tax Policy Handbook Edited by Parthasarathy Shome, Fiscal Affairs Department, International Monetary Department, 1995, P. 75
[31] Ibid
[32] William H. Oakland, Theory of Value Added Tax, Phd Dissertation, University of Massachusetts, 1961, P. 2
[33] Ibid

chain.[34]A VAT has at least three characteristics: These are: (1) It is a multi-stage tax through to the retail stage, (2) it is a consumption-based tax on which the final burden falls on the final consumers, and (3) it is a tax on the value-added and fully credits input VAT already paid. A VAT is similar to the retailer's sales tax in its ultimate effect in that both taxes produce the same amount of revenue taxing final consumption only and, theoretically, with no taxes on business intermediaries.[35]Krever puts the similarities between the two taxes as follows.[36]

> *"Both systems are based on the registration of taxable businesses. Both systems can set a turnover threshold and only require businesses with turnovers above the threshold to register. Both systems require registered businesses to fi le regular returns. Auditors in both systems have to check that purchases allegedly acquired for business purposes were actually used in the business and not for the personal consumption of the business owner".*

5.2 Value Added Tax in General

5.2.1 The Definition of Value Added Tax

Before discussing the Ethiopian Value-added Tax, first, we need to have a clear idea about the meaning of the term "Value Added". Value added is the value that a person (whether a manufacturer, distributor, advertising agent, hairdresser, farmer, racehorse trainer, or circus owner) adds to his raw materials or purchases before selling the new or improved product or service.[37]

A value-added tax is a generic name associated with a multistage tax that is levied on the value-added by each business firm at every stage of production and distribution of goods and services.[38]

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[34]Bird R. M. Value Added Taxes in Developing and Transitional Countries: Georgia State University Working Paper No 05-05, 2005.
[35] Richard Krever, Designing and Drafting VAT Laws for Africa VAT in Africa, African Tax Institute, Pretoria University Press, 2008, P. 11
[36] Ibid
[37] Alan A, Tait, Value Added Tax, international Practice and Problems, IMF Washington DC, 1988, P. 5
[38]Consumption Tax Forms and Base Alterations, available at https://www.cambridge.org/core/terms last visited 06/20/2022

The first VAT directive of the European Commission defined VAT as follows;[39]

> *The principle of the common system of value-added tax involves the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transactions that take place in the production and distribution process before the stage at which tax is charged. On each transaction, value-added tax, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of value-added tax borne directly by the various cost components.*

Staff from the IMF, OECD, and World Bank offered the following definition of VAT in a background paper presented to the International Tax Dialogue conference:[40]

> *The key features of the VAT are that it is a broad-based tax levied at multiple stages of production, with – crucially – taxes on inputs credited against taxes on output. That is, while sellers are required to charge the tax on all their sales, they can also claim a credit for taxes that they have been charged on their inputs. The advantage of this is that revenue is secured by being collected throughout the process of production (unlike a retail sales tax) but without distorting production decisions (as a turnover tax does).*

Professor Alan Shenk who drafted the VAT legislation for many African countries, on the other hand, defined Value Added Tax (VAT) as a type of multistage sales tax imposed on goods and services that is collected in chunks at each stage of production and distribution of goods or the rendition of services in proportion to the value-added by each taxpaying firm.[41]

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[39] First Council Directive of 11 April 1967 on the harmonization of legislation of member states concerning turnover taxes (67/227/EEC) (OJ P 71, 14.4.1967, p. 1301), Art. 2.

[40] International Tax Dialogue (ITD), 'The Value Added Tax: Experience and Issues' (Background Paper Prepared for the International Tax Dialogue Conference on the VAT, Rome, March 15–16, 2005, ITD), 8, www.itdweb.org/VATConference/Documents/VAT%20-%20EXPERIENCE%20AND%20ISSUES.pdf (hereafter referred to as the 'ITD VAT Paper').

[41] Alan Shenk and Oliver Oldman, Supra Note at 2

Aaron on his part has Explained "value-added" as "the difference between the value of a firm's sales and the value of the purchased material inputs used in producing goods sold.[42] He added that Value added is the sum of a firm's wages and salaries, interest payments, and before-tax profits.[43]

Cnossen defined a VAT as a broad-based tax levied on sales of goods and services in all stages of production and distribution up to and including the retail stage, with systematic offsetting of the tax charged on goods and services purchased as inputs.[44]With a VAT, the difference between sales and purchases, called value-added, is taxed at any Stage of production or distribution.[45] He adds that the VAT on sales and purchases is stated on tax invoices, which represent documentary evidence of the entitlement to a tax credit.[46] In the process of VAT tax collection, a taxable person's output VAT of one person becomes a creditable input VAT for another person.[47]

Liam Ebrill Et al, however, argues that this tax is not a tax on the value-added proper despite having the name "Value Added Tax".[48] They argue that the tax which is known by the term VAT is a consumption tax not a tax on the value-added.[49]

5.2.2 **Types of Value Added Tax**

Three types of VATs differ in their tax treatment of purchases of capital assets (plant and equipment).[50] They are the consumption type VAT, the income type VAT, and the gross product type VAT. A consumption type VAT is one in which capital purchases are treated the same way as the purchase of any other input: the purchase price is deducted at the time of purchase. [51]With the income VAT, the VAT paid on the purchases of capital inputs is amortized over the

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[42] Aaron, Henry J. The Value- Added Tax: Lessons From Europe (Washington DC. The Brookings Institute, 1981.
[43] Ibid
[44] Sijbren Cnossen, Supra Note at 44, P.14
[45] Ibid
[46] Ibid
[47] Ibid
[48] Liam Ebrill, et. al, The Modern VAT, 2001, P.4
[49] Ibid
[50] Mr. Robert Merriam, US Advisory commission on intergovernmental relations, The Value added tax and Alternative Sources of Federal Revenue, Washington DC.1972. P.3
[51] James M. Bickley, Value Added Tax; A New US Revenue Source?, Congressional research Service, 2008, P.2

expected lives of the capital inputs. In the gross product VAT, no deduction is allowed for the VAT on purchases of capital inputs against the firm's VAT liability.[52]

5.2.3 Understanding the Concept of VAT

As we have already discussed, a value-added tax is a levy on the value that a taxable person adds in the course of its operations to the goods and services it purchases from other firms.[53]A difficulty with the VAT is that it can appear to laymen that tax authorities impose VAT tax in the absence of any value addition. Some people even go as far as thinking that the government is inflating the price of commodities by imposing 15 % VAT tax on the gross price at every stage of the transactions. They tend to take the literal economic concept of the phrase "value-added" and assume that value addition should occur only when commodities are physically transformed. As a result, the thinking is that imposing a VAT every time the goods/services change hands is not a tax on the value-added but rather a tax on the gross receipt of the good or service. The reality, however, is different.

Value is added not only by handling or processing these purchases into new products with the firm's labor force, machinery, buildings, and capital goods but also by making goods or services accessible and easily reachable to customers. The amount of value-added can be measured then as the difference between the prices of the taxable persons' sales and their purchases from other business entities.[54] For instance, let us compare the value of a kilo of bananas from the banana farm around Arba Minch and at a fruit store in Addis Ababa. If we see the physical configuration of the banana, then there is no physical modification made to it. The banana is not manufactured into juice or another type of product. It is the same banana in Addis Ababa and Arba Minch. But this does not mean that the value of the banana is the same at the two places. The one which is found in a fruit store in Addis Ababa is more valuable than the one which is found at the banana farm in Arba Minch because it is brought closer and made easily accessible to the consumer. Value is added to the banana of Addis Ababa by carrying it over and putting it in an appropriate place. The

[52] Ibid
[53] US Advisory Commission on Intergovernmental Relations, The Value Added Tax and Alternative Sources of the Federal Revenue, 1973, P.18
[54] Ibid

value difference is manifested by the price difference. The banana of Addis Ababa is more expensive than the banana of Arba Minch. This is evidence of the existence of value addition. If a kilo of banana at Arba Minch costs 15 Birr and the same banana costs 25 Birr in Addis Ababa, then it means this banana has added a value of 10 Birr which will be the subject of the VAT.

5.2.4 Value Added Tax versus Retailer's Sales Tax

Both the retailer's sales tax and the value-added tax are consumption taxes that share similar characteristics.[55] For some, there is no difference between the two except for a slight change in the method of collecting the tax. Musgrave for example contends that both the retail sales tax and the Value added tax are similar in that the tax base in both cases is consumption with the burden on the consumer.[56] The only difference for him is an administrative one in which the RST taxes the final product at the retail stage, while the VAT taxes it in successive stages as additions to the value of the product.[57] Both the RST and the VAT play a great role of avoiding cascading tax and both are efficient as they are believed to enable collect a large amount of tax with a minimum administrative and compliance cost[58]The only significant difference between the two types of taxing consumption expenditure is that RST imposed and collected only at one single stage of trade, whereas VAT is collected by way of fractionated payments made by all enterprises in a chain of business transactions from production to the final consumption stages.[59]

A VAT is better than an RST as the revenue lost on account of an equivalent threshold is smaller under VAT than under RST.[60]Nevertheless, many people do not agree with the idea that both VAT and RST are the same. Tait has listed the following main drawbacks of the RST as contrasted to the VAT.[61]

• The higher the rate, the more collection weight is put upon the weakest link in the chain—the retailer, especially numerous small retailers.

[55] Ibid
[56] Richard A. Musgrave, Problems of the Value Added Tax, National Tax Jour, Vol.25, No. 3,(1972), PP. 425-430
[57] Ibid
[58] Ibid
[59]Joachim Englisch 'Hybrid' forms of taxing consumption: A viable alternative to EU VAT?, World Journal of VAT/GST Law, 2015, Vol.4:No. 2, PP. 119-131
[60] Sijbren Cnossen, Modernizing VATs in Africa, Oxford University Press, 2019, P.14
[61] Alan A. Tait, Supra Note at 37, P.19

• All the revenue is at risk. It has been suggested that this is also true of VAT if the retailer successfully claims all his credit on purchases, but clearly, it is more difficult to do so under the accounting requirements of VAT.

• The audit and invoice trail is poorer than under a VAT, especially for services.

• There have to be troublesome "end-use exemptions."

• Revenue is not secured at the easiest stage, that is, at the time of importation, and this can be crucial for many developing countries.

Some argue that VAT has a lower compliance risk when it is compared with a retail sales tax because evasion by the retailer removes only a portion of the tax on the final sale.[62] They add that retail sales also may sometimes cause a significant cascading effect since it is often administratively difficult to separate out the sales of goods or services to businesses as opposed to sales to final consumers.[63] The result is that, although theoretically exempt, business-to-business sales are often taxed. With a VAT, all sales are taxable, but purchasing taxpayers who are VAT registered taxpayers can offset the tax on business-to-business sales by claiming a credit or refund of tax paid.[64] Nevertheless, Rothband does not agree with the view that VAT is better than RST. He argues that retail sales tax, other things being equal, is obviously simpler, less distorting of resources, and enormously less bureaucratic and despotic than the VAT.[65] For him, VAT doesn't have a clear advantage over the retail sales tax, except for multiplying bureaucracy.[66]

5.2.5 A Brief History of the Value Added Tax

The Value Added Tax is a very recent phenomenon unlike other consumption taxes such as tariffs, excises, and sales tax which existed for several centuries. Before the introduction of the VAT, the most commonly applied

[62] Eric Toder and Joseph Rosenberg, Effects of Imposing a Value Added Tax to Replace Payroll Taxes or Corporate Taxes, Research Associate, Urban-Brookings Tax Policy Center, (2020), P. 5
[63] Ibid
[64] Ibid
[65] Muray N. Rothband, The Consumption Tax, A Critique, The Alleged Superiority of the Income Tax, The Review of Australian Economics, Vol. 7 No. 2, 1994, PP.75-90
[66] Ibid

indirect/consumption taxes were specific taxes such as excise tax and sales tax and a broad-based cascading turnover tax.[67]

There is no consensus as to the exact place and date of the origin of the VAT. One view attaches its origin to the German businessman Dr. Wilhelm Von Siemens who proposed the VAT in 1918 as a 'refinement' or improvement to the existing German cascading turnover tax.[68]The second view relates its origin to the American economist T. S. Adams, writing between 1910 and 1921, who was believed to have proposed an invoice-credit method VAT as an alternative to business income taxation.[69]While Sullivan attaches the origin of the VAT to France in the 1920s,[70] Shoup on his side related the origin of VAT to Japan in 1949.[71]

Despite the lack of consensus about its true origin, it is unanimously agreed that the consumption VAT in its modern form first appeared in France in 1954.[72]France officially adopted the VAT on April10, 1954. However, the tax was not taken by many as a proper VAT, since it was applied only up to the wholesale level.[73] It was Denmark that adopted the first true VAT in July 1967.[74] The VAT was then adopted throughout European countries in a very short period of time.[75] The establishment of the European Economic Community following the Rome Treaty in 1957 was a major factor for the widespread expansion of the VAT. A common market was impossible given the diverse tax rules with differing tax rates and types of taxes. One of the best pillars identified for a successful economic integration was taken to be the establishment of a common tax system to avoid distortion and anti-competitive rules.[76] Then all member states accepted a recommendation to replace the

[6767] Liam Ebrill, et. al., Supra Note at 48
[68]Von Siemens, 'The improvement of the concept of sales tax, Siemensstadt, 1921, PP. 14–18.
[69]T. S. Adams, Fundamental Problems of Federal Income Taxation, Quarterly Journal of Economics 35(4), 1921, 527, 553
[70] Sullivan Clara K. The Tax on Value Added, Colombia University Press, 1965, P.13
[71] Shoup Carl S. Value Added Tax, Greece center of planning and economic research, 1971, P.15
[72] Liam Ebrill, et al, Supra Note at 48, P. 4
[73]Steve C. Wells and Tonya K. Flesher, Lessons for Policy Makers From the History of Consumption Taxes, the Accounting Historians Journal, Vol. 26, No. 1, 1999, pp. 103-126
[74]McLure, CharlesE. Jr.TheTax on Value Added: Pros and Cons,"Washington DC. American Enterprise Institute for Public Policy Research, 1972, P. 60
[75]Steve C. Wells and Tonya K. Flesher, Supra Note 73, pp. 103-126
[76]Ibid

existing diverse taxes with a VAT that was identical in rate, structure and exemptions.[77]

After the harmonization agreement, all European countries adopted the VAT in the time period starting from 1968 up until 1973.[78]The VAT was adopted in the European Economic Community partly for economic reasons of the need for harmonization and partly because of the need to avoid the inefficient taxation in Europe before harmonization.[79]The VAT was accepted for its efficiency advantages over other taxes in use such as turnover tax which was notoriously inefficient.[80]International Financial Institutions –such as IMF and the World Bank urged and compelled many developing countries to adopt the VAT as a way of generating government revenues following the great financial crisis of the 1980s which helped the spread of the VAT at a rate faster than any other form of tax in history.[81]

As of the late 1980s, several economically developed non-EEC countries, including New Zealand, Japan, Canada, South Africa, Singapore, Switzerland, Australia, and also many countries with developing economies have adopted the VAT.[82] Currently, more than 168 Countries including the most developed nations have so far implemented the Value Added Tax making it the most common consumption tax.[83]The United States is a notable exception.

In Africa adoption of VAT systems was influenced and facilitated by both internal and external pressures. External pressures come from international financial organizations such as the IMF and the World Bank[84] whereas internal pressures emanated from difficulties in collecting sufficient revenue from the predecessor taxes.[85] So far more than 45 countries in Africa have adopted a VAT. Ethiopia was the 35th African country to adopt a VAT which makes her relatively a latecomer.

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[77]Ibid

[78] Randall G. Holcombe, The Value Added Tax, Too Costly for the United States, George Mason University, Marcatus Center, 2010, P.11

[79] Ibid

[80] Ibid

[81] Alan A. Tait, Supra Note at 37, P.19

[82] William Gale, Raising Revenue with a Progressive Value Added Tax, Brookings institution and Urban-Brookings Tax Policy Center, 2020, PP. 43-88

[83] Ibid

[84] Richard Crever, VAT in Africa, Pretoria law press, 2008, P.10

[85] Ibid

The major attempt to make reforms in the Ethiopian tax system and the consumption taxes were taken by the imperial regime during the years from 1942 to 44. The only Consumption tax introduced before this period was the excise tax imposed on small foreign contingents and luxurious commodities in 1931, the latter of which was applicable to alcoholic drinks, cigarettes, incense, carpets, and clothing.[86] After the end of the Italian occupation, the first excise tax targeting tobacco was enacted in 1942.[87] Those excise taxes were expanded to Alcohol in 1943.[88] In 1948, the other excise tax, the "Highway Renovation tax," which targeted fuel, was introduced and added to the existing consumption tax pool.[89] In 1955, another excise tax targeting salt was enacted.[90] The first general sales tax called the "Federal Tax" was also introduced in 1954 though it was limited to imported and exported transactions, seemingly contrary to its name.[91] In 1956, another excise tax regime was introduced on mass consumption goods including cotton, sugar, yarn, and textile products.[92] A broad-based tax on goods and services including on the domestically produced goods and services (general sales tax) which replaced or expanded the 1954 general sales tax (Federal Tax) was introduced in mid-1956. The scope of the 1956 transaction tax was still limited to one level of distribution and even then to a limited number of goods though it was wider in scope than the preceding excise taxes.[93]By the end of the 1950s and in the early 1960s, changes were also made in the rate and structure of taxes. Sales taxes were mainly restricted to the manufacturers' and importers' level; hence they were not multistage taxes. The turnover tax, which expanded the 1956 transaction taxes from the one which was limited to manufacturing level tax into wholesaler's and retailer's level and services, was introduced as to the already existing sales tax regime in 1963.[94]

[86]Bahru Zewde, "Relations between Ethiopia and the Sudan on the Western Ethiopia Frontier," 1976, 301, quoted in Eshetu Cholle, Supra Note 11, p. 72

[87] Tadesse Lencho, Towards Legislative History of Modern Taxes in Ethiopia,(1941-2008), Mizan Law Review, PP. 104-158

[88]Ethiopian Alcohol Excise Duty, Proclamation No. 40,/1943 Negarit Gazette, 2nd year, No. 10

[89] Ethiopian Proclamation to Provide for the Renovation of Highways, number 103/1948,

[90] Tadesse Lencho, Supra Note at 87

[91]Decree to Provide for the Payment of a Federal Transaction Tax ,1956, Articles 4 and 7, Decree No. 17,

[92] Federal Excise Tax Decree,, 1956, Decree number 16, Negarit Gazette, 15th year, number 11.

[93] Tadesse Lencho, Supra Note at 87

[94]Proclamation to Provide for Payment of Transaction Taxes, 1963, Proclamation. No. 205, Negarit Gazette, 22nd year, No. 18

The Dergue regime did not make any new reform on the existing taxes except for widening the tax base, increasing the tax rate, and replacing taxes on agricultural income, and rural land with a rural land-use fee.[95]There was no change to the existing indirect taxes. Following the overthrow of the Dergue regime in 1991, the EPRDF-led government introduced sweeping changes to the existing consumption-based taxes. In 1993, the first reform was taken after the new EPRDF-led government took power. The major reform done by the 1993 sales and excise tax law was to eliminate the cascading turnover tax of the 1963 and replace it with a single-stage sales tax.[96] It was after the 2002 sweeping tax reform measures that the rules of sales taxation, which had been in effect for about five decades, were changed.

During the 2002 tax reform process, major changes were made to the existing rules including the introduction of the VAT. As a supplementary tax turnover tax was introduced for those whose annual turnover was below 500,000 Birr and later on for those whose annual turnover exceeds one million Birr. The existing excise tax rules were also repealed and substituted by a more detailed and expanded excise tax rules.

The Ethiopian VAT, like in other countries, was introduced, on the one hand, to overcome the side effects of the earliest forms of sales/consumption taxes such as the general sales tax, the turnover tax, retailer's sales tax, etc., and, on the other hand, due to the policy influence of international financial institutions such as the World Bank and the IMF.[97] The process for adoption of the VAT in Ethiopia began when the IMF sent its technical advisory team to Addis Ababa in 2000. The IMF and World Bank were inducing several countries to reduce their tariffs to promote free trade areas and, to compensate for the revenue loss that might occur; they were suggesting a VAT as a perfect type of tax. Ethiopia was not an exception in this case. The technical team explained the virtues of the VAT and recommended the government of Ethiopia to adopt a VAT by the year 2003. Some of the recommendations and Ethiopia's response included;[98]

[95] Eshetu Cholle, Towards a History of the Fiscal Policy of the Pre- Revolutionary Ethiopian State 1941-74,Journal of Ethiopian Studies, Vol. 17, 1984, PP 88-106
[96] Ethiopian Sales and Excise Tax Proclamation number 68/1993, Negarit Gazetta
[97]Dasalegn Mosissa Jalata, 'The Value-Added Tax Styles: Which is Adopted by Ethiopia?'Journal of Economics and Sustainable Development, 5(11), 2014, PP. 77–82.
[98]Ibid

- ✓ Ethiopia was to introduce a VAT with a uniform & standard rate of 15% - agreed.
- ✓ Ethiopia was to introduce a VAT with a single VAT rate, and not multiple rates – agreed.
- ✓ Ethiopia was to introduce VAT with a registration threshold of 250, 000 Birr – disagreed. The government made a threshold 500, 000 Birr.
- ✓ Ethiopia was to limit exemptions to a few transactions –agreed. But later on, the exemptions were expanded
- ✓ Ethiopia was to introduce the Turn Over Tax as a supplementary tax on small taxpayers – agreed
- ✓ Ethiopia was to introduce the VAT as a federal tax despite the possible constitutional limitations – agreed. Then VAT was introduced as a federal tax although the Federal Government later on agreed (since 2004) to share the proceeds of the VAT with the regional states.

Despite the agreement by the then Ethiopian government to adopt the VAT, it was difficult for Ethiopian tax experts to try to draft the legislation because the VAT was a completely new tax for Ethiopian scholars. As a result, the IMF had sent Professor Alan Schenk, a US professor of tax from the University of San Diego to draft the legislation. Professor Schenk had drafted VATs for several African countries. Professor Schenk drafted the Ethiopian VAT using the EU VAT directive as he did for other countries.

5.2.6 Why is VAT so popular?

No other tax in history has swept the world in a way that VAT has done. Some characterize the VAT as the Mata Hari of the tax world in which many are tempted, many succumb, and some tremble on the brink, while others leave only to return - eventually the attraction appears irresistible.[99]It has become one of the most dominant sources of revenue across the world within only a half-century. From relatively inauspicious beginnings in the early twentieth century, the VAT has been adopted by more than 160 countries and accounts for approximately 20 percent of worldwide tax revenue.[100] Economists have suggested several reasons for the popularity of VAT.

[99] Alan A. Tait, Supra Note at 87, P.9

[100]Michael Keen and Ben Lockwood, 'The Value Added Tax: Its Causes and Consequences', Journal of Development Economics 92 (2), 2010, 138. See also OECD, Consumption Tax

One of the most important reasons for the dramatic spread of VAT throughout the vast majority of the world in a very short period of time is its revenue-generating capacity. Some writers call it a 'money machine' because it helped countries generate more revenues than they would have had without the adoption of the VAT.[101] Cnossen has the following to say about the revenue-generating capacity of VAT.[102]

> *"Basically, the VAT is a revenue workhorse. Properly designed and administered, it can raise more revenue with lower operational and economic costs than can other broad-based consumption taxes".*

The justifications suggested for the better revenue-generating capacity than other taxes are the broad-based nature of the tax and its ability to minimize tax evasion and avoidance efforts through its invoice-based VAT calculation system.[103]Discussion about these concepts is made within the following subtopics.

The other benefit that made VAT preferable to its predecessor indirect taxes of turnover tax and retailer's sales tax is because it avoids the cascading effect of the TOT and the administrative difficulty of the RST.[104]The sales tax that was implemented prior to the adoption of VAT was the type of tax that takes a straightforward percentage of all business turnovers as goods and services changes hands. Taxes become cascading in effect as a taxed good or service passes from the manufacturer to wholesaler to retailer.[105] VAT avoided this effect by introducing a credit for the input tax paid by the purchaser.

Value Added Tax is preferable to the Retailer's Sales Tax since it enables governments to collect a substantial proportion of tax revenue at pre-retail

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Trends, 2012: VAT/GST and Excise Rates, Trends and Administration Issues, OECD Publishing, Paris, 2012, 58, 211–19

[101] Ibid; see also Michael Keen and Ben Lockwood, 'Is the VAT a Money Machine?' National Tax Journal 59(4), 2006, P. 905, and US President's Advisory Panel on Federal Tax Reform, Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System, 2005, 192;

[102]Sijbren Cnossen, 'Global Trends and Issues in Value Added Taxation', International Tax and Public Finance 5(3), 1998, 399, 413.

[103] Kathryn James, The Rise of the Value Added Tax, Cambridge Publishing, 2015, P. 26

[104]Kaisa Alavuotunki, Mika Haapanen & Jukka Pirttilä, The Effects of the Value-Added Tax on Revenue and Inequality, The Journal of Development Studies, 2018, PP. 3-20; Richard M. Bird and Pierre P. Genrdon The VAT in Developing and Transitional Countries, Cambridge University Press, 2007, P.278

[105] Alan A. Tait, Supra Note at 37, P.9

stages in the production stages and the production process thereby assuring the Government of a large proportion of total tax revenue even though considerable evasion might be done by the retailers.[106]

VAT is also preferable to the Retailer's Sales Tax since it has the capacity to significantly reduce the incentive to evade tax by spreading the impact of the tax overall firms.[107]This is because unlike the retailer's sales tax, in which the last firm only collets the tax from consumers, every firm has a duty to collect VAT every time the good or service changes hands. As for the retail sales tax, if it is evaded by the retailer, the government loses all the revenue that could have been collected from the transaction. Regarding VAT, however, the government still has the chance to generate revenue from subsequent stages though firms might have evaded their tax duty at one or more stages of the transaction.

A consumption-type VAT is applauded for encouraging saving and investment and promoting economic growth since it credits an input tax paid for capital goods in the value added by allowing deduction of the full value of capital equipment purchased from the output VAT collected. In other words, capital equipment is subject to tax only to the extent that it contributes to domestic final consumption. [108] It is also commended for its simplicity to administer and enforce.[109] The role of VAT in saving and investment is also described in the Preamble of the Ethiopian VAT Proclamation as follows.[110]

"….WHEREAS, the tax enhances saving and investment as it is a consumption tax and does not tax capital…."

Bickley Contends that, the more a tax is neutral, the less the tax affects private economic decisions and, consequently, the more efficient becomes the economy.[111] When a single rate VAT, which is constant over time, is levied on all consumption expenditures it would be relatively neutral compared to other

[106] Alan Tesch, The Case for a Value Added Tax in Australia Vol,54, No.4, 1982, PP. 404-417
[107] Ibid
[108] George E. Lent, et al, The Value Added Tax in Developing Countries, International Monetary Fund, 1973, PP. 318-378
[109] Ibid
[110] Ethiopian VAT Proclamation Number 285/2002, Preamble part.
[111] James M. Bickley, Value Added Tax, A New US Revenue Source?, CRS Report for Congress, 2008.

major revenue sources.[112] It does not alter choices among goods, and it does not affect the relative prices of present and future consumption.[113]

A destination-principle VAT is preferred by countries that follow a pro-export promotion economic policy since it is in line with the principles of the World Trade Organization, it promotes tax harmonization, it encourages exports, and it promotes economic growth.[114]The discussion of the meaning of destination-principle is made later in this chapter. Please refer to it.

The invoice credit method VAT also plays a great role in minimizing tax avoidance and evasion since it has an inbuilt cross-checking mechanism or self-policing system.[115] This self-policing system arises from the fact that taxpayers have an incentive to ask their suppliers for receipts because they can deduct input costs from their VAT bills[116]. This incentive creates paper trails directly into the tax structure. Since the amounts are recorded in two sets of books, the risk of cross-checks is thought to deter firms from reporting differing amounts.[117] This leaves no space for gains from a pact between two taxpayers since the two sides of a transaction have opposing interests.[118]Discussion of this concept is made later in this chapter.

However, many argue that the credit invoice method VAT is more susceptible to fraudulent refund claims than the income tax or retailer's sales tax through various techniques. These include falsification of invoices, the false claiming of refunds, and 'missing trader' fraud. The latter involves the use of a bogus company established to falsely claim VAT credits (with or without false invoices); the company then disappears before VAT liabilities fall due.[119]

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[112] Ibid
[113] Ibid
[114] Ibid, See also The Preamble of the Ethiopian VAT Proclamation number 285/2002
[115] Ibid
[116]Agha, A., and J. Haughton, "Designing VAT Systems: Some Efficiency Considerations, Review of Economics and Statistics,78(2), 1996, 303–308.
[117]Bird,R.M., and P.-P. Gendron, VAT Revisited: A New Look at Value Added Taxation in Developing and Transitional Countries, (Washington, DC: USAID), 2005,
[118] Richard M. Bird and Pierre P. Genrdon The VAT in Developing and Transitional Countries, Cambridge University Press, 2007, P.19
[119] Kathryn James, Supra Note 103, P. 125; US Government Accountability Office, Value-Added Taxes: Lessons Learned from Other Countries on Compliance Risks, Administrative Costs, Compliance Burden, and Transition (GAO-08-566), Washington, DC, 2008, 14.

Besides its perceived advantages, other factors were also responsible for the rapid spread of the VAT. These include the influence of international organizations such as the IMF, the OECD, and the World Bank[120] and the adoption by the European Economic Community of the VAT.[121]The VAT spread all over the world at a rapid pace from the end of the 1960s up until the late 1970s.[122]Then after a period of slow growth, it spread well into the vast parts of the world by the end of the 1980s and 1990s.[123]

5.2.7 Disadvantages of the VAT

One of the most important criticisms of VAT is its regressive nature – the tax represents a larger percentage of the income of a low-income household than a high-income household.[124]Many argue that a VAT, like any consumption-based taxes, is inherently regressive since it forces individuals with the least ability to pay face the highest overall relative burdens.[125]

Illustration 1:

Assume that three taxpayers whose annual turnover is one million ten million and 100 million Birr are registered for VAT and are expected to collect pay it to the tax collecting authority. All the three of them are duty-bound to hire an accountant, to buy invoices and cash register machines take for instance 50,000 Birr. The cost of these items is equal. This cost is expected to be incurred by the taxpayers themselves. We can see that those with lower income will be expected to face a compliance cost that is equal to those who have higher income. This means a person with a 100 million birr and a person with 1 million birr is incurring similar compliance costs. This makes VAT compliance costs regressive in nature.

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[120] Liam Ebrill, et al, Supra Note at 48, P. 6
[121] Alan Schenk and Oliver Oldman, Supra Note at 2
[122] Liam Ebrill, et al, Supra Note at 48, P.5
[123] Ibid
[124] Alan Schenk and Oliver Oldman, Supra Note at 2
[125] Murray L. Weidenbaum, et al, Value Added Tax Orthodoxy and New Thinking, Kluwer Academic Publishers, 1989, P. 9, See also Sijbren Cnossen, Modernizing VATs in Africa, Oxford University Press, 2019, P.77; Cnossen holds that uniform tax on all goods and services weighs more heavily on lower than on higher incomes. This violates an important tax policy rule that holds that the after-tax income distribution should not be more unequal than the before-tax income distribution generated by the market

Illustration 2:

In Ethiopia, we see that the majority of the people are from lower-income groups and the government collects its VAT mainly from the majority poor. Assume that a pair of shoes is priced to be 2000 Birr. The VAT to be collected from these shoes will be 2000X15/100= 300 birr. If a rich man buys a pair of shoes, he will pay 300 birr VAT. Similarly, a poor man buying the same shoes will be expected to pay 300 birr. If ten poor men buy the same shoes, they will pay 10X300= 3000 Birr in total. Hence, the government collects 3000 birr from the poor men (they are ten in number to indicate the majority of our country) whereas it collects only 300 from the rich man. Hence, we say that the lion's share of the VAT revenue comes from the poor. This makes VAT regressive in nature.

The only effort made to achieve progressivity with an invoice-credit VAT has been done by assigning different tax rates to different goods and services. This approach was tried by the European VAT system (The Traditional VAT) and the result was significant in mechanical and administrative complexity.[126]For example, a VAT-registered person who trades in two or more goods is expected to apply different VAT rates for the transaction of each good. For that purpose, he might be expected to have separate records which result in larger compliance costs. He needs also to have better accounting knowledge to calculate his tax liability. Tax authorities also need to employ experts that are capable of applying varying VAT rates for various goods and services.

Nonuniform VAT rates and extensive exemptions destroy neutrality and affect patterns of consumption, as well as patterns of production and distribution, while significantly escalating administrative and compliance costs.[127]The other problem is the effect of a VAT on inflation. Critics of VAT argue that it increases the price of consumer goods which adversely affects the lives the ordinary people.[128]In addition to high progressivity, significant compliance costs are also raised as one of the most important limitations of a VAT.[129]With the invoice-credit method, VAT the claim to an input VAT credit must be

[126] Daniel S. Goldberg, Supra Note at 10
[127] Alan Shank and Oliver Oldman, Supra Note at 2
[128] Richard A. Musgrave, Problems of the Value Added Tax, National Tax Journal, Vol. 25 No. 3, 1972, PP. 425-430
[129] Richard M. Bird and Pierre P. Genrdon, Supra Note 118, ,P. 20

proven by an invoice issued by the supplier, the business customer must check whether the invoice complies with all legal requirements, and the information provided therein must be correct.[130] This increases the compliance cost of the VAT to businesses.

The other limitation of the VAT as raised by critics is the vulnerability of the refund system to fraud.[131] Englisch argues that invoice credit VAT creates a possibility for certain fraud opportunities which are absent in a RST system, especially because the entitlement of the business customer to the tax credit is normally not contingent upon the prior payment of the corresponding VAT liability by the supplier.[132]A VAT can have cascading effects when it is not properly implemented.[133] VAT can have cascading effects and compliance burdens when it is combined and applied alongside simplified turnover taxes, which is not creditable for those taxpayers who purchase goods from non-registered turn-over taxpayers.[134] Goods exempted from VAT may also be subject to cascading taxes with the inevitable distortions.[135] Ethiopia applies different turnover tax rates to different sectors which means tax authorities need to police the boundaries between sectors, which may distort firms' choices close to those boundaries.[136]

There are also chances for distortion that may happen due to those businesses that are not registered for VAT because of the registration threshold. VAT-registered taxpayers may not get VAT credit for the input VAT they paid when purchasing their inputs from the unregistered sellers. Businesses that are not registered for VAT might be encouraged to avoid buying from businesses that are registered since they cannot reclaim the VAT charged.[137] On the other hand, businesses thatare registered for VAT will prefer to buy their inputs only from the registered businesses so as to get credits for their input VAT.[138] If VAT-

[130]Joachim Englisch, Supra Note at 59
[131] Richard M. Bird and Piere Pascal Gerdon, Supra Note 118, P. 20
[132]Joachim Englisch, Supra Note 59
[133] Tadese Lencho The Value Added Tax, Teaching Material Unpublished
[134] Laura Abramovsky, David Philips and Ross Warwick, Redistribution, efficiency and the Design of VAT, A review of the Theory and Literature, UK Institute for Fiscal Studies, 2017.
[135] Ibid
[136] Ibid
[137] David Philips and Lucie Gadenne, The Impact of VAT and turnover Taxes on firms' Supply Chain Choices: Evidence From India, IFS Briefing Note BN 231,
[138] Ibid

registered persons buy their inputs from unregistered persons, a VAT might create cascading effects to an extent greater than the turnover tax.

5.2.8 Methods of Calculating VAT

The modern VAT calculation ranges from the invoice credit system to the credit subtraction method to the sales subtraction method to the addition method. Let us review them one by one.

A. The Credit Invoice method VAT Calculation

Alan Shenck and Oliver Oldman define the credit-invoice VAT as a credit-subtraction VAT, like the European VATs, that relies on invoices to verify tax reported on taxable sales by sellers and input credit claimed by purchasers on allowable taxable purchases.[139]They regard it as the most prevalent method of calculating VAT that relies on a "tax-against-a-tax" methodology.[140]

Under the *credit-invoice method*, a taxpayer is obliged to issue invoices constituting VAT for all his sales to his buyers. Each sale would be marked up by the amount of the VAT. A sales invoice for a seller is a purchase invoice for a buyer. A taxpayer is expected to calculate the net VAT to be paid to the government through a three-step process. First, the taxpayer must aggregate the VAT shown on its sales invoices. Second, the taxpayer must aggregate VAT shown on its purchase invoices. Finally, aggregate VAT on purchase invoices should be subtracted from aggregate VAT shown on sales invoices, and the difference will be the net VAT that will be paid to tax collecting officials. The following Illustration helps understand how the credit-invoice method works

Assume that Challa, a resident of Bahir Dar, is a computer dealer who sells computers purchasing from Temesgen, another computer dealer residing in Addis Ababa. According to the Ethiopian VAT legislation, both Challa and Temesgen are obliged to register for VAT as long as their annual turnover (gross sale) is above one million Birr. Hence, let us assume that both of them are registered for VAT. This means both traders are required to issue invoices for any person who purchases computers from them. And every time they sell computers they must include the 15% VAT amount in the sales price. Let us

[139] Alan Schenk and Oliver Oldman, Supra Note at 2
[140] Ibid

further assume that Challa bought ten Laptops with a cost of 20, 000 birr each in the month of April from Temesgen. The amount of VAT that Temesgen collects from Challa for each laptop will be 20,000x 15/100= 3,000 birr. The total VAT (Input VAT) amount of ten Lap tops that Challa will pay will be 10x 3,000= 30,000 birr

Challa will pay Temesgen a total of 230,000 birr. From this, the 30,000 birr is paid in the form of Input VAT. Challa should obtain an invoice (Input Invoice) that contained the VAT amount he paid to Temesgen. Otherwise, he will not get any credit on the VAT amount he collects when he sells the Laptops. The next step will be for Challa to sell those Laptops he bought from Temesgen. Assume that Challa wants to sell each laptop for 22,000 birr with a 2,000 birr profit. The amount of VAT he will collect from each laptop will be 22,000x15/100=3,300 birr. The total VAT (Out Put VAT) to be collected from the ten Laptops will be 3,300x10= 33,000 Birr. Challa must issue an invoice (Out Put Invoice) containing the VAT he charges for all his sales and must keep a copy invoice for all the sales if he wants to get credit from the tax authorities. In other words, Challa must bring to the tax authority both input and output invoices. Now let us calculate the net VAT that Challa has to pay to the government based on the credit invoice method.

Input VAT= 30,000 birr
Out Put VAT= 33,000 birr
Net VAT= Output VAT- Input VAT
Net VAT=33,000-30,000
Net VAT = 3,000 birr
Why has the invoice credit method gained wider acceptance than other methods?

Four justifications are suggested by Alan Tait for the reason why most jurisdictions prefer the invoice credit method. These are:[141]

1. The invoice method attaches the tax liability to the *transaction* making it legally and technically far superior to other forms. This is because invoice helps as important evidence of the transaction and of the resulting tax liability.

[141] Alan A. Tait, Supra Note at 37, P. 5

2. The invoice credit method creates a good audit trail. This makes taxpayers watchdogs of each other. This in turn minimizes tax evasion and avoids challenges for governments.

3. Other methods are not effective in applying multiple VAT rates than a single rate to be used for jurisdictions that prefer multiple stages.

B. Credit Subtraction VATs

In contrast to a credit invoice VAT, a subtraction-method VAT is computed annuallyby the seller and collected annually at each stage of production. The tax due is computed by multiplying the VAT rate by the amount by which the business taxpayer's gross receipts exceeded its deductible expenditures for the year.

One main advantage of this method is that it results in lower administrative costs for the government and it decreases compliance costs for the taxpayers. However, this method will not be easily workable when goods are exempted or zero-rated or when border-tax adjustments are used for trade.[142] The reason for this is that all sales and purchases are lumped together, which makes it much more difficult to determine which goods were taxed at a different rate, or which goods were exported.[143]So far the only country that used the sales subtraction method VAT without invoice is Japan.[144]

C. Sales-Subtraction Method VAT

In the sales-subtraction method VAT, the net tax liability is computed by multiplying the tax base by the tax rate.[145] The tax base is obtained by subtracting the amount of total purchases from the total sales. The data on total purchases and total sales is obtained from company sales and purchase annual book of records. Unlike the invoice credit method VAT which is imposed on individual transactions, this method of VAT is calculated based on cumulative data for each fiscal year to be taken annually.[146] The seller is obliged by the law

[142] Robert J. Shapiro, David G. Raboy and M. Jeff Hamond, Enterprise Economics IV: The Case For and Against Value Added Taxations, 1995, P.23
[143] Ibid
[144] Alan Schenk and Oliver Oldman, Supra Note at 2
[145] Ibid
[146] Ibid

to price and record taxable goods and services inclusive of VAT so that the recorded data will be used to calculate annual VAT net liability.[147]

The design features of the sales subtraction-method VAT are less articulated than a credit-invoice method VAT. This is mainly because few taxes characterized as sales subtraction-method VATs have existed in practice.[148] However, sales subtraction-method VAT is usually differentiated from invoice credit-method VAT since the former does not use credits and that tax due is not calculated by subtracting tax paid from gross tax liability. Rather, persons subject to the tax calculate their VAT liability by subtracting the value of their total non-labor inputs from the total value of their sales and then multiplying it by the VAT rate to determine their tax liability.[149] As a result, the sales subtraction method VAT is described as being "accounts-based," rather than "transaction-based VAT[150]and is commonly perceived to be a tax on an entity. In contrast, the credit-invoice method tax is commonly understood to be a tax on specific goods and services.[151]

D. Addition Method VAT

The addition method VAT is calculated by adding the economic factors of production (wages, rent, interest, and profit for VAT purposes) for the tax year and by multiplying the amount by the tax rate.[152] This method is used by some countries such as Israel, Argentina, Italy, and France to calculate the value-added tax of the margin-based financial services, which are more difficult to calculate using the credit invoice method.[153]

5.2.9 Destination and Origin- Based VAT Principles in VAT

The issue of jurisdiction or who taxes international goods or services appears in the picture when goods and services are transacted internationally. There are two alternative methods of taxing international transactions of goods or

[147] Ibid
[148] Itai Grinberg, Where Credit is Due, Advantages of the Credit- Invoice Method for a Partial Replacement VAT, George town University Tax Law Review, Vol.63, 2010, PP. 309-358
[149] Ibid
[150] Ibid
[151] Ibid
[152] Allan Schenk and Oliver Oldman, Supra Note at 2
[153] Sijbren Cnossen, The VAT Primer for Lawyers, Economists and Accountants, in The VAT Reader, What a Federal Consumption Tax Means for America, Tax Analysts paper, P.36

services. The origin principle and the destination principle are the two methods available for a given country to apply its tax jurisdiction. Except for a few countries, almost all countries of the world are using the destination-based method of taxing international transaction of goods while the principles used in the international sale of services is inconsistent.[154]

According to the origin principle, a VAT is imposed on the goods and services in the country of production, regardless of where they are consumed.[155] In this case, imports are not free of the VAT and exports bear tax on the value-added within the taxing jurisdiction. Under a destination principle, however, VAT is imposed on imports and rebated on exports. In a country that applies a destination principle, exports of most goods, exports of services related to exported goods, and exports of only additional specified services are relieved of the VAT or zero-rated.[156]

5.2.10 The Concept of a Good VAT (Modern VAT) versus Traditional VAT

Even though VAT has become popular for its advantages over its predecessors, not all VATs are living up to their expectations. Many VAT systems have defects and limitations. Hence, several writers have developed the concept of an ideal or 'good' VAT regime or the concept of the Modern VAT so as to differentiate them from bad or traditional VATs.[157] The prescriptions of modern VAT entail a uniform rate of VAT extending from the manufacturing through to the retail stage of the economy, levied on a broad consumption base of goods and services with very limited exemptions/exclusions.[158] On the other hand, traditional VAT systems have multiple positive rates and multiple exemptions.[159]For discussion of exemptions please refer to the later parts of this chapter.

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[154] Alan Schenk and Oliver Oldman, Supra Note at 2
[155] Ibid
[156] Ibid
[157] Liam Ebrill, et al, Supra Note at 48, P. 15
[158] Martin A. Sullivan, Introduction, Getting Acquainted with VAT, Tax Analysts the experts papers, 2011, P.7
[159] Richard Krever, VAT in Africa, Designing and Drafting VAT Laws for Africa, Pretoria University Press, 2008, P. 15

The New Zealand VAT, which is also applied by South Africa and other South African Customs union (SACU) countries, is commended for being a typical modern VAT system.[160]The New Zealand model VAT is characterized by very limited exemptions and a low, single standard rate of tax.[161] This model VAT system is praised for being revenue productive with broad-based nature and insignificant distortion on the economy.[162]

5.3 Value Added Tax Law of Ethiopia

5.3.1 The Salient Features of the Ethiopian VAT System

The Ethiopian VAT law, which was issued by Proclamation number 285/2002 by the house of people's representatives, came into force on January 01/2003 replacing the pre-existing general sales tax which was in force for more than four decades. The VAT legislation was designed with a standard and uniform rate of fifteen percent intended to be applied on a broad consumption base including almost all transactions. It also had a considerable number of exemptions and zero ratings for some transactions.

The value-added tax regulation number 79/2002 together with the numerous directives issued by the ministry of finance (initially known as the Ministry of Finance and Economic Development) are all the legal instruments that regulate the Ethiopian VAT. Although the original VAT Proclamation included substantive and procedural aspects of the VAT, a new and separate proclamation whose purpose was to regulate the procedural aspect of all kinds of taxes was later enacted in 2016. This proclamation was "Federal Tax Administration Proclamation number 983/2016." The enactment of the tax administration proclamation effectively repealed the procedural part of the original VAT Proclamation. The VAT Proclamation 285/2002 was also amended twice, first by Proclamation No. 609/2008, which was enacted primarily to regulate the use of sales register machines, followed by proclamation number 1157/2019, issued mainly to change filing periods and decrease the VAT withholding rate to 50 percent.

[160] Sijbren Cnossen, Supra Note at 44, P. 48
[161] Ibid
[162] Ibid

The various directives which were issued by MoFED have brought substantial modifications, additions, and deletions from the original VAT Legislation. For instance, many items and transactions are added to an exempt list by successive directives. The VAT registration threshold which was set to be 500,000 Birr by the proclamation 285/2002 has been increased to one million Birr by Directive No. 27/2012 effective from 28 June 2019. The Ministry of Finance and Economic Development has increased the registration threshold based on the power given to it by the VAT Proclamation to increase or decrease the threshold based on the new developments.[163]Despite the threshold increase from five hundred thousand Birr to one million birr, the dollar value of the birr is much lower than the five hundred thousand Birr threshold set 17 years ago. This is due to the rampant devaluation of the purchasing power of the Birr currency. Based on the exchange rate of the Birr to USD, the original five hundred thousand Birr threshold was equivalent to 48,000 USD. Even though the threshold in now one million Birr, the equivalent is now approximately 21,000 USD.

The Ethiopian VAT legislation is adopted from the European model VAT which makes it partly traditional due to the numerous exemptions it contains, making it narrow-based as compared to the modern VAT which is implemented by New Zealand, Australia, South Africa, and SACU countries.[164] The typical modern VAT is a broad-based VAT with a single, uniform, lower tax rate with no or very few exemptions.[165] The only feature that makes the Ethiopian VAT legislation better than the EU model directive (resembling the New Zealand modern VAT model in this regard) is the application of a positive single standard VAT rate.

5.3.2 The Allocation of VAT Taxing Right in the Federal Setting of Ethiopia

One of the main characteristics of a federal system is the system of fiscal federalism in which revenue is shared between the central government and regional states. If the federal system is to work well, regions must be given the power to collect their own revenues so as to be free and independent from federal power domination. Federalism without fiscal federalism is meaningless

[163] Ethiopian VAT Proclamation number 285/2002, Article 16(2)
[164] Richard Krever, VAT in Africa, Pretoria University Press, 2008, P. 2-15
[165] Ibid

and that is why the Constitution of Ethiopia has included revenue-sharing principles and provisions from article 94 to article 100.[166]The Constitution has divided the revenue powers into four categories; these are. (1) revenue sources that are exclusively reserved for the federal government; (2) revenue sources that are exclusively reserved for the regional states; (3) revenue sources that are concurrent powers of both the federal and regional states, and (4) revenue sources that are not designated in the constitution.[167]

Article 99 of the constitution provided that if any new tax which is not designated in the constitution emerges and the need arises to adopt it in Ethiopia, then the new tax shall be designated by the two-thirds majority vote of the two houses (The house of Peoples Representatives and the House of Federation).[168]The Value Added Tax was not designated, at least in name, in the Constitution when it was promulgated in 1995, rather it was introduced in Ethiopia in 2002 seven years after the constitution was enacted.

Some commentators do not accept the idea that VAT was undesignated on the ground that it was not a new tax. They argue that VAT was only a change of name since it is in substance similar to the sales taxes which are designated in the constitution as regional taxes. However, since the idea that VAT is a new and undesignated tax was recognized by the two houses and the government authorities, the issue of designating it was presented to the two houses. The joint session of the two houses decided that the power to impose VAT be given to the federal government. One may ask a question why the joint session of the two houses conferred the power of taxing through the mechanism of the VAT on the federal government which had the effect of taking the VAT from the regions. The reason is that the VAT can only be effective if implemented at the federal level because of the absence of internal borders and the problems with cross-jurisdictional crediting.[169] Despite the decision by the two houses to give the taxation power of VAT exclusively to the federal government, later on, FIRA unilaterally decided to share VAT revenue between the federal

[166] Ethiopian Constitution, Proclamation 1/1995, Federal Negarit Gazetta, Articles from 94-100
[167] Ibid
[168] Ibid
[169] Elias Egwebuike and E.O Nwadialor, The Genesis and Development of Value Added Tax Administration, Case Study of Nigeria, International Journal of Academic research in Accounting, Finance and Management Sciences, Vol. 10, No. 2, 2020, PP. 15-30

government and states, with 70 percent transferred to the federal government and 30 percent to the states.[170]

5.3.3 The Scope of VAT under the Ethiopian VAT Legislation.

According to the Ethiopian Value Added Proclamation, the VAT applies to:

1. Every taxable transaction by a registered person[171] and

   - A Taxable transaction is defined under Article 7(3) as a supply of goods or a rendition of services in Ethiopia in the course or furtherance of a taxable activity.[172]

   - Taxable activity is also defined by article 6 of the same proclamation as an activity that is carried on continuously or regularly by any person in Ethiopia, or partly in Ethiopia, for consideration.[173]

2. The import of goods and services by any importer unless they are exempt.[174]

From the above provisions and the practice of other jurisdictions, we can understand that the following five conditions must be fulfilled in order for goods or services supplied domestically to be the subject of taxation. Bear in mind that the following conditions need not be fulfilled on imports.

I. Taxation of Domestic Supplies of goods and services

According to the Ethiopian VAT legislation, the following five conditions must be fulfilled cumulatively for a given transaction to be subject to the VAT.

[170] Wollela A. Yesigat and Richard Krever, Value Added Tax and Fiscal Federalism in Ethiopia, African Journal of International and Comparative Law Vol.28. No. 2, 2020, PP.147-170
[171] Value added Tax, Proclamation 285/2002, federal Negarit Gazetta, Aricle 7 (1)
[172] Ibid
[173] Ibid
[174] Ibid

A. There must be a supply of goods or rendition of service:

One of the conditions that must be fulfilled for an activity to be the target of VAT tax is the supply of goods or rendition of services. The question that we ask here is what is a supply? What constitutes a supply and what does not constitute a supply? What are goods and what is a service? These questions need to be answered for a clear understanding of the term supply.

The supply of goods is defined by the VAT proclamation as a sale of goods or a grant of the use or right to use goods, whether with or without a driver, pilot, crew, or operator, under a rental agreement, credit agreement, freight contract, agreement for charter, or any other agreement under which such use or right to use is granted, or a transfer or provision of thermal or electrical energy, gas, or water.[175] Tait claims that the sale of goods is not the only component of a supply. He suggests that the supply of goods can include the letting of goods on hire, the loan of goods, and lease-sale contracts.[176] Cnossen defined a supply of goods as the transfer of the right to dispose of tangible property as owner.[177]

The Ethiopian VAT proclamation also includes leases or rentals of goods as supplies. However, it is not clear why a provision of thermal or electrical energy, gas, or water is listed separately from goods and services as if they are different in the proclamation even though they are already included in the definitional part of the law as goods.[178]If the supply of goods is defined as a sale or rent of goods then what needs to be mentioned is the definition of goods which is also addressed under article two of the Ethiopian VAT proclamation. Article two defines the term "goods" as all kinds of corporeal movable or immovable property, thermal or electrical energy, heat, gas, refrigeration, air conditioning, and water, but does not include money.[179]Money is excluded from the definition of a good because it is a means of exchange for something used for consumption and is thus not subject to the VAT unless the money is used for a numismatic purpose.[180] The Proclamation has also defined the term "services" simply as work done for others that does not result in the transfer of

[175] Ibid
[176] Alan A. Tait, Supra Note at 37, P. 386
[177] Cnossen, The VAT Reader, Lawyers, Economists and Accountants, Tax Analysts paper, 1989, P. 35
[178] VAT Proclamation, Article 4(1)(a)(3)
[179] Ibid
[180] Ibid

goods.[181] However, if somebody transferred a good without cash payment but for any personal service, he obtained it will be taken as a supply Tait suggests a similar definition of services as any transfer or provision for a consideration that is not the supply of a good.[182]This type of definition is supposed to be advantageous as nothing will escape from taxation.

B. The supply must be made by a Registered Person/Taxable Person:

Registered persons are known alternatively as taxable persons by Tait and as firms or businesses by academic discourses.[183] Registered persons or taxable persons are persons who carry out regular businesses and whose annual turnover reached a minimum gross amount set by the law.[184] Supplies of goods or rendition of services can be taxed only if they are supplied by taxable/registered persons.[185]Many VATs define a taxable person subject to the VAT rules as a person who is registered or is required to register for the VAT.[186] In this case, a private individual who casually sells his own used goods cannot be taxed since he is not a taxable person. He cannot become a taxable person until he carries on a regular business and he is obliged to register up on fulfilling the minimum threshold provided by the law.

Supply by a taxable/registered person may not be the subject of taxation unless it is a part of regular or continuous activity. The fact that a person is not registered will not save him from VAT liability as long as his annual turnover exceeded the minimum threshold and as long as he carries out a regular and continuous activity.[187] In other words, failure to register and collect tax from purchasers cannot relieve a person of the duty to collect and remit tax. Instead, the tax official may unilaterally register persons who fail to register.[188] Even though only persons whose annual turnover are obliged to register for VAT, those whose annual turnover is below the said amount are not barred from registering since they are allowed by the Ethiopian VAT proclamation to

[181] Ibid
[182] Alan A. Tait, A. Supra Note at 37, P.387
[183] Ibid
[184] Ibid
[185] Ibid
[186] Allan Schenk, et al., Value Added Tax, A comparative Approach Cambridge University Press, New York, 2015, P.
[187] Ibid, see also the Ethiopian Value added Tax, Proclamation 285/2002, Article 45
[188] Ibid

register voluntarily provided they supply more than 75 percent of their supplies to a registered person.[189]

In other words, a business person who conducts a regular or continuous business activity is obliged by the law to be registered if his annual turnover exceeds a threshold level of one million Ethiopian Birr.[190] Hence, the wording of the Ethiopian VAT proclamation as a registered person seems to be an error since a person can be a taxable person and liable to pay VAT even though he might not be registered.[191]

Similar to the Ethiopian VAT system, the VAT Directive of the European Union imposes VAT on taxable supplies by a taxable person.[192] Similarly, the VAT systems of the United Kingdom and South Africa use the terms "taxable person" and "registered person" interchangeably and define a taxable person as a registered person or who is required to register.[193] The VAT system of Australia also imposes a VAT on a person who makes supplies and it is only a person who is registered or is required to register that can make taxable supplies.[194]

C. The supply must be made in the course of a taxable activity:-

For a tax to be imposed on a supply of goods or rendition of services by the taxable person, the taxable person must be engaged in a taxable activity. Taxable activity is an activity that is carried on continuously or regularly.[195] But it should be noted that only domestic supplies are expected to meet the continuity or regularity criteria as imports are taxable without being required to

[189] Ibid
[190] Alan Schenk, et al., Supra Note at 186, P. 60
[191] Value added Tax, Proclamation 285/2002, Article 7(1), Articles 3(1),(2) and (3) and Article 15
[192] European Economic Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.
[193] United Kingdom Value-Added Tax Act 1994, 3(1) and Republic of South Africa Value-Added Tax Act No. 89 of 1991
[194] Australia A New Tax System (Goods and Services tax) Act 1999, No 149(10)
[195] Value added Tax, Proclamation 285/2002, Article 6

meet this condition. Bertram and Edwards have developed what can be taken as the best criterion for an activity to be regarded as taxable activity.[196] These are:

Continuity: Supplies should be made regularly and fairly frequently as part of continuing activity. Isolated or single transactions will not usually be liable to VAT**.**

Value: The supplies should be for a significant amount; trivial, even if repeated, transactions would not usually count unless the amount exceeded the Vat threshold**.**

Active Control: Control should be in the hands of the supplier. He should be actively engaged in the "control or management of the assets concerned" (including operation through an agent).

Intra versus inter-trade: Supplies should be to members outside the organization and not just between members of the organization.

The appearance of Business: The activities should have the characteristics of a normal commercial undertaking with some acceptable method of record-keeping in place.

D. The Supply must be for consideration

For a supply of goods or rendition of services by a taxable/registered person to be the subject of VAT, the supply of a good or the rendition of service must be made for consideration.[197]Consideration is also known as “taxable Value”. Cnossen defines “consideration” or “taxable values” as all forms of payments received by the supplier, in cash or in-kind, whenever and however paid, regardless of who pays them.[198] Alan Schenk et, al. reckon that not only must there be a consideration but also there must be a sufficient link or connection between the supply and the consideration so that it can be taken as a supply for VAT purposes.[199] In other words, the consideration or payment received by the person must have a direct link to the goods supplied or the service rendered for

[196]Bertram, David, and Stephen Edwards, Comprehensive Aspects of Taxation, 1984-85 Edition, Part 1, London, New York: Holt, Rinehart and Winston, 1984.
[197] Ethiopia VAT Proclamation Number 285/2002, Article 6(2)
[198] Sijbren Cnossen, The VAT Reader, 1973, P. 34
[199] Allan Schenk Oliver Oladman, Supra Note at 2

a supply to be taken as a taxable supply. This link requirement is relevant to ensure the existence of reciprocal obligation at the time of supply.[200]

Nevertheless, it must be noted that consideration is different from profit. A taxable person might supply goods or render a service not for profit even if he has obtained some kind of consideration from the customer. The absence of profit does not make a supply to be regarded as free of consideration.[201]Based on the above definition gifts or donations cannot be regarded as supplies since they are granted for the donee without any payment. However, if somebody transferred a good without cash payment but for any personal service, he obtained it will be taken as a supply. For instance, any supply by the employer for his employees of any goods free of charge is considered a supply and therefore taxable.

One important issue that must be discussed here is that any taxable/registered person has a duty to charge an appropriate price for the goods he supplies or for the services he renders. If his supplies are found to be under-priced or below the fair market value of the goods or services, the tax authority has the right to make adjustments taking the fair market value of the goods or services traded,[202]

E. The Supply must take place in Ethiopia or Partly in Ethiopia

The fifth condition needed to apply the VAT to a supply is that the supply must be made in Ethiopia or Partly in Ethiopia.[203] Imports, discussed below, are subjected to VAT though they do not have links with Ethiopia and though they are not made in the course of a taxable activity.

II. Taxation of Imports

Imports, whether goods or services are the subjects of VAT when unless they are exempt. For imports to be taxable, they need not fulfill the conditions of being carried out in the course of taxable activity and imported by a registered

[200]Amand, When Is a Link Direct? 7 VAT Monitor 3, 1996).
[201] Ethiopia VAT Proclamation no. 285/2002, Article 6(2)
[202] Sijbren Cnossen, Supra Note at, 198, P. 37; see also VAT Proclamation number 285/2002 Article
[203] Ethiopian VAT Proclamation Number 285/2002, Article 6

person. Immediately, when the imported goods or services enter the Ethiopian customs places, they will be subjected to the VAT.

5.3.4 The Place, Time, and Value of Supply of Goods and Services

As we have discussed above, for a given transaction to be the subject of the VAT, the supply of the goods or services must take place wholly or partly in Ethiopia. Sometimes, however, the existence of the goods or services in Ethiopia may not be sufficient since knowing the specific location of the good or service within a given country might be important for the VAT purpose.[204]As far as the supply of goods is concerned the general trend in almost all jurisdictions as in Ethiopia is to make the place where the goods were delivered or transferred or made available to the person supplied as the place of the supply.[205]The fact that a legal title did not pass at the time the goods are delivered is not an issue.[206]

Occasionally goods might be transported before they are handed over to the person supplied. In this case, a legal provision is needed to indicate the place where the goods are said to be supplied. Accordingly, when goods are transported before they are delivered to the buyer, the place of the supply of the goods will be the place where the transportation started.[207] This rule goes in line with the common commercial understanding that goods are at the risk of the buyer while being transported.[208]

Nevertheless, the above rule does not work for thermal energy, gas, or water. The law provided that the place of supply for these goods will be the place where they are delivered unless they are exported.[209]The place of supply of goods imported from abroad is the place of arrival according to the customs laws of the country.[210]

[204] Victor Thuronyi, Supra Note 21, P. 198
[205] Victor Thuronyi, Supra Note 21,P. 198; See Allan A. Tait Value Added Tax; International Practice and Problems, P.371 See Ethiopian VAT Proclamation Article 9(1)
[206] Victor Thuronyi, Supra Note at 21, P. 198
[207] Ethiopian VAT Proclamation Article 9(1)
[208] Victor Thuronyi, Supra Note at 21, P. 198
[209] Ethiopian VAT Proclamation No. 285/2002,Article 9(1)
[210] Alan A. Tait, Supra Note at 37, PP 49

The other issue that remains is the determination of the place of supply for services. The issue of the place of supply for services has two aspects i.e. domestic supply of service and imported supply of service. The Ethiopian VAT legislation provided the place of supply of services to be the place where the taxable activity of the person is located.[211]The law in addition to the general provision has listed in detail what can be taken as a non-exhaustive list of places which can be regarded as the places of services of the supply.[212]Unlike the domestic supplies of services, locating the place for cross-border supplies of services can be challenging. First, importation of services is not accessible to the ordinary customs laws of the country which are intended only to be implemented for goods that are physically imported.[213]This challenge might prevent a successful imposition of the VAT tax at the place and time of import since it is difficult to trace their importation. Second, the place of production or the place of consumption of some types services may not be traceable and might prevent us from implementing the destination principle which provides that goods or services must be taxed at the place where they are received or consumed.[214]

The system used by the Ethiopian law and elsewhere to overcome the above problems is reverse taxation (charging).[215] A reverse-charging rule requires the customer enjoying the service being supplied by a foreign supplier to pay the VAT.[216] This rule treats the customer supplied with a service originating abroad as making the supply to itself. The customer residing in Ethiopia is obliged to withhold the VAT amount on the payment he makes to the supplier and pay to the tax authorities as an output tax on that supply.[217] If the customer pays that VAT as input tax, he can claim a VAT credit, and he will owe no VAT. However, if the customer makes exempt supplies, then no VAT credit is allowed. Exempt supplies are supplies in which no output VAT is charged and there is no input VAT credit.

[211] Ethiopian VAT Proclamation No. 285/2002, Article 10(1)
[212] Ibid
[213] Victor Thuronyi, Supra Note at 21, P. 198
[214] Ibid
[215] Ethiopian VAT Proclamation Article 23
[216] Alan A. Tait, Supra Note at 37, PP. 392
[217] Ethiopian VAT Proclamation Number 285/ 2002, Article 23(3)

The other issue dealt with by the Ethiopian VAT legislation is the time of supply of goods and services. Allan A. Tait reckons that the time of supply helps us know the rate of VAT applicable to the supply at a particular time when the VAT rates change frequently since the difference in the rate will bring a substantial variation on the tax liability of the person.[218] Victor Thuronyi explains the importance of specifying the time of supply as it enables the tax authorities to determine "when a tax invoice has to be issued for a supply, when tax is due in respect of a supply, the rate at which the tax is payable, and in which taxable period a return has to be made in respect of that supply and in which any tax credit can be claimed by the person receiving the supply".[219]

The Ethiopian VAT legislation, like VAT legislation in other countries, provides that supply occurs when the VAT invoice is issued provided the invoice is issued shortly (the law gives five days) after the supply.[220] Often, however, the supplier does not issue invoices within the specified time. In this case the law has set the time at which the delivery or shipment of the good took place to be the time of supply. If payment is effected before the delivery of the goods, the time whereby the payment is done is deemed to be the time of supply.[221]The reason why the law specifies the payment date as the time of supply is to make sure that the VAT liability which arises as an advance payment is made and does not await any transfer or dealing with the goods.[222]If a supply takes place regularly at intervals, then the time of supply will be the time at which each invoice is issued or each payment is made.[223]The rules set out for goods also apply for supply of services.

The other issue we need to discuss under this section is the value of taxable supply. The correct VAT liability of the taxable person could be figured out only if the exact value of the supply for the tax accounting period is known. The common rule is that the value of taxable supply is equal to the sum of all payments or consideration received or entitled to be received by the taxable

[218] Ibid
[219] Victor Thuronyi, Supra Note at 21, P. 195
[220] Ethiopian VAT Proclamation No. 285/2002, Article 11(1)
[221] Ibid
[222] Victor Thuronyi, Supra Note at 21, P. 197
[223] VAT Proclamation number 285/2002, Article 11(5) and Victor Thuronyi, Tax law designs and drafting P. 198

person from the supply he made whether paid from the customer or some other person.[224]

The Sixth VAT Directive of the European Union defines taxable value of a supply as "everything which constitutes the consideration that has been or is to be obtained by the supplier from the purchaser, the customer or a third party for such supplies including subsidies directly linked to the price of such supplies."[225] When a supplier receives payments by other than cash in the form of goods and services, the fair market value of the payment will be taken into account.[226]

The federal Tax Administration Proclamation defines the fair market value of goods, an asset, service, or benefit at a particular time and place as "the ordinary open market value of the goods, asset, service, or benefit at that time and place."[227]The issue of fair market value arises when some taxpayers engage in understating the price of goods or services so as to avoid their tax liabilities. This is especially the case when the supplier is a taxable person and the supplied person is not taxable person. In such a case, the supplier might reduce the actual value of the supplies to avoid creating an input tax that the person supplied cannot reclaim.[228]Understating the prices might be made between related persons. To curb such problems, the tax authorities are allowed by thelaw to make an adjustment of the understated price with a fair market value of the goods or services.[229]

5.3.5 VAT Base, Exempt and Zero-rated Transactions Under Ethiopian VAT law

5.3.5.1 VAT Base, Exempt and Zero-Rated Transactions Explained

Tax base refers to the base which is taxed. It means the income, consumption, or wealth of individuals on which the taxation is to be imposed. The tax base for invoice credit VAT is agreed to be the consumption of individuals.

[224] Ibid
[225]Sixth Council Directive 77/388/EEC of May 17, 1977, Art. 11(A)(1)(a
[226] Ethiopian VAT Proclamation number 285/2002, Article 12(2)
[227] Federal Tax Administration Proclamation umber 983/2016 Article 3
[228] Victor Thuronyi, Supra Note at 21, P. 214
[229] Ethiopian VAT Proclamation number 285/2002, Article 13

An exempt transaction is a transaction in which a trader has to pay VAT on his inputs without being able to claim any credit for this tax whereas a zero-rated transaction is a transaction in which the trader is fully credited for any VAT he pays on inputs and also is exempt from output VAT.[230]Input tax is a tax paid on the purchases while output tax is a tax collected on sales.

Exemption is different from zero-rating and reduced-rating. While zero-rated transactions allow registered taxpayers to reclaim the VAT paid on any inputs used in the purchasing or production process, the exempt transaction do not do that. As a result, the zero-rated transaction does not contain any tax element in the final price sold to the ultimate consumers. On the other hand, in exempt transactions goods and services are not taxed when they are sold though the producer or purchaser of those goods or services do not have the right to reclaim refund of the taxes he paid while purchasing the inputs. Hence, an exempt good or service is of a higher price than that of a zero-rated good or services since it contains a tax component. In other words, a good or service which is zero-rated is a taxable transaction, but the VAT rate is 0 per cent.[231] A reduced transaction is neither zero-rated not exempt but taxed at a tax rate which is below the standard rate adopted by a given country's VAT law. Exempted goods or services will be more generously priced only if those goods or services are sold directly from the producer to the final consumers in which case there will be little of no irrecoverable input VAT. The more the goods/services change hands, the less advantage that exemption will have for the final consumer since the irrecoverable input VATs outweigh the exempt output VAT. The following example shows how the impact of exemptions vary depending up on the chain of transaction that the good/service passes.

Assume an exempted good passed from X to Y and then to Z. Let us say X sold the good for 10,000 birr. X will collect 1,500 birr VAT from Y. Hence, Y will pay a total of 11,500 birr. Then if Y need a 1000 birr profit, he will sell the same good for Z for 12,500.

[230] Alan A. Tait, Supra Note at 37, PP. 371

[231] In fact some people do not accept the phrase a VAT rate zero per cent alleging that it cannot be called as a tax rate in the absence of any tax to be collected.[231]

5.3.5.2 Exempt Transactions under the Ethiopian VAT Legislation and elsewhere

The Ethiopian VAT regime exempts and excludes specific goods, services, activities, entities or sectors from VAT taxation for economic, administrative, and political justifications. The difference between exemptions and exclusions is that in the case of exemptions, taxpayers are obliged to register for VAT, while in the case of exclusions they are not duty-bound to register.

The Ethiopian VAT proclamation though providing the list of exempt supplies does not define the phrase "Exempt Supply/transaction". This has created confusion among the general taxpayers. However, it can be understood from other jurisdictions and theoretical literature that an exempt transaction or supply is a transaction in which the output tax is freed and the input VAT paid when purchasing is not credited.[232] The basic characteristics of exemptions in VAT are that they do not grant absolute relief from tax liability. The only thing that exemptions do is relieve the exempt trade's value-added from output tax while input taxes already paid are not returnable.[233]Suppliers who are treated by the law as exempt are not required by the law to be registered and to keep record books.

Exemptions are justified for at least three reasons according to Allan Tait. These are: first, to improve the progressivity of the VAT, which has been criticized by many for being regressive; second, because there are meritorious goods and services that deserve to be tax free: and third, because there are goods and services that are too difficult to tax administratively.[234]Services such as banking, finance, insurance, betting, gaming, lotteries, and legal services are exempted just because they are difficult to tax whereas education, health, water; books are exempted on the basis that they are meritorious goods and services. Finally, some goods and services such as food, housing, milk, and bread are exempt in order to improve the progressivity of the VAT.

Nevertheless, exemptions are not free of criticism. The narrowing effects on the tax base, the need to make the tax fair, the complexity of the tax system with

[232] European Commission, A retrospective Evaluation of Elements of the EU VAT System, Institute of Fiscal Studies P. 40
[233] Alan A.Tait. Supra Note at 37, P 50
[234] Liam Ebril et al, SUPRA note at 48 and PP. 85. Alan A. Tait ,Supra Note at 37, P. 56

the exemptions, and the trade-off between the rate structure of the VAT and the base on which those rates are levied are the grounds raised against the application of exemptions.[235]For example, Cnossen contends that VAT exemptions distort input choices, stimulate uneconomical self-supply, distort competition, discriminate against exports, and complicate administration and compliance.[236]

Despite the complaints, almost all countries continue to include exempt items and transactions in their national VAT legislation and Ethiopia is no exception. For instance, some 60% of the base is exempted under the European Model VAT, that is, the base is not taxed on output but on inputs.[237]The effects of exemptions include revenue reduction or increase, distorted output choices, an incentive to self-supply, and distorting destination principles.[238]Here, the New Zealand model VAT is much appreciated for being a broad-based and single rate revenue-productive VAT with very limited exemptions.[239].

5.3.5.3 Types of Exemptions Under the Ethiopian VAT

Like any other African countries, Ethiopia applies standard exemptions in its VAT legislation. Standard exemptions are those found in OECD countries, more specifically those laid down in the EU's Common VAT Directive.[240]These are found in almost all jurisdictions including by those countries that have the ideal VAT base such as the New Zealand model VAT. It must be borne in mind however that the connotation 'standard' does not mean that the exemptions and exclusions constitute best practice.[241]

The standard exemptions listed by the Ethiopian VAT proclamation are extensive and include the supply of educational services, dwellings, financial services, foreign currency, gold to the National Bank, religious services, prescription drugs, humanitarian aid, electricity, kerosene, water, transport,

[235] Victor Thuronyi, SUPRA note at 21, , P. 207
[236] Sijbren Cnossen, Modernizing the European VAT, Cesifo Working Papers, No. 8279, 2020, PP. 2-3
[237] Ibid
[238] Liam Ebril et al, Supra Note at 48, PP. 85
[239] Sijbren Cnossen, Mobilizing VAT Revenues in African Countries, International Tax Public Finance, Springer, 2015, PP.1077–1108
[240] European Economic Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax
[241] Sijbren Cnossen, Supra Note at 239 P.121

postal service, license fees, goods imported by government agencies, books and printed materials.[242]Transport of sick/injured persons; hospital and medical care; human blood, tissues, and organs; dental care, charitable work, education, noncommercial activities of non-profit-making organizations; sporting services, cultural services, insurance and reinsurance, letting of immovable property, betting, lotteries, gambling, supply of land and buildings, certain fund-raising events are treated as standard exemption by most countries.[243]Gambling is exempted in the Ethiopian Vat unlike the VATs of other countries.

Among the Developed world New Zealand has one of the broadest VAT bases because not only does New Zealand not provide non-standard exemptions it also taxes items that other countries have specified as standard exemptions.[244] The category of exemptions is also elusive since there is no clear border upon which each exempted items fall since an item may fall both, for instance, under the meritorious or public goods class. Below, we shall see those goods and Services Exempted under the Ethiopian VAT proclamation and the reasons suggested for their exemptions one by one by categorizing the group of exemptions in to five categories.

i) Activities Exempted for the Sake of the Public Interest/Meritorious Goods or Services

The Ethiopian VAT legislation exempts healthcare, education, and social services because they are considered as activities in the public interest or because they are meritorious.[245] The exemption of health and educational and social services and, more generally, social and cultural services, are justified by the fact that they generate positive externality for the society.[246]Among the most important exemptions provided by the VAT proclamation of Ethiopia is health, education, social and cultural services. These activities and services are often deemed to be merit goods or services whose consumption should not be affected because of the imposition of the VAT.[247] The concept of healthcare as a public or merit good has received wider recognition by VAT legislations all

[242] Ethiopian Value Added Tax Proclamation, Number 285/2002, Article 8
[243] Richard M Bird and pierre Pascal Gerdon, Supra Note 118, P.121
[244]Ibid
[245] Ethiopian VAT Proclamation Number 285/2002, Article 8(2)
[246] Sijbren Cnossen, Supra Note at 44, P 129
[247] Sijbren Cnossen, The C- Inefficiency of the EU VAT and What Can be Done About it, International tax and Public Finance, 2021, P. 12

over the world. Healthcare is treated as a merit or public good because consuming it is beneficial not just to the consumer but to other members of society.[248]

ii) Exemptions of Public sector, Nonprofit, and Charitable Activities

The Ethiopian VAT legislation, like most VAT systems, exempts public sectors, nonprofit organizations, and charitable activities from the payment of VAT.[249] Some of the most important public sector utilities include: telecommunications; the supply of water, gas, electricity, and thermal energy; the transport of goods; passenger transport; warehousing; commercial radio and television broadcasting; postal services; healthcare; education; libraries; museums; preventive medicine; cultural services; and sewage disposal. To exempt or not to exempt these goods and services by the public bodies is one of the most controversial topics in the discourse of VAT.

Almost all African countries influenced by EU directive have exempted most of these government utilities.[250] The argument advanced to exempt public utilities is that there is no full consideration received from the supply of these goods and services which makes the determination of taxable value impossible.[251]Moreover, the exemption of these public utilities is supposed to enable these goods and services to be supplied at lower prices for the public.[252]Among the public utilities exempted by the Ethiopian VAT legislation are water, electricity, kerosene, passenger transport, and postal services while telecommunication and broadcast services are taxable.[253]Among the cultural goods and services Ethiopian VAT law exempted only books and newspapers whereas sports, gambling, entertainments and artists are all taxable.[254]

Nonprofit entities and charitable activities consist of activities of nonprofit organizations, charities, non-governmental organizations, and other similar

[248] Fiona Martin, The Case for Specific Exemptions From the Goods and Services Tax: What Should we do About Food and, Health and housing, ejournal of Tax Research, Vol.18 No.1, 2012, PP. 99-123
[249] Richard M. Bird and Pierre Pascal Gerdon, The VAT in Developing and Transitional Countries, Supra Note 118,, P.88; Value Added Tax Proclamation, number 285/2002, Article 8
[250] Sijbren Cnossen, Modernizing VATs in Africa, Supra Note at 44, P. 160
[251] Ibid
[252] Ibid
[253]Ethiopian VAT Proclamation number 285/ 2002, Article 8
[254] Ibid

entities. The supplies of goods and the rendition of services by nonprofit entities and charitable activities except a few transactions are generally exempted by VAT regimes around the world.[255] The arguments to exclude services and goods supplied by charities and nonprofit organizations are that these organizations facilitate income distribution and fulfill social objectives.[256]Despite the criticisms, the Ethiopian VAT legislation like most VAT regimes have exempted services and goods supplied by the nonprofit and charitable entities.[257]

iii) Activities that are Exempted Due to Difficulty to Tax

VAT regimes exempt a number of transactions from VAT not because they wanted to encourage them and not because they wanted to achieve some social, economical or political objectives, but because the difficulty or at least perceived difficulty in applying the invoice-credit method VAT**.** This emanates from the fact that these transactions are by their very nature unreachable to the VAT system. Some of the most common exemption in this category includes financial services (partially limited to some services), insurance services, real property, gambling, lottery and games of chances, agricultural products etc. Below we shall see some of the items and the issues that are debated in taxing or exempting them. However, the so-called games of chances including betting, lottery and gambling are not exempted in the Ethiopian VAT legislation even though in the EU directive and other African jurisdictions they are exempted on the ground of difficulty-to-tax transactions.

A) Exemption of Real Property (Land, Buildings, and Structural Components)

The VAT policy on real property is complex due to a number of reasons. The first reason is the fact that real property is usually acquired both for consumption and saving purposes which makes separating the investment part of the property from the consumption part impossible.[258] The second problem

[255] Pierre Pascal Gerdon, VAT Treatment of Nonprofits and public Sector entities, In the VAT reader tax Analysts, 2011, P. 239

[256] Nonetheless, these arguments are rejected by others on the grounds of equity, simplicity and efficiency.

[257]Ethiopian VAT Proclamation number 285/ 2002, Article 8(2(h))

[258] Robert Conrad and Anca Grozav, Real Property and VAT(Contribution in a book titles VAT in Africa), Pretoria University law Press, 2008, P. 81

with real property is that it can be owned and used as consumption goods by owner-occupants or rented to others or used for production purposes.[259] The third problem is that real properties are not traded frequently which makes valuation difficult.[260]

Since real estate services are self-supplied, owner-occupied housing is problematic to the VAT regime due to the fact that sometimes it may not have observable market value.[261]Because this involves final consumption on which one would like the tax to "stick."[262] All the attempts that were made in the past to impute value to services enjoyed from owner-occupation have proved to be administratively difficult, inequitable, and, politically, most unattractive.[263] Thus, it has become mandatory to exempt services enjoyed from owner-occupation.[264]

To avoid discrimination and distortion of the economy, almost all VAT systems are exempt from VAT of the leasing of used residential dwellings in a manner they exempted owner-occupied houses. However, the issue of what types of dwellings are exempted is still unsettled so far. In today's world, there are two approaches. These are the tax approach that imposed taxes on all immovable property except the lease and sale of used dwellings and the exempt approach which purports to exempt all types of immovable property except a newly built dwelling.[265]

The Ethiopian VAT legislation follows the second approach of exempting all dwellings except the sale or transfer of newly built dwellings. [266] The reasons for exempting dwellings from taxation are the difficulty in computing the rental value and the sale value of owner-occupied dwellings.[267]If rental values of owner-occupied dwellings cannot be taxed and only the rental values of rented dwellings are taxed this would favor the occupiers and is thus

[259] Ibid
[260] Ibid
[261] Liam Ebrill, et al, Supra Note 48, P.98
[262] Ibid
[263]Alan A. Tait, Supra Note at 37, P 87
[264] Liam Ebrill, et, al, Supra Note 48, P.98
[265] Sijbren Cnossen, Supra Note at 44, P. 188
[266] Ethiopian VAT proclamation Number 285/2002, Article 8.
[267] Sijbren Cnossen, Supra Note at 44, , P. 129

discriminatory.[268]The sales of new dwellings are not exempted since they are sales to final consumers which mean the consumer has to pay the full tax.

B) Exemption of Financial Services

Financial services are one of the most controversial transactions when the issue of exemption is raised. The European VAT directive of the 2006, from which the Ethiopian VAT law was based entirely, exempted financial services without accounting for differences between fee-based and margin-based services.[269]The decision to exempt financial services from VAT is related to the conceptual and administrative trouble associated with measuring the value of financial services on a transaction-by-transaction basis, rather than social or economic policy reasons.[270] In other words, writers explain that financial services are exempted because they are difficult-to tax transactions.[271]This is not always the case.

Among the financial services, margin-based services are hard to tax through the invoice-credit method VAT, since the value of the intermediation charge is embedded in interest returns, interest rates cannot be taxed, as they are not consumption but income.[272] As the value of the intermediation charge is not known, VAT cannot be charged on it and passed on to customers on a transaction-by-transaction basis. The value of the intermediation charge is necessary if VAT liable customers are to credit the tax against their VAT on output.[273]

Unlike margin-based financial services, Fee-based services can be taxed using the invoice-credit method without any problem. Taxing fee-based services would raise the tax on Business-to-Customer (B2C) services and enable

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[268] Ibid

[269]Common VAT Directive, Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax, OJ L347/1 recasting Sixth Council Directive 77/388/EEC of 12 May 1977 on the Harmonization of the Laws of the Member States relating to Turnover Taxes – Common System of VAT: Uniform Basis of Assessment, (1977) OJ L145/01.

[270] Patrick Honohan, Taxation of Financial Intermediation, Theory and Practice of emerging economies, Oxford University Press, 2003, PP. 345

[271] Alan A. Tait, Supra Note at 37, P.92

[272] Sijbren Cnossen, Modernizing the European VAT, Cesifo Working Papers, 2020, P.9

[273]Poddar, S., Consumption Taxes: The Role of the Value-added Tax, 2003, P. 345-380 in: See also P. Honohan, Taxation of Financial Intermediation*:* Theory and Practice for Emerging Economies, New York, NY: Oxford University Press for the World Bank, 2003.

business users of financial services to credit the tax on fee-based services in full.[274]

Despite a widespread view that margin-based financial services are VAT-exempt because of technical difficulty or impossibility of applying the invoice-credit method VAT, there are people who consider this view as a mere perception.[275] A number of commentators argue that taxation of all kinds of financial services is possible in some way, although it is not clear what method is appropriate.[276] One alternative which is practiced by Denmark and Israel is an addition-method VAT on the sum of payroll and business cash flow although Denmark does not include business cash flow in the base and Israel taxes profits instead of business cash flow.[277]The other alternative which is called the" ingenious cash-flow method" was developed by Poddar and English[278] though it is objected on the ground of being complex and costly to comply.[279]

The wording of Article 8(2)(b) of the VAT proclamation which listed among the exempt supplies as "the rendering of financial services" seem to connote the same meaning as the EU directive of exempting all financial services whatever their type.[280]However, a thorough reading of the VAT regulation reveals that not all financial services are exempt from taxation. Article 20 of the VAT regulation has specifically provided the list of financial services that are entitled exemption.[281]

Accordingly, the types of financial services which are exempted by the Ethiopian VAT legislation are;[282]

[274] Sijbren Cnossen, Modernizing the European VAT, Cesifo Working Papers,(2020), P.9
[275] European Commission, A retrospective Evaluation of Elements of the EU VAT System, Institute of Fiscal Studies, 2010, P. 74
[276]Mirrlees, J., S. Adam, et. al, Tax by Design*:* the Mirrlees Review, Oxford University Press for the Institute for Fiscal Studies, 2011.
[277] Sijbren Cnossen, the C-inefficiency of the EU VAT and What Can be Done About it, Journal of International tax and Finance, 2021.
[278]Poddar, S., & English, M. Taxation of financial services under a value-added tax: Applying the cash low approach. *National Tax Journal*,*50*(1), 1997, 89–111.
[279]Kerrigan, A, The Elusiveness of Neutrality – Why Is It So Difficult to Apply VAT to Financial Services? *International VAT Monitor* 21(2), 2010, 103-112.
[280] Ethiopian Value Added Tax, Proclamation 285/2002, Article 2(8(b))
[281] Ethiopian Value Added Tax Regulation, 79/2002, Article 20
[282] Ibid, Article 20

- The granting, negotiating, or dealing with loans, credit, credit guarantees, or any security for money, including management of loans, credit, or credit guarantees by the grantor;

- Transactions concerning money (including the exchange of currency), deposit, savings, and current accounts, payments, transfers, debts, checkups, or negotiable instruments, other than debt collection and factoring;

- provision of credit under a purchase agreement or sale of goods, but only if the credit is provided for a separate charge, and the separate charge is disclosed to the recipient of the goods;

- to the extent provided in this regulation, provision or transfer of ownership of an insurance policy, or the provision of reinsurance in respect of any such policy;

- provision, or transfer of ownership, of an interest, of an interest in a scheme whereby provision is made for the payment or granting of by a benefit fund, provident fund, pension fund, retirement annuity fund, or preservation fund;

- provision of intermediation services by a buy-aid society or medical-aid fund;

The fact that the Ministry of Finance is given the power to make any of the above lists taxable, to make additional financial services as exempt or Zero-rated makes the list non-exhaustive.[283]

In addition to the transactions which are not exempted, the Ethiopian VAT legislation has also listed fee-based financial services which qualify for the exemption. Nonetheless, the lists are not exhaustive. The following are the list as provided by the VAT regulation;[284]

- Legal, accounting and record package services, actuarial, notary, and tax agency services (including advisory services) when rendered to a supplier of financial services or to a customer of that supplier of financial services;

[283] Ibid Article 20(4).
[284] Ibid Article 20(5)

- Safe custody for cash, documents, or other items;
- Data processing and payroll services;
- Debt collection or factoring services;
- Management services, such as management ofa superannuating fund;
- Trustee, financial advisory, and estate planning services, and
- Leases, licenses, and similar arrangements relating to property other than a financial instrument

Those services which are not included in the list are not entitled to an exemption.

C. Exemption of Insurance Services

Insurance services have been exempted under the VAT regimes of most African countries (except the SACU countries that tax all insurance services except long term insurance like health and life insurance services) as they are based on the EU's Common VAT Directive.[285]Similar to most African VAT regimes the Ethiopian VAT legislation lists the provision of or transfer of ownership of an insurance policy or the provision of reinsurance as one type of financial service which is exempted.[286]The law defines insurance policy as an insurance covered under a policy treated as general insurance business or long term insurance business under the Ethiopian insurance law.[287]

iv) Goods and Services Exempted for Progressivity

Like many other countries the Ethiopian VAT proclamation has provided exemptions for some items for the purpose of improving the fairness of the tax rate by improving progressivity of the tax.[288] Unlike some countries which zero-rated some items such as basic food for equity reasons,[289] the Ethiopian VAT legislation has only exempted them. Food stuffs and the agricultural

[285] Sijbren Cnossen, Supra Note at 44, P. 222
[286] EthiopianValue Added Tax Regulations No. 79/2002, Article 20(2((d))
[287] Ibid
[288] Alan A. Tait, Supra Note at 37, P.56
[289] Sijbren Cnossen, Modernizing VAT;s in Africa, P. 132

inputs are zero-rated in Anglophone countries while in the Francophone countries they are only exempted.

The Ethiopia VAT legislation treated food items and other non-standard items as exempted similar to the francophone countries.[290] The items that are exempted by the Directives of MoFED in addition to the standard exemption provided by the proclamation are injera, publication and supply of books, fuel gas, animal skins and hides, air tickets, pension fund, agricultural raw materials, medicine, milk, bread, palm oil, wheat, mosquito nets, input for leather, food grain and other cereals, supplies by disabled individuals, and license fees.[291]The above list of non-standard exemptions made by the Ethiopian VAT legislation for basic foodstuffs, agricultural and industrial inputs, and various services are not found in the EU's VAT legislation but are a typical African phenomenon.[292]

V) Businesses Exempt Because of VAT Registration Threshold (Administrative Reasons)

Of the major areas where VAT exemption is reasonability applied, the VAT registration threshold applies to smaller businesses.[293] Despite the disadvantages of exemption, substantial registration thresholds are seriously recommended to avoid the disproportionate administrative and compliance costs small businesses might face.[294]The reasons for the need to exempt smaller and low income businesses below a certain level of threshold are the relatively high compliance and administrative costs incurred by the low income businesses and the regressive nature of these costs.[295] However, there is no exact answer for how much low or high the registration threshold should be. As a result several countries showed much variation regarding the threshold amount. For instance, the registration threshold used by many African countries shows big discrepancies. South Africa (USD 93, 000), Seychelles (USD 245, 000), Zambia (USD 145,000), Djibouti (278, 000), Equatorial Guinea (USD 162, 000) are among those who have set a highest registration threshold,

[290] Ibid
[291] See the Various Circulars at www. Ministry of Finance. Gov. et
[292] Sijbren Cnossen, Supra Note at 44, P. 122
[293] European Commission, A retrospective Evaluation of Elements of the EU VAT System, Institute of Fiscal Studies, 2010, P.19
[294] Ibid
[295] Laura Abramovsky, et al, Redistribution, efficiency and the Design of VAT, A Review of the Theory and Literature, UK Institute of Fiscal Studies, 2017, P. 8

whereas Namibia (USD 20, 000), Uganda (USD 20, 000), Cape Verde, (UAD 2,000), Algeria (2,000), and Egypt (USD 21,000) are countries with the lowest registration threshold.[296]

According to Keen and Mintz, there are three key factors that must be considered while setting the appropriate level of the VAT registration threshold: the revenue that is foregone from excluding firms below a given threshold from the scope of VAT; the administration and compliance costs saved from such exclusion; and the distortions to production, competition and firm growth resulting from such expulsion.[297]Based on estimates of operational costs for developed countries (USD100 for administrative costs and USD500 for compliance costs) given by Cnossen,[298] a VAT rate of 15%, a ratio of value-added to sales of 35%, and a marginal cost of public funds of 1.3, a threshold of USD 40,000 is suggested as an ideal threshold for developing countries.[299]

The Ethiopian registration threshold under the current currency exchange rate is around 21,276 USD which is very low when compared with the above suggested mount and the VAT registration threshold of many other countries.

The Ethiopian VAT Proclamation sets two kinds of registration for VAT. These are mandatory registration and voluntary registration. The VAT registration threshold for the mandatory registration was set originally when The Ethiopian VAT Proclamation was adopted for the first time and was set to be an annual total sales amount of five hundred thousand Birr.[300] In fact, it was recommended to the Government of Ethiopia to make the registration threshold two hundred fifty-thousand Birr.[301] Nonetheless, the recommendation was rejected on the ground of the limited administrative capability to administer it. Later on, in 2019, the government has increased the baseline from five hundred thousand Birr to an annual gross turnover (total sales amount) of one million Birr because of great inflation and the two-decade-long decline in the

[296] Sijbren Cnossen, Mobilizing VAT Revenues in African Countries, Springer, International tax and Public Finance, 2015, PP.1077-1108

[297]Keen, M., and Mintz, J. The Optimal Threshold for a Value-Added Tax, 88 *Journal of Public Economics* 3-4, 2004, PP. 559-576.

[298] Sijbren Cnossen, S, Administrative and Compliance Costs of the VAT: A Review of the Evidence, 8 *Tax Notes International* 25, 1994, PP. 1649-1668.

[299]Keen, M., and Mintz, J, The Optimal Threshold for a Value-Added Tax, 88 *Journal of Public Economics* 3-4, 2004, 559-576.

[300] Ethiopian Value Added Tax Proclamation, Number, 285/2002, Article

[301] Tadese Lencho The Value Added Tax Teaching Material Unpublished,

purchasing power of the Birr.[302]Those businesses whose annual turnover is below one million Birr are not duty-bound to register for the VAT but have the freedom to register if they wish provided that the business regularly supplies more than 75 % of its goods and services to a VAT registered person.[303]The latter qualification is criticized as it discourages the voluntary registration of businesses.[304]

5.3.5.4 Types of Zero Rated Transactions Under the Ethiopian Legislation

A zero-rated transaction is a transaction which is subject to tax at a zero rate, and input tax on purchases attributable to that sale is creditable.[305] When goods or services are zero-rated by the law no output tax is imposed on the consumer and all previous input taxes paid are refunded to the final seller of the goods or services. Under a VAT, a taxable transaction becomes a truly nontaxable only when it is zero-rated, that is, when it is subject to a tax rate of zero so that any VAT imposed on previous transactions is credited at the time of final sale[306]. Zero-rating goods or services means that while no VAT is due on the supply, the supplier remains entitled to claim a tax offset for input tax incurred in making that supply, and therefore may be eligible for a refund of input tax paid.[307]Tait describes zero-rating as the only true way to ensure that goods are provided free of VAT.[308]Zero rating is criticized for being prone to fraudulent claims for refunds and for the high administrative cost of dealing with many nontaxable or negative returns, especially in most developing and transitional countries.[309]

Historically, the country which applied the zero-rate system was the Netherlands. Instead of exempting exports from tax as the original official directive of the EC required the Dutch taxed exports as zero-rated and allowed

[302] Ministry of Finace, VAT Withholding Directive No. 27/2012 effective from 28 June 2019.
[303] Ethiopian Value Added Tax Proclamation, Number, 285/2002, Article 17
[304] Marius Van Oordt, The VAT Under Excess Capacity,: The Case of Ethiopia, 2011, P. 5
[305] Alan Schenk and Oliver Oldman, Supra Note at 2 P. 263
[306] Richard M. Bird and Pierre P. Gerdon, The VAT in Developing and Transitional Countries, 2009, P. 133
[307]Itai Grinberg, Where credit is Due, Advantages of the Credit- Invoice Method for a Partial Replacement VAT, George town tax law review, Vol. 63, 2010, PP 309-361
[308] Alan A. Tait, Supra Note at 37, P. 53
[309] Richard M. Bird and Pierre P. Gerdon, Supra Note at 306, P. 133

the exporter to claima credit the entire tax paid on inputs.[310] Unlike many African countries which provide for numerous exemptions on internal supplies, the Ethiopian VAT has a very limited number of items or transactions that are zero-rated. The following transactions are provided by the Ethiopian VAT Legislation as Zero-rated;[311]

A. The Export of Goods or Services to the Extent Provided in Regulations;

Zero-rating of exports is a common practice by almost all countries of the world. Exports is zero-rated in order to implement an origin-based VAT because exports have to conform to the WTO principles. Zero-rating is used primarily to "border adjust" exports of goods and services to conform to the destination-based taxation principle, and can provide a full refund for VAT paid with respect to a product in earlier stages of production and distribution. Zero-rating an export of goods and services under the destination principle does not mean than those goods and services are getting favorable treatment when they are traded internationally, rather it simply means that exports are consumed outside the jurisdictional reach of the national VAT and therefore should be taxed only in the country of consumption.[312]Hence, it must be understood that zero-rating of exports has a totally different role from the zero-rating of domestic supplies. When supplies made for domestic supplies are zero-rated it means that a supply is favorably treated by completely relieving the good or service from VAT liability. The following three types of transaction are zero-rated to give a preferential treatment over other transactions.

B. The Rendering of International Transport Services

The supply of international transport is the second transaction which is zero-rated from VAT taxes. The zero-rating by the VAT proclamation is described broadly to include both the supply of the transport services themselves and also supporting supplies of goods and services (e.g., selling provisions to shippers or repairing an aircraft). The international transport and related supply of goods and services is zero-rated for the purpose of protecting international transport

[310] Alan A. Tait, Supra Note at 37, P.53
[311] Ethiopian VAT Proclamation number 285/2002, Article 7(2)
[312] Itai Grinberg, Supra Note at 307, PP 309-361

businesses based in the Ethiopia from unfair competition from other countries.[313]

C. The Supply of Gold to the National Bank of Ethiopia;

The purpose of zero-rating of gold to the National Bank of Ethiopia is to prevent national reserves from VAT taxation. Failure to protect the supply of gold to the National Bank may result in taxing the national reserves which would have the effect of deteriorating national reserve.[314]

D. Supply of a Going Business

The other transaction which is zero-rated by the Ethiopian VAT legislation is a supply of a going concern by a registered person to another registered person in a single transaction of substantially all of the assets of a taxable activity or an independent functioning part of a taxable activity.[315] When a working business is sold from a taxable person to another taxable person, the buyer is expected to pay an input VAT. [316]However, the buyer has a right to claim an input credit later on when he supplies goods/services using the working business. This means that the buyer will be entitled to claim back all the input VAT he paid when buying the working business. Nevertheless, the recovery of the input VAT by buyer paid might take several years which might in turn create cash flow problems on him.[317] To avoid this short-term problem, and recognizing that in the long run there is no revenue significance in this kind of sale, the Ethiopian VAT proclamation has provided that such sales or transfers are zero-rated.[318]

5.3.6 Ethiopian VAT Rate versus the VAT Rate of Other Jurisdictions

Ethiopian VAT legislation applies a single standard VAT rate of 15 per cent which makes it better than several African and European countries which used multiple rates. A uniform VAT rate is advised for numerous reasons. It is

[313] Victor Thuronyi, Tax Law Design and Drafting, International Monetary Fund Press, 1998, P. 219
[314] Ibid
[315] Ethiopian VAT Proclamation Number 285/2002, Article 7(3)
[316] Victor Thuronyi, Supra Note at 21, P. 220
[317] Ibid
[318] Ibid

believed that a uniform rate can reduce compliance and administrative rate, minimize the chance for tax evasion and avoidance and avoids distortionary effects on consumer and producer choices.[319] It is also argued that a uniform rate VAT can increase the efficiency of the tax by making the VAT system simple with fewer compliance costs.[320] According to Tait, as the number of rates increase, tax forms become more complicated and the chance of error, on the part of both taxpayer and tax officials, become much greater; the the potential for evasion increases as well.[321]

The Ethiopian VAT rate is below the standard VAT rate of the Sub-Sahara which is around 16.86 % and the average standard rate of European Union which is 20.7%, with three countries – Denmark, Hungary and Slovenia – applying a standard rate of 25%.[322] In Sub Saharan Africa, Djibouti has a lowest VAT rate of 7 %; whereas Madagascar and Morocco have the highest VAT rate of 20 %.[323]

Despite the simplicity of a uniform rate, there are nevertheless counter-arguments in favor of differential VAT rates. For instance, with the exception of Denmark, the VAT rates of most EU member states are differentiated rates. The most common argument raised in favor of varying VAT rates is to save the low income groups from the negative consequences of the VAT rate.[324]In other words, the differential rates promote progressivity. Accordingly, some European Union member countries and several African VAT legislation have implemented differentiated VAT rates.[325]That said, there is a wider consensus that developing countries need to apply uniform rates due to administrative limitations and efficiency reasons. That is why Ethiopia and most developing countries are inclined to standard single tax rates.

[319] Sijbren Cnossen, Modernizing the European VAT, Cesifo Working Papers,(2020), P. 12
[320] Ibid
[321] Allan A. Tait, Supra Note at 37, P. 42
[322] European Commission, A Retrospective Evaluation of Elements of the EU VAT System.
[323] Sijbren Cnossen, Mobilizing VAT Revenues in African Countries, Springer, International tax and Public Finance, 2015 ,PP.1077-1108
[324] Ibid
[325] Ibid

5.3.7 Application of the VAT Rate Under the Ethiopian VAT Legislation

A VAT can be calculated inclusive or exclusive of the rate in the price of the good or service. Normally, the invoice-credit method is calculated using the exclusive method.[326] The application of the VAT-exclusive method is very simple as it is calculated by simply applying the rate to the sales price.

For example, if the price of a pair of shoes is stated as 1000 Birr without the VAT included in it and the tax rate is 15 %, then the amount of VAT tax will be 1000 x 15/100= 150 Birr. On the other hand, if the price of the same pair shoes is 1000 birr with the VAT included, then we need to extract the VAT amount from the 1000 VAT inclusive price with a different formula. In such a case the formula used is by multiplying the VAT inclusive price by 15/100+15. Hence, the VAT amount in the above case will be calculated as 1000x 15/15+100= 130.43 Birr.

As we said above, in principle the VAT-exclusive method is used in the credit-invoice method of the Ethiopian VAT legislation. However, there are exceptional situations in which a VAT-inclusive method might be necessary because of the inaccessibility of these transactions to the VAT-exclusive method. This inaccessibility might occur because of the peculiarity of the transaction or because the transactions were made without imposing the VAT. However, it must be understood that the VAT which is collected using the VAT inclusive method is equal to the VAT collected using the exclusive method. The following transactions are some of the examples that use the VAT inclusive method in practice in the Ethiopian VAT system.

A. **Post- Facto Transactions**: This is the case where a person engages in transactions without registering for the VAT despite being obliged by the law to be registered and collect VAT for the government. Any person whose annual turnover exceeds one million birr and who is engaged in taxable activity for consideration is obliged to register. If he continues supplying goods or services without fulfilling such obligation and the tax authority later discovers this fact, the supplier will be obliged to pay VAT on all the earlier transactions. This is because it is assumed that all his prior sales contain the VAT amount that could have

[326] In fact, sellers have the option to quote prices inclusive or exclusive of VAT though they may need to write down the invoice using the VAT exclusive method.

been withheld and paid to the government. Nevertheless, VAT exclusive method is not possible since the businessman has been selling without issuing invoices and the VAT amount is assumed to be the part of the sales price. The VAT inclusive method will be suited to extract his VAT liability from his total untaxed previous sales.

B. Used-Car Dealing: This is the other transaction which is not accessible to the exclusive VAT method. When used car dealers buy cars from owners, they are not able to obtain invoice since the owners of the car are not registered for the VAT and are not entitled to an issue invoice. However, the dealer is duty-bound to register for VAT and collect VAT as he fulfills the conditions for VAT registration. In such a case, the dealer collects output VAT using the VAT exclusive method. However, the amount of VAT he paid to the owners of the used cars is unknown because of no invoice was issued. This poses difficulty in calculating the net VAT payable to the tax authority. Nevertheless, the used car dealer, just like any VAT registered businessman, has the right to get credit for the input VAT he has paid. Therefore, the input VAT is extracted from his purchase price using the VAT inclusive method. Once the input VAT is extracted using the VAT inclusive method then the net VAT will be obtained by deducting input VAT from output VAT. The above example also can be used to understand the used-car situation.

C. Lottery Sales: Lotteries are distributed from the Ethiopian National Lottery administration to the customers through individual lottery sellers. However, it is inconvenient for the Ethiopian national lottery administration to issue receipts for each lottery sale. Hence, it becomes necessary to include the VAT amount in the total price during the lottery sales and to later on extract the VAT payable to the government from the total sales using the inclusive method.

D. Sale of Telecom Services: telecom service is another kind of supply which is not accessible to the exclusive VAT method. In this regard, it similar to lottery sales. Ethio-telecom sells airtime to millions of its customers throughout the country. The service is provided by selling airtime using access? cards. Thousands of vendors are involved in the sale of the airtime. Hence, issuing invoice for each and every sale and calculating VAT for each sale using the VAT exclusive method is

impossible. Thus, VAT inclusive method is preferred. Ethio-telecom sales airtime by including the VAT amount in the sales price. Once, the total sales amount is collected, and then the VAT that amount that belongs to the tax authority is deducted using the VAT inclusive method from the total sales and paid to the government.

5.3.8 Taxpayer Control Mechanisms Under the Ethiopian VAT Legislation

If the VAT system of a given country is to work well, taxpayer control provisions are mandatory. The methods of taxpayer control include: registration, deregistration, invoice, refund mechanisms (VAT Returns), and taxpayer audit mechanisms. These control mechanisms will be dealt one by one in the following sections.

I. Taxpayer Registration

Registration is one of the mechanisms that help bring a person within the control of the tax authorities.[327]The reason why registration is regarded as a controlling mechanism is because only registered or persons who are duty-bound to register are required to file tax returns. The minimum threshold needed by the law for a mandatory registration, the issues and debates involved while setting threshold limits, and the options for voluntary registration are discussed in the earlier sections of this chapter. We recall that taxable persons whose annual turnover is more than one million Birr are duty-bound to register and those whose annual turnover is less than one million Birr can voluntarily register for the VAT if they supply 75% of their annual supplies to a VAT registered person. A person who is required by the law to register for the VAT has an obligation to collect VAT even if he is not actually registered. The law provides penalties on those who fail to register while they are obliged by the law to register. A person engaged in taxable transactions without VAT registration is liable by Ethiopian VAT law to pay a hundred per cent of the amount of tax payable had he been registered and additional 2,000 Birr for every month to be counted from the date he failed to register.[328]

[327] Alan A. Tait, Supra Note at 37, P. 270
[328] Ethiopian VAT Proclamation Number 285/2002, Article 45

Once the person fulfils the minimum requirements for a registration; the next step is the application for a registration by filling the VAT registration form that is prepared by the tax authority.[329] The tax authority is expected to provide tax forms together with the VAT guidelines. Once the form is filled out and submitted, the authority verifies the details of the form and registers the person as a taxable person. The tax authority issues a registration certificate which contains (a) the full name and other relevant details of the registered person; (b) the date of issuance of the certificate; (c) the date from which the registration takes effect; and (d) the registered person's taxpayer identification number.[330]

The taxable person once registered and provided with a VAT identification number, is obliged by the law to indicate this number on all official documents and communications such as on invoices, tax returns, and so on.[331] This number is used by the tax collecting authorities and by taxable persons themselves to guarantee the proper implementation of an invoice-based VAT.[332] Every invoice is important to the tax authorities wishing to collect the VAT recorded on it and also to any taxable person paying the VAT recorded on the invoice to ensure deduction of the input tax on the invoice.[333]

II. Deregistration (Cancellation of Registration)

A registration is not eternal. Rather, any registered person may cease to be registered if he no longer meets the registration requirements or if the tax authority cancels the person's registration.[334]A taxpayer might be deregistered on one of the three grounds. The first is when taxable person no longer meet the requirements, when the annual sales amount decline and drops below the threshold amount. In such a case a person may apply for deregistration. Once this application is accepted by the tax authority his registration status will be cancelled.

[329] Ibid
[330] Ethiopian VAT Proclamation Number 285/2002 Article 18(3), Victor thuroyni, Tax Law Design and Drafting,(1996),P.185
[331] Ibid
[332] Victor thuroyni, Supra Note at 21, ,P.185
[333] Ibid
[334] Alan Schenk and Oliver Oldman, Supra Note at 2; P. 87

The second ground is when the taxable person no longer engages in a taxable activity. The tax authority may cancel the registration on its own initiative if the person is found to no longer engage in a taxable activity.[335]

The third ground which may result in cancellation is when the person is registered by mistake, in which case the tax authority may cancel the registration.[336]Despite the application of the above three grounds for cancelation of registration in many jurisdictions, the Ethiopian VAT legislation provides only the first ground as the only reason for deregistration.[337]

III. Invoice

A VAT invoice is an invoice, chit, till roll print, or other document that is issued by a taxable person who makes a taxable supply and that records the supply and the amount of VAT payable on it.[338] The issue of invoices in the proper form is an essential part of the procedure for imposing and enforcing the value-added tax in an invoice credit method VAT.[339] It is a crucial control document as it helps establish the tax liability of the supplier and the entitlement of the buyer for a tax credit for the input VAT charged.[340]

The jurisdictions that follow the invoice-credit VAT system in general, and the Ethiopian VAT legislation in particular, provide that only a taxable person who is registered for VAT has the right to issue a VAT invoice and to claim tax credit for an input VAT paid while purchasing only if he presents an input VAT invoice and an output VAT invoice.[341]Moreover, the VAT invoice plays a big role for the purpose of auditing by the tax authority.[342]According to the Ethiopian VAT law, a registered person is required to issue the VAT invoice within five days after the supply is done.[343]An invoice must contain the

[335] Ibid
[336] Victor thuroyni, Supra Note at 21, P. 187
[337] Ethiopian VAT Proclamation Number 285/2002, Article 19(1)
[338] Victor thuroyni, Supra Note at 21,, P. 228
[339] Ibid
[340] Alan A. Tait, Supra Note at 37, P. 279
[341] Ethiopian VAT Proclamation Article, 22(1), see also; Victor thuroyni, Tax Law Design and Drafting, P. 228
[342] Victor thuroyni, Supra Note at 21, P. 228
[343] Ethiopian VAT Proclamation, Article 22(3)

minimum information required by the law. According to the Ethiopian VAT, the following information must be included in the VAT invoice.[344]

(a) Full name of the registered person and the purchaser, and the registered person's trade name, if different from the legal name,

(b) Taxpayer identification number of the registered person and the purchaser,

(c) Number and date of the VAT registration certificate;

(d) Name of the goods shipped or services rendered;

(e) Amount of the taxable transaction;

(t) Amount of the excise on goods subject to an excise tax;

(g) Sum of the VAT due on the given taxable transaction;

(h) The issue date of the VAT invoice, and

(i) Serial number of the VAT invoice.

The Ethiopian VAT legislation seems to have omitted some relevant information that should have been part of the invoice. One bit of necessary information that should have been provided is the date of supply of goods and services when it is different from the date of issue of the invoice.[345] The VAT rate is also relevant information missed by the VAT proclamation.

A taxable person is, in addition to the obligation to issue invoice, also required to keep the record of invoices and other related documents for at least ten years.[346] These documents are;

(a) Original tax invoices received by the person,

(b) A copy of all tax invoices issued by the person,

(c) Customs documentation relating to imports and exports by the person,

[344] Ibid
[345] Alan A. Tait, Supra Note at 37, P.280
[346] Ethiopian VAT Proclamation Number 285/2002 Article 37

(d) Accounting records; and

(e) Any other records as may be prescribed by the Minister of Revenue by the directive.

Failure to keep the invoice is punishable by two thousand Birr for each month that the failure continued.[347]

IV. VAT Returns (Refund Mechanisms)

A VAT return is a formal document on which required information is filled in and submitted to the tax authority at regular intervals whether monthly, bi-monthly, quarterly, bi-annually, or yearly.[348] It is another relevant document which is useful to control and administer the VAT.[349]The existence of a standardized form enable taxpayers to know what is needed from them and to easily comply with their obligations. The Ethiopian VAT, like most VAT legislation, obliges taxable/registered persons to submit a tax return containing the information of taxable transactions and other relevant information at regular intervals.[350]These regular intervals or periods are called accounting periods by the Ethiopian VAT proclamation. Originally, when the VAT legislation was adopted for the first time, the accounting period to submit VAT returns was every month.[351] However, the VAT return submission interval or accounting period is modified by VAT amendment proclamation of 1157/2019. According to this amendment proclamation, two types of accounting periods are provided. For those taxable persons whose annual gross turnover is more than seventy million Birr the accounting period is the end of every calendar month whereas taxable persons whose annual turnover is below the said amount it is every three months.[352]Tax returns usually contain the following information.[353]

[347] Ibid, Article 45(d)
[348] Victor thuroyni, Supra Note at 21, P. 230
[349] Ibid
[350]Ethiopian VAT Proclamation Number 285/2002, Article 26(1)
[351] Ibid ; article 26(2)
[352] Ethiopian VAT Amendement Proclamation number 1157/2019, Article 2(1)
[353] Victor thuroyni, Supra Note at 21, P. 230

- The total VAT collected on all taxable supplies made by the taxable person (output tax) in the VAT period,

- The total VAT paid by the taxable person on supplies made to the taxable person in the VAT period and for which a credit is allowed (the allowable VAT credit or input tax deduction),

- The amount of any bad debts to be set off against output tax in that VAT period, and

- The amount of any excess of allowable input tax over output tax in the previous VAT period that can be carried forward (allowable excess VAT credit or input tax deduction).

V. Taxpayer Audit Mechanisms

A VAT audit is a selective review by the tax authority of the taxpayer's book of accounts and records, including year-end statements, balance sheets, and profit and loss accounts, to ensure that the major areas of purchases, sales, and stocks are significantly accurate**.**[354]The main purpose of the VAT audit is to find out the actual VAT liability of the taxable person according to the law.[355]

5.3.9 VAT Assessment, Payment, Credit, Refund and Carry forward

A. VAT Assessment and Payment

The Ethiopian Value Added Tax Legislation, like the VAT laws of most jurisdictions, follows the self-assessment system of VAT payment.[356] As our country applies the invoice-credit method of VAT calculation, the tax liability of the person is calculated to be the difference between the tax collected on the taxable sales by the taxable person or output tax and the tax paid on purchases or inputs tax by the same taxable person.[357]

[354] Alan A. Tait, Supra Note at 37P. 290
[355] Ibid; P.291
[356] Ibid: P. 284
[357] Alan Schenk and Oliver Oldman, Value Added Tax, Comparative Approach, P. 141: See also The Ethiopian VAT Proclamation No. 285/2002, Article 20(1)

The following example shows how a given commodity is taxed according to the Ethiopian VAT legislation as it passes from manufacturer through to the consumer. The chain of distribution is outlined immediately below:

Manufacturer_____15%_____Wholesaler_____15%_____Retailer_____15 %_____Consumer

Assume that the manufacturer "M" who is registered for the VAT in Ethiopia intends to sale a quintal of sugar at the factory to the wholesaler for a VAT exclusive Price of three thousand (3000) Birr. Hence, M has a duty to impose an additional 15% VAT tax on the price of the sugar before selling it to his buyer and add the tax amount on the sales price. Accordingly, M has to calculate the VAT tax as follows:

Price= 3000

VAT Rate = 15%

VAT tax= 3,000x15/100= 450

Total Price= 3,450 Birr

Wholesaler "W" must pay 3,450 to the manufacturer. "W" has the right and duty to claim an invoice credit of the payment he made to his seller if he wants to request VAT credit on his sales VAT. The 450 birr which is paid by "W" to "M" is called an input VAT. The manufacturer "M" will be duty-bound to pay the whole 450 Birr to the tax authority if he has bought all of his inputs from a person who is not taxable/ tax registered. Wholesaler "W" then intends to sell the quintal of sugar that he bought from M to the retailer" R". Assume that W wants to gain a profit of ten percent from the value of the sugar he bought which will be 3000x10/100=300 Birr. Accordingly, the sales price of the sugar will be 3,300 Birr. Bear in mind that W will not include the 450 birr input VAT on his sales price. Hence, the output VAT will be calculated as follows:

Price= 3,300

VAT Rate= 15%

Out Put VAT Tax= 3300x15/100= 495

Total Price= 3,495 Birr

Here, the total price to be received from the Retailer "R" is 3,495 from which 495 Birr will be the output VAT that will be collected from the purchaser. Nevertheless, "W" will not submit all the 495 Birr the tax collecting authority. Rather, he is expected to pay only the difference between the output VAT and the VAT he has paid to the manufacturer. Hence the VAT "W" is going to pay will be as follows;

Net VAT= Out Put VAT- Input VAT

Net VAT= 495- 450= 45 Birr

Net VAT= 45 Birr

"W" has two invoices namely an invoice he obtained when he bought the sugar and an invoice he issued when he sold the sugar for the retailer.

Now let us further assume that retailer "R" sold the quintal of sugar he bought from "W" to R. "R" has already paid an output VAT of 495 Birr to W when he buys the sugar. Assume that "R" wants to make a profit of ten per cent on his sales to the consumer. The VAT amount and the total price will be calculated as follows.

The VAT exclusive Price will be: 3, 300x10/100=330.

Price= 3,630

VAT rate= 15 %

Out Put Vat= 3630x15/100= 544.50

Total price= 3630 + 544.50=4,174.50

The Net VAT that is going to be paid by "R" for the government authority will be calculated as the difference between output VAT and input VAT as follows.

Net VAT= Output VAT- Input VAT

Net VAT= 544.50– 495= 49.50

Net VAT= 49.50

Hence, "R will pay 49.50 to the tax collecting authority. Bear in mind again that Retailer " R" will have the right to claim the input VAT he paid while purchasing the sugar only if he produce the input and output invoices and if he is a VAT registered person engaged in a taxable activity. In this example, the total tax collected by the government on the quintal of sugar while it passes from the Manufacturer "M" through to the Consumer "C" will be: 450+45+49.5=544.50 Birr.

Once the taxable person assesses the net VAT liability, the next step is to effect the payment to the responsible tax authority, the Ethiopian ministry of revenue in the Ethiopian case.[358] However, payment is not just made at any time, rather the taxable person is expected to make payment of the VAT together with his VAT report, completed assessment forms or returns every three months regularly for those whose annual turnover is below seventy million Birr and, for those whose annual turnover is above seventy million, it is made at the end of every calendar month.[359]Originally, the VAT reporting period was at the end of every calendar month[360], now however, the amendment proclamation number 1157/2019has extended the VAT reporting and payment period to every three months.

B .VAT Credit and Conditions to Claim Credit for Input VAT

One of the basic features of the invoice-credit VAT, including the Ethiopian VAT, is the credit scheme that a taxpayer obtains for the VAT he paid while purchasing the input. The law entitles a VAT registered person reporting taxable supplies to claim input VAT on these acquisitions in order to prevent the cascading of tax attributable to business inputs.[361]For a person to be able to claim tax credit he must first be a registered person or a person who has an obligation by the law to register, second, he must have already paid an input VAT on purchases or imports. Third, he must prove it by input and output invoices. Fourth, he must collect the output VAT in the course of a taxable

[358] Ethiopian VAT Proclamation number 285/2002 Article 26(1)(b)
[359] Ethiopian VAT Amendement Proclamation number 1197/2017 Article 2(1)(a)
[360] Ethiopian VAT Proclamation number 285/2002, Article 26(2)
[361] Alan Schenk and Oliver Oldman, Supra Note at 2 P. 144

transaction. Fifth the supply must be done for consideration and sixth the transaction/item or entity should not be an exempt transaction/entity or item.[362]

C. Treatment of Excess Input Credit (VAT Refund or Carry Forward)

The issues of VAT refund and VAT carry forward arise when the input VAT/credit for the VAT accounting period exceeds the output VAT collected by the taxable person. It is a key characteristic of the invoice-credit VAT that some taxable persons might pay more tax in their inputs than the tax due from their outputs.[363] This happens mostly when a taxable person is engaged in exports or when a taxable person's cost for capital goods is much larger than the current taxable amount of sales.[364] Excess input VAT over output might also occur when the taxable person experiences a loss or when he purchased capital inputs which cost a large amount of money.[365] In this case, there is no doubt that the registered person will not be obliged to pay VAT. However, what about the excess VAT he has paid? Should he bear the loss that arises from the payment of the input VAT by himself? The answer is no. In principle, VAT legislation should put in place mechanisms of VAT refunds for the excess VAT regardless of the nature of the transaction. The excess input tax over output tax should be refunded or carried forward for the next accounting period for failure to do this will result VAT to be a tax on business than a tax on consumption.[366]Nevertheless, providing refunds has not been so easy for developing countries. Almost all developing countries limit the refund mechanism only to exports while other taxable persons are allowed only to carry forward their excess input VATs.[367] Likewise, the Ethiopian VAT legislation follows a double standard in relation to the excess input VAT over the output VAT. Exporters who export at least twenty five percent of their taxable supplies are entitled for a refund of the excess VAT they paid over the output[368], the rest of the registered persons are allowed only to carry forward their excess payments to the next five VAT reporting periods.[369]If the taxable person cannot carry forward the excess input VAT within the five accounting

[362] Ibid: Supra Note at 2: P. 145
[363] Liam Ebrill, et al, The Modern VAT, P. 155
[364] Ibid: P. 155
[365] Alan schenk and Oliver Oldman, Supra Note at 2, P. 167
[366] Alan A. Tait Supra Note at 37, P. 285
[367] Liam Ebrill, et al, The Modern VAT, Supra Note at 48, P. 157
[368] VAT Proclamation Number, 285/202, Article 27(1)
[369] Ibid : Article 27(2)

period, he will be entitled for a refund of the remaining amount within two accounting periods.[370]

Summary

Despite controversies on their relevance and drawbacks, consumption taxes have already been taken by several tax jurisdictions as good alternative sources of revenue for their respective governments. Among the various types of consumption taxes, VAT has become the major source of revenue in most countries. Despite its recent development, the revenue-generating capacity, neutrality, and efficiency have enabled it to reach all corners.VAT is not without any disadvantage however, like any other tax, VAT has its own limitations. Nevertheless, more than one hundred sixty governments have preferred it with its limitations and implemented it. Ethiopia adopted VAT in 2002 with the help of international financial institutions. Even though there are at least three types of calculated VAT the widely applicable one is the credit invoice method. This method uses invoices to calculate the VAT liability of the taxpayers. According to the Ethiopian VAT law individuals whose annual turnover is more than one million birr must register for VAT though those whose turnover is below the said amount might register voluntarily. However, registration is not sufficient for a person to be obliged to collect tax. To be VATable, there must be a supply of goods and services' by a registered person; and the supply must be a taxable activity that is it must be a regular and continuous activity, and the supply must be for consideration and finally it must be in Ethiopia. If all these conditions are fulfilled the transaction is subject to VAT.

However, not all supplies by registered persons are taxable since there are transactions that are exempt and zero-rated for various reasons. While exempt transactions are only freed on out puts zero-rated transactions are freed from tax on out puts and inputs are credited.

Just like any tax law, the Ethiopian VAT legislation provided the taxpayer control mechanisms. The methods of taxpayer control include: registration, deregistration, invoice, refund mechanisms (VAT Returns), and taxpayer audit mechanisms. The Ethiopian Value Added Tax Legislation, like the VAT laws

[370] Ibid : Article 27(2)

of most jurisdictions, follows the self-assessment system of VAT payment. As our country applies the invoice-credit method of VAT calculation, the tax liability of the person is calculated to be the difference between the tax collected on the taxable sales by the taxable person or output tax and the tax paid on purchases or inputs tax by the same taxable person. The tax payer is entitled to tax credit when he shows to the tax authority the two invoices. If the input VAT is more than the output VAT he will be entitled to tax refund.

Review Questions

1. Explain why the Value Added Tax is preferred over its predecessors
2. One of the mechanisms used by many VAT jurisdictions to reduce its progressivity is applying exemptions and zero-rating. However, exemptions and zero ratings are criticized for distorting the economy and making the tax system complex and inefficient. Discuss these problems with illustrations.
3. One of the procedures that need to be fulfilled by the taxpayer in relation to VAT is that they must register. Explain the procedures in detail of how registration takes place and the effects of failure to register
4. The VAT calculation method that obtained wider application throughout the world is the credit invoice method. Discuss with illustrations how this method works and the reason why it got wider acceptance and preferred from other methods.
5. Discuss the advantages and disadvantages of standard VAT rate and reduced rate.
6. Explain the taxpayer control mechanisms used by the tax authority to monitor the taxpayers.
7. List and explain all the conditions that must be fulfilled by any domestic transaction to be subjected to VAT according to the Ethiopian VAT law.
8. Discuss the rule of reverse taxation and when it is applied.

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Chapter Six

The Turnover Tax Law in Ethiopia

Introduction

This chapter is somewhat a direct extension of chapter five. The two chapters cover very similar topics. Turnover tax is a tax that has a tremendous resemblance to VAT since both are categorized under the consumption tax group. Besides, they are similar for they are imposed on transactions when goods and services change hands. However, the way the two taxes are calculated, the individuals who need to register for payment, the tax base on which they are imposed the rate of tax applied etc. is different. That is why they are discussed in different chapters. In this chapter, we will discuss the meaning and nature of the turnover tax, its similarity and difference with other indirect/consumption taxes, transactions that are exempt, businesses that must register for turnover tax and its scope and the method of assessing it.

6.1 Meaning and history of Turnover Tax in Ethiopia

Turnover tax also known as cascade tax is a tax that the government imposes on certain goods and services at every stage of production and transaction.[1] What makes turnover tax different from value-added tax is that it is imposed on gross receipts rather than on the value-added. Moreover, turnover tax does not have an input credit mechanism. It is also different from retail, manufacturers or wholesalers sales tax, which are all single-stage taxes, because of its multistage nature.

By their nature turnover taxes are cascading as a tax is imposed at each stage of the transaction without the credit mechanisms imposed on inputs. This tax is usually regarded as a presumptive kind of tax used by developing countries, such as Ethiopia, for its simplicity though accuracy might be affected.[2]Turnover tax is usually taxed a very low rate compared to most taxes, and it is calculated

[1] Jason Gordon https://thebusinessprofessor.com/en_US/accounting-taxation-and-reporting-taxation/cascade-tax-definition; last Accessed on 27/12/2021: Barend defined turnover tax as a tax calculated and payable on a taxable turnover of the registered small and micro businesses by applying the relevant tax rate.[1] Zee also defined turn over or cascading tax as a multi-stage general tax which is imposed at various stages of the production to distribution chain.

[2] Barend Lindeque, Turn over tax: Is it good to be true for micro- Business in South Africa? An Exploratory Study; Available a thttps://repository.up.ac.za/bitstream/handle/2263/30665/Lindeque_Turnover_2012.pdf?sequence=3&isAllowed=y, last accessed on 27/12/2021

on gross income without any deduction.[3]What makes turnover taxes different from value added taxes is that they do not account for taxes already paid, with a new tax being collected at each stage of transaction.[4]

In Ethiopia Turnover tax was introduced for the first time in 1963 by expanding the already existing specific sales tax. That tax was levied only at the manufacturing level into the wholesalers and retailers' level.[5] Since then, cascading turnover tax continued as a major indirect tax in Ethiopia until it was eliminated in 1993 and replaced with a single stage sales tax.[6] However, after ten years of its absence from the Ethiopian tax system, it was reinstituted again in 2003 as a supplementing tax to the newly introduced Value Added Tax to be applied for small businesses.[7]

The Value Added Tax, as in other countries, was introduced in the Ethiopian tax system to curb the bad effects of the turnover tax.[8] When compared to the turnover tax, VAT has several advantages.[9]The VAT avoided (1) the cascading effect or a tax on tax effect of the turnover tax, (2) the distortion on the production and consumption choice of the economy and consumers, (3) the unpopularity of the burden of the turnover tax, and (4) the anti- investment and anti-growth aspects of the turnover tax.[10]Besides avoiding the side effects of turnover tax the VAT discouraged of the vertical integration of businesses and it minimized tax avoidance schemes.

Despite the adoption of VAT by several countries, collecting VAT on all businesses, small and big, has been impossible due to administrative limitations especially for the governments of developing countries. Of course originally, the dominant view among tax experts was to make sure that all potentially taxable transactions are caught in the fiscal net by lowering the VAT threshold

[3]KIPPRA, Tax Compliance Study. Tax Policy Unit, Macroeconomics Division, Kenya Institute of Public Policy Research and Analysis, Nairobi,(2004)

[4]Kimaru Thairu, Adoption of Turn over tax in Kenya: A snapshot of Small and Medium Enterprises in Gikomba Market, Nairobi Kenya, International Journal of Social Sciences and entrepreneurship Vol.3, Issue 1, (2014), P.18-30

[5]Proclamation to Provide for Payment of Transaction Taxes, 1963, Proclamation. No. 205, Negarit Gazette, 22nd year, No. 18

[6] Sales and Excise Tax, 1993, Proclamation number 68, Negarit Gazette, 52nd year, No. 61

[7] Federal Democratic republic of Ethiopia Turn Over Proclamation Number 308/2002, Page2024, number 21, 9th year,

[8] Alan A. Tait, Value Added Tax, International Practice and Problems, P. 9

[9] Cnossen Modernizing VATs in Africa, P 1

[10]Sijbren Cnossen Modernizing VATs in Africa,(2019), P. 1

as low as possible and even to the elimination of any threshold.[11]However, gradually it became much clearer that the cost of lowering the threshold is higher than the revenue gain due to the regressive nature of the VAT compliance cost and administrative cost.[12]

As noted in the preceding chapter, almost all countries provide registration thresholds that vary by country in order to determine businesses which are to be excluded from VAT.[13]Ethiopia provides a VAT registration threshold of one million Birr annual gross sales (originally the registration threshold was five hundred thousand Birr) for businesses to mandatorily be registered.[14]Those businesses whose annual turnover is below the threshold are not duty bound to register for or to collect VAT. Nevertheless, the registration of some businesses while leaving others out of the scope of VAT might raise equity issues and distort the economy.

Some countries simply exempted businesses below the VAT threshold from sales-based taxes altogether. Other countries, such as Ethiopia, introduced simplified taxes such as a turnover tax to fill the gaps created because of the registration threshold.[15]The turnover tax was enacted as a necessary evil with all its drawbacks.[16]

6.2 Scope of the Turnover Tax

All persons who are not registered for VAT and who supply goods and render services except exempt supplies have an obligation to register for and pay turnover tax.[17]As we explained earlier, businesses who do not register, who do not have to register for VAT because their annual gross sales is below one million Ethiopian Birr, or those who do not register voluntarily even if their

[11] Richard M. Bird and Pierre Pascal Gerdon, The VAT in Developing and Transitional Countries, P. 115

[12]Keen, M., and J. Mintz (2004) "The Optimal Threshold for a Value-Added Tax," Journal of Public Economics,88(3/4): 559–76.

[13] David Philips and Lucie Gadenne, The Impact of VAT and turn over Taxes on firms' Supply Chain Choices: Evidence From India, IFS Briefing Note BN 231,

[14] Ethiopia VAT Amendment Proclamation of number 1197/2019

[15] David Philips and Lucie Gadenne, The Impact of VAT and turn over Taxes on firms' Supply Chain Choices: Evidence From India, supra note at 13

[16]John F. Due and Ann F. Friedlaender, Government Finance, Economics of the Public Sector, 2002, pp. 415-416; Cited inn Tadesse Lencho, Legislative history of modern taxes in Ethiopia,(1941-2008)

[17]FDRE, the Turnover Tax, 2002, Proc. No. 307, Federal Negarit Gazeta, 9th year,No. 21

annual gross sales is below one million have an obligation to register for and collect turnover tax.[18]

For a person to be a taxable person, conditions that are applicable for registration to VAT, except the registration threshold, are also applicable for turnover tax. In fact the law is not as explicit as it is in the VAT. The turnover proclamation defines the term "taxable transaction" in the definitional part of the proclamation but does not use it in the body and the law and does not require "taxable activity" as a precondition. The law simply provides that a person who sells goods and services has an obligation to collect turnover tax.[19]It is not clear why the law defined the term "taxable transaction" if it does not use it as a condition from a person to be a taxable person. From the law, it is not clear if anybody who sells goods and services has an obligation to collect turnover tax or if the person should be engaged in a continuous and regular activity to be taxable. The plain meaning seems to connote that anyone who sales goods and services is liable to collect and transfer tax to the government.

Nevertheless, it is unjustifiable to oblige any casual non regular sales by a person to collect turnover tax and free him from value added tax. If casual sales do not attract VAT, for a stronger reason, it should not attract turnover tax. Hence, it would make common sense that a person must be engaged in a taxable transaction, i.e. an activity which is continuous and regular, so that he will be obliged to collect turnover tax.

Therefore, just like the registration for VAT (except the one million Birr threshold), those who must register for and collect turnover tax are those who;

- Supply goods or render services
- are engaged in a taxable transaction
- receive consideration for their supplies
- supply the goods or services in Ethiopia or partly in Ethiopia

6.3 Rates of Turnover Tax

Unlike the value added tax which applies a single uniform rate, turnover tax has two different tax rates. Goods and services are treated at different tax rates. While all sorts of goods are taxed at two per cent (2 %), services are taxed in

[18] FDRE, the Value Added Tax, 2002, Proc. No 285, Federal Negarit Gazeta, 9th year, No. 21
[19]FDRE, the Turnover Tax, 2002, Proc. No. 307, Federal Negarit Gazeta, 9th year,No. 21

two alternatives ways.[20]The services rendered by contractors, grain mills services, rentals of tractors, and combine harvesters are taxed at two percent (2%) whereas all other services rendered locally are taxed at the rate of ten per cent (10 %).[21] The base used to apply the tax rates is the gross receipt or turnover received by the turnover tax registered person.[22] Unlike the VAT whose base is the vale added only, the base of turnover tax is the total price of the goods or services.

6.4 Exempted Transactions

The transactions which are exempted by the turnover proclamation are identical to the transactions which are exempted by the VAT legislation. The standard exemptions provided by the turnover tax proclamation similar to the VAT proclamation include the used dwelling, financial services, educational services, health services, religious services, prescription drugs, humanitarian services, supply of books, transport services, electricity, water, kerosene, supply by the disabled individuals, supply of currency and license fees.[23]In addition to the standard exemptions, the items that are exempted from turnover tax by the directives of MoFED include injera, publication and supply of books, fuel gas, animal skins and hides, air tickets, pension fund, agricultural raw materials, medicine, milk, bread, palm oil, wheat, mosquito net, input for leather, food grain and other cereals, supplies by disabled individuals, license fees.[24]

6.5 Assessment, Filing of Return and Payment of the Turnover tax

In principle, any businessman who is not registered for VAT has a duty to assess his tax liability by himself**.** Indeed, he is expected to assess his tax liability, to prepare a turnover tax return and to make a payment together with the submission of the turnover tax return. Nonetheless, the tax assessment of the category "C" taxpayers, who are not required by the law to keep books of account, is made by the tax authority based on a presumptive taxation using the total gross sale amount of the income tax.[25]The taxpayer must submit his tax return and the tax amount to the tax authority within a month by the end of

[20]Ibid
[21]Ibid
[22]Ibid
[23]Ibid
[24] See the Various Circulars at www. Ministry of Finance. Gov. et
[25]FDRE, the Turnover Tax, 2002, Proc. No. 307, Federal Negarit Gazeta, 9th year,No. 21

every accounting period.[26] The law has provided varying accounting periods for the different categories of taxpayers. For category "A" taxpayers whose annual gross sale is more than one million birr the accounting period is every month, for category "B" taxpayers whose annual gross sale is between five hundred thousand and one million birr it is every three months and for category "C" taxpayers it is every year.[27]

Turnover tax is based on a self-assessment system. This does not, however, mean that whatever the amount assessed by the taxpayers is acceptable by the tax authority.[28] There are cases in which the tax authority might reassess the tax liability of the taxpayer. These are when the books of account prepared by the taxpayer are unacceptable, when the amounts of tax are understated, if the taxpayer fails to submit his tax amount, and if no book of account or other supporting documents are maintained. In such situations, the tax authority can make official assessment taking the relevant and available information and taking the fair market value of the sales that are understated by the taxpayer.[29]

Summary

Turnover tax is a cascading tax that is applied on the gross receipts of goods and services when they change hands. It is one of the oldest taxes that were used in different countries starting from the ancient times. Nevertheless the popularity of turnover tax has been declining due to its bad effects on the economy like distortions, cascading effects and burden on the consumers. Even though it is abandoned in many jurisdictions, it still exists in some countries as a supplementary tax to other types of taxes such as retailer's sales tax and the value added tax. In Ethiopia too, turn over tax is provided as an alternative tax for those who are not required to register for VAT. This is due to the fact that all businesses cannot be registered due to administrative limitations. Currently Category C taxpayers whose annual turnover is below the VAT threshold are expected to register for turnover tax and to collect from the buyers at each stage of the transaction using two types of tax rates depending up on the type of the good or service.

[26]Ibid
[27]Ibid
[28]Ibid
[29]Ibid

Review Questions

9. One of the criticisms on Turnover tax is that is has a cascading effect. Discuss how cascading happens in relation to turnover tax
10. Elucidate why turnover tax still existed in Ethiopia despite its harsh consequences such as its cascading nature.
11. Discuss which businesses in Ethiopia are required to register for turnover tax and the reporting period
12. Expound the tax rates provided by the turnover law of Ethiopia and their effect when they are used combined with VAT registered individuals

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Chapter Seven

Excise Taxes Law in Ethiopia

Introduction

Excise taxes are a type of consumption or indirect taxes.[1] Unlike general consumption taxes such as VAT and ToT, excise taxes apply to a few goods and services; in other words, they are selective in coverage.[2] They are imposed on the consumption of specifically listed items. Even though the taxes are mainly imposed on goods, there are cases whereby the scope of the taxes is also extended to services.[3] The administration of excise taxes is simple. The taxes are applied on limited types of goods and services and the computation of the excise tax liability is not complex. These features give rise to the administrative simplicity of excise.[4] Their enforcement does not require much resources and time from the tax administration. Excise taxes are not imposed with the only intent of revenue-raising; there are other objectives of excise taxes that are deliberately discriminatory in their intent.[5] As will be discussed in detail below, excise taxes are intended to bring about certain behavioral changes in taxpayers. Hence, the taxes violate the neutrality principle of taxation. Alcoholic beverages, tobacco products, petroleum products, and automobiles are the common goods that are subject to the tax, whereas wagering, sports betting, advertisement, brokerage, and internet use of social media are examples of excisable services. The design of excise tax involves a combined use of specific and ad valorem rates for the determination of the required tax liability. For some excisable goods, the tax is measured in terms of physical characteristics of the tax base, such as weight or quantity, while for others a certain percentage of the value of the tax base, i.e. a percentage of the price.[6]

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[1]The etymological definition of the word 'excise' is derived from the Latin word 'excisere', which means to carve or to cut out. Others attach the word to the Dutch word 'exijs', which in turn derived from the old French 'assise', meaning session, settlement, or assessment. Ben J.M. Terra, Excises, in Victor Thuronyi, (ed.), Tax Law Design and Drafting, volume 1, International Monetary Fund: 1996, p. 250

[2] Sijbren Cnossen, Economics and Politics of Excise Taxation, in Theory and Practice of Excise Taxation: Smoking, Drinking, Gambling, Polluting, and Driving (Edited by Sijbren Cnossen), Oxford University Press, 2005, p.2

[3] Supra note 1, p. 250

[4] Ibid

[5] Supra note 2, p.2

[6] Victor Thuronyi, Comparative Tax Law, Kluwer Law International, 2003, p. 328

In the history of taxation, excise taxes are regarded as one of the oldest forms of tax. Around 3000 B.C, ancient Egypt had an excise tax that was levied on oil and beer. [7]Around 207 B.C.– A.D. 220, there were excises levied on tea, liquor, fish, and reeds used for fuel and thatching in the Han dynasty of China.[8] In the 16th century, Holland developed and applied excise taxes on beer, sugar, salt, spirits, and other goods. From the 16th to the 18th centuries, excise taxes spread to other European countries and the USA, a former English colony.[9] The introduction of excise tax in developing countries was a later phenomenon. Influenced by the policies of colonial powers, the beginning of the domestic production of goods significantly reduced the importation of goods from foreign countries. Excise taxes were introduced in the developing countries to become a major source of revenue as customs duties had fallen because of the reduction in imports caused by domestic production.[10] Since the 20th century, there has been a sizable growth in income tax and value-added taxes around the world. This change brought the reduction of the share of excise taxes as a source of tax revenues. Still, governments are collecting meaningful excise tax revenues from items, such as vehicles, petroleum products, tobacco products, and alcohol.[11]

In the design of excise tax legislation, drafters should provide clear rules on the following issues:[12] (1) the types and definition of goods and services subject to excise tax, (2) the identity of the persons (taxpayers) that are responsible for collecting the tax, (3) the time that when the tax is to be collected, (4) technical issues such as withdrawal of goods from the warehouse, and how to deal with leasing, exempt purchasers or uses, (5) the excise tax effects of returns, lost or damaged goods, exporter's refunds, and (6) issues related to effective dates, such as how to treat floor stock at the time of the imposition, termination, or change in the rate of a tax.

So far, we have seen the essential characteristics, general history and design considerations of excise taxes. The remaining parts of this chapter will focus on

[7] Ulrik Boesen, Excise Tax Application and Trends, Tax Foundation, p. 3
[8] Supra note 1, p. 250
[9]John Fitzgerald Due, Excise Taxes, Policy research working Papers, Volume 1251, World Bank Publications, 1994, p. 2
[10]Ibid, p. 3
[11] James R. Hines Jr., Excise Taxes, The New Palgrave Dictionary of Economics (pp.4156-4159), 2018, p. 4157
[12] Supra note 1, p. 250

the objectives, and types of excises taxes. It will also explain the history of excise taxes in Ethiopia. A significant part of the chapter is devoted to discussing and assessing the current excise tax proclamation of Ethiopia. The taxpayers and goods covered by the proclamation, the excise values and rates, and the excise tax assessment and collection techniques will receive due attention. There will be an explanation on the controlling mechanisms introduced by the proclamation. At the end of the chapter, you will get a summary, and review questions.

7.1 Why Excise Taxes?

There exist different types of excise taxes. Each type of tax targets a different set of excisable goods and services. This leads to the existence of more than one objective for the imposition of excise taxes. The levying of excise taxes is justified on different rationales or objectives which may sometimes contradict each other. Excise taxes that are primarily designed to discourage consumption differ from those excise taxes whose primary aim is revenue generation. Like other types of taxes, excise taxes involve a trade-off among different objectives. Governments should address the trade-off problems in designing excise tax systems. The following are the common objectives for the imposition of excise taxes.[13]

1. Revenue Generation: Governments use excise taxes, just like other taxes, to raise money for their expenditure. There are excise taxes that have no purpose other than raising revenues for the governments. Some excise taxes collected from the conventional excisable goods, such as alcohol and tobacco products, are collected for tax revenue though they have also other specific objectives. Some goods are not excisable per se but are included in the list of goods subject to excise taxes. In the USA, excise taxes were imposed on telephone services to solve budget deficit problems.[14] Cotton and textile products have remained excisable goods in Ethiopia for a long period. The extension of the excise taxes on such goods cannot be justified on other objectives of excise taxes than that of raising revenue.[15] These types of

[13] William Mccarten and Janet Stotsky, Excise Taxes, in Parthasarathi Shome (editor), Tax Policy Handbook, International Monetary Fund, 1995, p. 100. See also Supra note 11, p. 4157
[14] Bruce F. Davie, Tax Expenditures in the Federal Excise Tax System , National Tax Journal , Vol. 47, No. 1, March, 1994 , p. 42
[15] Taddese Lencho, Towards Legislative History of Modern Taxes in Ethiopia (1941-2008), Journal of Ethiopian Law, Vol. XXV No. 2, pp. 132-133

excise taxes are called revenue excise taxes. Their existence is justified only on the ground of revenue-raising.[16]

Even though general sales or consumption taxes have great revenue potential, excise taxes can also produce a significant amount of revenue. In developing countries, the enforcement of general consumption taxes is adversely affected by weak tax administrative capacity and tax evasion. These challenges have led the countries to aggressively collect significant revenues from excise taxes.[17]

The imposition of excise taxes on demand inelastic products is driven by the revenue needs of states. Products like tobacco, petrol, alcohol, and salt do not have substitutes that consumers would find equally satisfactory. People always demand and consume them despite their prices being increased due to taxes and other reasons. According to Sijbren Cnossen,

> *The absence of close substitutes for addictive or indispensable products, such as tobacco, alcohol, and energy, implies that the demand for them is inelastic. In turn, this means that the potential for distortion of economic decisions by the imposition of excise duties is relatively small.*[18]

Hence, excise taxes on demand inelastic products are sustainable sources of revenue for governments.

2. Discouraging the Consumption of Undesired Goods: Governments may use excise taxes to discourage some products that are designated as harmful or detrimental to society.[19] Tobacco and alcoholic products are the usual examples of these products. Excise taxes on alcohol, tobacco, and carbon are usually justified to discourage their consumption. The excise taxes act as a deterrent tool for discouraging people, including the users, from producing and consuming the products. Taxes that are designed to discourage consumption are often colloquially called sumptuary or sin taxes.[20] The taxes induce the producers and consumers to reduce their engagement with the goods by increasing their cost (prices). The effectiveness of excise taxes in

[16]Supra note 9, p. 3
[17] Supra note 13, p. 100
[18]Sijbren Cnossen, The Economics of Excise Taxation, International Studies Program, Working Paper 10-18, May 2010 p. 3
[19] The ITEP Guide to Fair State and Local Taxes, p. 21
[20]Supra note 7, p. 4

reducing the consumption of harmful products is not straightforward. There are mixed responses to the issue. Some studies find out the taxes are effective while others are not. In one article, it is stated

> *"Cigarette consumption, for instance, has been steadily declining as a result of increased awareness of*
> *tobacco's negative health effects, as well as the higher prices created by cigarette excise taxes"*[21]

On the other side, we do find the following conclusion.[22]

> *" Because many of the goods and services taxed by sumptuary excises have relatively*
> *inelastic demands, these taxes may have only a limited impact on curtailing consumption."*

3. Correcting Negative Externalities: The production or consumption of some goods, such as vehicles, fuels, alcohol, and tobacco products, bring harmful side effects on third parties (or the society in general). For instance, vehicles benefit their users by transporting them from one place to another. But, vehicles also create negative externalities or social costs for non-users. They create environmental pollution or climate change, which is a good example of negative externalities, by emitting gases. They also generate noise pollution. Smoking cigarette poses a health problem for non-smokers. This is the other instance of negative externality generated by the user of the product (smoker).

   Governments impose excise taxes on these products with on objective of internalizing the negative externalities that are created by the use of such products.[23] These types of excise taxes are called Pigouvian taxes. Named

[21] Supra note 19, p. 23

[22] J. Fred Giertz, Excise taxes,(…) p. 133

[23] Supra note 13, p. 100. Let assume that there is a factory that produces some consumable goods. The smoke at the factory pollutes the air. The pollution creates a health risk to the society that breaths the air. The pollution of the air is a cost of production. But it is not included in the price of the product to clean the air. The pollution is shifted to the society. This is called negative externality. Since the cost of air pollution in not included, the price of the product is low. This leads the consumers to purchase and producers to produce more products. More air will be polluted. The reverse would happen if the cost of production (air pollution) is included in the price of the product. The imposition of excise tax on the product reflects the full cost of production of the product because it includes the cost of pollution. It also makes the factory pay

after the British economist Arthur C. Pigou, Pigouvian taxes refer to those taxes that are imposed on goods and transactions that create the social cost of negative externalities. The excise (Pigouvian) taxes are used as a tool for government intervention to resolve the problem of negative externalities. Governments may spend the excise tax revenues on correcting the negative externalities. The taxes act as a way of raising revenues to compensate those people (including the user) that are harmed by the externalities.[24] For example, the excise tax revenue collected from vehicles and petrol may be used to rehabilitate the environment. In designing excise taxes that are imposed on goods with effects of negative externality, Pigou suggested that the size of the excise tax should be equal to the cost of the negative externality. The tax rates should be set at the level that is adequate to raise revenues to cover the costs of internalization of the externality. For example, the excise tax rate on tobacco should enable the government to cover the health costs related to smoking. The same is true for fuel/petroleum excise tax rates to raise funds for infrastructure costs associated with driving. Pricing the negative externalities is a major challenge in the design of Pigouvian-excises taxes. It is difficult to measure the amount of the costs of the negative externalities.[25]

The interplay between Pigouvian and Sin taxes needs to be made clear. The main rationales behind the Pigouvian and Sin taxes are internalizing the externality and discouraging consumption respectively. Due to the differences in their objectives, Pigouvian and Sin taxes are not always the same. Compare the following. Excisable products like tobacco and alcohol generate negative externalities and they are also treated as undesirable or harmful products. Hence, the taxes on these products are both Pigouvian and sin taxes. Wagering or sports betting does not have negative externalities, but wagering is subject to excise tax. This case demonstrates that a sin tax may not necessarily be a Pigouvian tax. Though driving a car is not a harmful activity in general, it generates negative externalities in the form of environmental pollution. So, Pigouvian taxes may not always be sin taxes.[26] Despite the imposition of the sin taxes, people may continue to consume harmful products. If such products

for the full cost of production. The tax will influence the factory to reduce its production thus reducing the level of pollution. In this case, the excise tax internalizes the externality.

[24]Supra note 9, p. 3

[25] Supra note 7, p. 4

[26] Ibid, p. 4

generate negative externalities, it is necessary to make the taxes internalize the externalities (making the taxes both sin and Pigouvian taxes).

4. Improving vertical equity: It is a common practice to levy excise taxes on luxury goods, such as luxurious automobiles and jewelry. The purchase of such items reflects the ability-to-pay of persons. The imposition of excise tax on luxury goods is justified on the ground that the purchasers are high-income earners and hence they should pay more taxes than the low-income earners. In developing countries, the excise tax on luxury goods rests on other objective-discouraging people from spending their money on luxury (non-productive, undesired) goods.[27]
5. Benefit-Received Purpose: In some cases, excise taxes may be used as a means to raise revenues for the specific benefits of the taxpayers. The taxes are imposed for the benefit of the persons that paid the excise taxes. The tax burden falls on those persons that are particularly benefited from government services financed by excise taxes. It is argued that excise tax revenues collected from tobacco, alcohol, fuel, and related items should be earmarked to finance health expenditure, repair the degradation of the environment, and pay for the building and maintenance of the road transport system.[28] The current excise taxes of Ethiopia generally are not earmarked taxes. An exception to this observation is the Highway Renovation and Road Taxes of 1948 which were introduced as earmarked taxes to raise revenues for the construction and maintenance of highways.[29]

In the literature on public finance, three economic justifications are advanced in support of levying excise taxes.[30] Though it is difficult to apply the economic justifications as common justifications for all types of excise taxes, they properly indicate rationales behind some types of excise taxes. For a multifaceted understanding of excises taxes, the traditional economic justifications are presented as follows.

1. The Ramsey Rule: The Ramsey rule holds that excise taxes should be imposed on demand inelastic products to minimize the social costs or

[27]Supra note 9, p. 3
[28]Supra note 18, p. 20
[29] Supra note 15, pp. 130-131
[30] William F. Shughart, II, editor, Taxing Choice: The Predatory Politics of Fiscal Discrimination. New Brunswick, NJ and London: Transaction Books, 1997, pp. 13-14

burden of the main taxes, such as income and general sales taxes, on the general public. The demand for goods like tobacco and alcohol remains unchanged regardless of the change in their cost or price. People that consume these goods will continue to purchase them even though the purchasing price changes (increases). So, it is justified to levy an excise tax on such products because doing so does not discourage consumption or will not result in reducing demand very much. If a government wants to raise more revenue with the least social cost or opposition, it should impose high excise tax rates on those goods that are demand inelastic. It is held that the Ramsey Rule is the reason for placing heavy excise taxes on alcohol and tobacco.[31] The Rule has been reflected in excise tax legislation. The past, as well as current excise tax proclamations of Ethiopia, have explicitly mentioned the importance of levying excise taxes on those basic goods which are demand inelastic.[32]

The Ramsey Rule is criticized on the following count. Governments impose sin taxes intending to discourage the consumption of harmful products like tobacco and alcohol, however, the Ramsey Rule does not give recognition to this regulatory purpose of the sin tax.

2. Benefit Principle (User fee): This justification is advanced in support of those excise taxes whose revenues will be spent for the sole benefit of the taxpayers. The only people who pay the excise taxes are the ones who use the service funded by the revenues collected from the taxes.[33] In the USA, gasoline excises taxes are used to raise revenues for the maintenance of highways. This is an example of an excise tax that is based on the benefit principle of tax.
3. Correcting negative externalities: Excise taxes should be imposed on those goods that generate negative externalities. In such circumstances, the taxes play two roles. First, they serve as a penalty to discourage users of the goods from producing negative externalities. Second, the taxes act as a way of raising revenues to compensate those non-users that are harmed by the externalities.[34] Robert W. McGee offers us the following example.

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[31] Robert W. McGee, The Philosophy of Taxation and Public Finance, Kluwer Academic Publishers, 2004, p. 231

[32] See Preambles of Excise Tax Proclamation (Proc. No. 307/2002), Excise Tax Proclamation (Proc. No. 1186/2020)

[33] Supra note 31, p. 231

[34]Supra note 9, p. 3

"…. when someone purchases cigarettes, he pays only for the cost of the cigarettes, not for the cost of curing or treating his cancer, which will not be incurred for a few decades. When someone buys an alcoholic beverage, the price he pays reflects merely the cost of providing the product, including some profit margin. It does not include the cost of providing alcohol abuse facilities. Thus, the total cost is not captured in the selling price, so excise taxes have to be increased to make up the difference."[35]

7.2 Types of Excise Taxes

Based on the method of assessment of the tax liability, excise taxes could be categorized as specific taxes and ad valorem taxes.[36] There are two methods for the computation of excise tax liability. One is to determine the tax based on a physical unit of measurement of the excisable goods, such as their weight, length, or volume. The other is to compute the tax as a certain percentage of the value or price of the excisable goods.

To illustrate: If 1 Birr of the excise tax is imposed per 1 pack of cigarettes, this type of excise tax is a specific tax. If the amount of excise tax is equal to 10% of the value of the excisable good, such as automobiles, then this is an example of ad valorem tax. Both methods have their pros and cons. For example, the computation of the tax based on the physical attributes of the good is easy to administer as the attributes can be easily observable by tax officers. However, the method may become inequitable as more excise tax could be imposed on large numbers of cheap goods than on small numbers of expensive goods.

On the other hand, the determination of the excise tax based on an ad valorem basis (the value of the goods) makes the tax system more productive and equitable. Since the tax liability is a certain percentage of the value of the goods, the tax base would not be affected by inflation. The method, which is particularly important in countries with high rates of inflation, allows for knowing and collecting the real value of revenues from excise taxes. It is also equitable as the economic value of goods is presumed to be an appropriate determinant of tax liability.

However, the determination of the value of the good is not always simple. It involves complex processes. There is room for subjective assessment of the goods and this leads to either undervaluation or overvaluation of prices. In the

[35] Supra note 31, p. 235
[36] Supra note 11, p. 4157

design of excise tax legislation, the choice of the computation methods requires the balancing of different trade-offs. The purpose of the excise tax, the nature of excisable goods, and the capacity of tax administration are among the factors that need to be taken into consideration.

For example, the taxation of luxury goods on an ad valorem basis than on a specific basis is recommended for the objective of excise taxes on equity grounds. Specific rates are preferable for goods that are difficult to calculate their taxable value at either the production, importation or distribution stages where excise should be levied. For alcoholic beverages, the imposition of an excise tax based on the unit of alcoholic content[37] makes more sense given the purpose of the tax. [38]

Based on the type of the market channel where the tax is imposed, we can identify two types of excise taxes: manufacturers' excise taxes and retail excise taxes.[39] Manufacturers' excise taxes are imposed on the producer or importer of the excisable item. If the excise tax is assessed on an ad valorem basis, the cost of production or import or the wholesale price may be considered as the value of the item. As the term indicates, retail excise taxes are imposed on the retailer or, in other words, at the last point of sale to the ultimate buyer.

The potential to raise more revenue, administrative simplicity, and distortionary effects are important factors to determine the pros and cons of the two types of excise taxes. To illustrate, imposing the excise taxes early in the value chain, such as at the manufacturer’s level, limits the number of taxpayers, lowers the cost of enforcement, and enhances compliance. This in turn makes the implementation of the excise taxes cheaper and more efficient.[40] In any country, there are fewer manufacturers or importers than retailers. The tax administration can easily spot and control manufacturers and importers than retailers. There will be an ease of administrative burden on the tax administration if the excise tax is imposed on manufacturers and importers. Due to this administrative

[37] or with a combination of specific and ad valorem rates if beverages are categorized as luxury goods as well.

[38] Supra note 1, p. 253

[39] Ibid. As one type of indirect tax, an excise tax may be imposed one of more value chain or distribution channels of a market- that starts from the producer and ends at the consumer.

[40] Supra note 7, p. 10

advantage, an excise tax at the manufacturer and importer level is more common in developing countries.[41]

On the other hand, excise taxes at the manufacturer or importer level would bring unexpected and undesired distributional and efficiency effects on the intermediate channels of the market. The suggestion is that excise taxes as well as other indirect taxes should be as close to the final point of sale to consumers, i.e at the retailers' stage.[42]

In summary and with respect to the objective they want to achieve, we can put excise taxes into

I. Revenue excise taxes (excises imposed for revenue purposes only)
II. Sumptuary or sin taxes (excises imposed to discourage consumption of goods like tobacco products, and alcoholic beverages)
III. Pigouvian excise taxes (excise taxes imposed to correct negative externalities)
IV. Benefit principle-based (or earmarked) excises taxes
V. Luxury excise taxes.

7.3 Excise Taxes in Ethiopia

7.3.1 Historical Development and Legal Framework

The imposition of excise taxes in Ethiopia dates back to the time before the occupation of Italy in 1935. During the pre-occupation period, there were excise taxes on alcoholic drinks, cigarettes, incense, carpets, and wear.[43] After the departure of Italy from Ethiopia, and particularly in the 1940s, a series of excise tax laws were enacted by the then government. The legislation targeted tobacco, alcoholic drinks, petrol, and highway users (road toll). The excise taxes on tobacco and alcoholic drinks were introduced as tools for discouraging consumption of harmful products while the excise taxes on petrol and highway users as benefit taxes.[44] Since the 1950s, the scope of excise taxes broadened to cover unconventionally excisable goods like salt, sugar, cotton, and textile fabrics. There were excise taxes on alcohol that was destined for 'medical

[41] Supra note 1, p. 253
[42] Supra note 13, p. 102
[43] Supra note 15, p. 128
[44] Ibid, p. 131

purposes or used in hospitals (Currently, alcohol is exempted by Proclamation (No. 1186/2020). The inclusion of more goods in the excise tax regime of Ethiopia signaled the government's intention of using excise taxes as the main tool of revenue collection. So, the major historical development of excise taxes in Ethiopia is the eventual use of the taxes as revenue tools while downgrading the other specific objectives to a subsidiary level.

Excise taxes had been introduced by separate pieces of legislation until the end of the 1980s. There were separate laws for the different categories of excisable goods. In 1990, the government brought an end to the era of separate legislation for different categories of excisable goods by enacting consolidated legislation. In some instances, there was amending legislation that aimed at changing some parts of the main legislation. Though the use of consolidated excise tax legislation eases the accessibility of the law, it is important to incorporate specific provisions relating to the structures and rates on the different products subject to excise tax. The use of consolidated excise tax legislation, specifically proclamation, remains unchanged to date.

Before 1991, the taxing power of the country was undivided and remained in the hands of the central/unitary government. The adoption of the federal system by the transitional charter of 1991 (and then by the FDRE Constitution of 1995) has brought a new tax environment- the constitutional division of taxing powers between the federal government and regional states. The Federal government retains the exclusive power to levy the tax on imports and enterprises owned by it (the federal government). The regional states hold the exclusive taxing power on individual traders and enterprises owned by them (the regional states).[45] Excise taxes on jointly owned enterprises and private business organizations are the concurrent power of excise taxation of the federal and regional governments.[46]

The existing excise tax system of Ethiopia consists of the main and chat (khat) excise tax regimes, which are established by the excise tax proclamation (No. 1186/2020) and chat excise tax proclamation respectively. The main excise tax regime will be discussed later in this chapter. We begin with the chat excise tax regime.

[45] The Constitution of the Federal Democratic Republic of Ethiopia, Federal Negarit Gazetta, 1st Year, No. 1,1995, Articles 96(1)), 96(3)), 97(4)(?) 97(6)
[46] Ibid, Article 98

There are specific federal and regional proclamations concerning the excise taxation of chat. Unlike the federal Proclamation, the regional chat proclamations are not excise tax laws per se. Their nomenclature does not contain the word 'excise'. They are titled 'chat product tax'. Their preamble does not reflect the non-revenue specific objectives of excise taxes. Hence, the regional chat proclamations could be treated merely as a revenue-raising tool for the regional governments.

At the Federal level, the chat excise tax is introduced to 'reduce the domestic consumption of chat which is growing at a higher rate'.[47] This indicates that the Proclamation treats 'chat' as a harmful or undesirable product. Whether 'chat' is useful or harmful good in Ethiopia is subject to debate. There are supporters and opponents of chat production on different grounds. The supporters base their claims on cultural, religious, and economic grounds, while the opponents focus on the psychological and health impacts of the chat. At the time of its enactment by the House of Peoples' Representatives, the Excise Tax Proclamation was a subject of debate among lawmakers concerning its nomenclature. Given its cultural, religious, and economic importance in some communities of Ethiopia, some members of the House opposed the treatment of 'chat' as an excisable good. Despite their objections, the House approved the Proclamation as excise tax legislation. The taxpayers that shall have the obligation to pay the chat excise taxes are the sellers of chat.[48] They may sell the chat as either wholesalers or retailers or exporters. The growth of the chat by itself does not create the legal obligation to pay the chat excise tax. It is the possession of chat for commercial purposes (selling of chat) that creates the obligation. The chat excise tax is computed on a specific (unit) basis: 5 Birr per 1 kilogram.[49] The FDRE constitution does not contain a specific provision that allocates chat excise taxation power between the federal government and regional states. Based on the identity of the taxpayers and the nature of the transaction[50], it may be that regional governments will have exclusive taxing power over individuals that engage in the domestic (commercial) supply of chat while the federal governments retain exclusive excise power when chat is

[47] Chat Excise Tax Proclamation (No. 767/2012), Preamble
[48] Ibid, Article 3
[49] Ibid, Article 4
[50] The Constitution allocates taxing powers to the federal government and regional states based on the identity of taxpayers and in some cases nature of transactions (e.g taxes on imports and exports). See supra note 45, Articles 96,97 and 98

exported to a foreign market. The domestic supply of chat by companies will be the concurrent excise taxing power of the federal and regional governments.

The main excise tax regime is contained in the current Excise Tax Proclamation (No. 1186/2020) and is broader and more detailed than the previous (repealed) excise tax proclamations. Content-wise, the new proclamation differs from its predecessors on the following issues.

- In principle, its scope of application extends to services, in addition to locally manufactured goods and imports.[51] (As it will be discussed later, the Proclamation fails to specify those excisable services.)
- It changes the tax base for locally manufactured goods from the 'production cost' to 'ex-factory prices'. The rationale for the change is stated in the second preamble of the new proclamation as "…to alleviate the problem encountered by taxpayers due to lack of predictability on the amount of tax they are liable to pay". The preamble does not tell us the problem in detail. While the repealed Proclamation was in force, there were controversies among the taxpayers and tax authority on the issue of whether or not packing and marketing expenses should be included in the cost of production of goods. The new Proclamation is intended to address this problem by incorporating such costs in the 'ex-factory prices' of the goods.
- It makes tax rates subject to inflation adjustment by the Minister of Finance.[52]
- To engage in the manufacture or importation of excisable goods or supply of excisable services, it is a mandatory requirement to get a license from the tax authority. [53] (The license does not substitute other business-related permits or requirements, such as commercial registration, trade licenses, or investment permit)
- Excisable goods stored in the factory of a licensed manufacturer are subject to the control of the Authority.[54]
- Excise stamps shall be affixed on those excisable goods that are identified by a directive to be issued by the Minister of Finance.[55]

[51] Excise Tax Proclamation (No. 1186/2020), Federal Negarit Gazette No. 25, 17th March, 2020 Article 5(1)(C)
[52] Ibid, Article 10
[53] Ibid, Article 15
[54] Ibid, Article 25

- It permits refund of excise taxes paid on those excisable goods that do not reach consumers or are used as inputs to make unexcisable goods [56]
- Several new goods are added to the list of excisable goods by the New Proclamation.[57]
- The tax rates are also amended (increased) by the same law.[58]

7.3.2 Objectives of the Excise Taxes

Proclamation (No 1186/2020) does not directly tell us the objectives of the excise taxes in Ethiopia. It is by analyzing the contents of the preamble and other parts of the Proclamation that one can identify the objectives. The preamble states that it is necessary to impose excise taxes on goods and services that

- are luxury,
- hazardous to health,
- cause social problems,

In the schedules attached to the proclamation, we find an extensive list of excisable goods that are grouped into 19 major sections. They include cooking oil, soft drinks, beverages, tobacco products, sugar, salt, textile products, rubber tires, vehicles, and video and camera equipment. By looking at the nature of the excisable goods, one can make the following inference. First, the nature of the above items is not the same. Some of them pose risk to health while others do not. Some of them are relevant to our day-to-day life while others may not. The levying of excise taxes on a broad range of items, including on those non-conventional excisable products like cooking oil, textiles, video and camera

[55] Ibid, Article 29
[56] Ibid, Article 30
[57] The newly excisable goods are the following: Fats and oils; Chewing gum whether or not coated; Sugar confectionery including white chocolate; Chocolate and food preparations containing cocoa; Artificial flowers, foliage and fruits, and articles made of artificial flowers, foliage and fruits; Human hair and wigs; Natural or cultured pearls and precious or semiprecious stones; Motor vehicles for the transport of 10 or more persons (including the driver); Three-wheeler motor vehicle; Tractors (including single axle tractors, road tractors for semi-trailers and track laying tractors); Other vehicles with only electric motor for propulsion; Motor vehicles for transport of goods, including crane lorries, mobile drilling derricks, concrete mixer lorries and the like; Motor cycles; Trailers and semi-trailers, other vehicles not mechanically propelled, parts thereof; Carnival and festive entertainment and gambling machines; Smoking pipes and cigar or cigarette holders.
[58] Supra note 51, See the Schedules

equipment, and tractors cannot be justified on grounds other than raising revenues. The government regards excise taxes as a major tool for collecting revenue for its activities. It is safe to conclude that the excise taxes are intended to raise revenue for the government.[59] But they are not designed as benefit taxes or earmarked taxes as there is no indication that the revenues collected from items, such as rubber tires, petroleum, vehicles, and plastic shopping bags, will be spent on the specific purposes associated with roads or environmental protection.

Second, the preamble of the Proclamation makes it clear that the excise taxes shall be imposed on those goods that are hazardous to health and cause social problems. Tobacco and beverage products are examples of goods that affect the health and safety of society. Hence, discouraging the consumption of harmful goods and correcting negative externality are the other objectives of the country's excise taxes. The Proclamation aims at reducing the production and consumption of goods that are harmful to society. Note that the tax rates/tariffs also reflect the government's intention of discouraging the production and consumption of goods that generate negative externalities. Old vehicles cause more pollution than new vehicles. As a result, the Proclamation imposed the maximum tax rates, which are 400% and more, on the old vehicles that had been in use for more than 7 years. New vehicles are subject to minimum tax rates.

Third, luxury goods are the other targets of the excise tax proclamation. Perfumes, beauty products, fireworks, human hair and wigs, and precious stones may be regarded as both luxury and non-essential items for the Ethiopian society. Ensuring vertical equity and discouraging their consumption are the likely reasons for the imposition of excise taxes on these products.

Finally, the targeting of demand inelastic goods, as mentioned in the preamble of the Proclamation, seems to reflect the Ramsey Rule.

[59] Unlike the current Proclamation, the 2002 Excise Tax Proclamation clearly indicated, in its preamble, that the excise taxes are imposed on the selective goods in order to improve government revenue.

7.3.3 The Territorial Application of Excise Taxes

The territorial application of excise taxes is determined by one of the origin or destination principles.[60] Since the tax burdens of indirect taxes, including excises taxes, are designed to be shifted to the final users of the products, it gives the sense to apply the destination principle than the origin principle. The international and national practices show that the destination principle has more predominant application than the origin principle.[61]

The excise tax regime of Ethiopia is built based on the destination principle. Ethiopia imposes excise taxes on locally produced goods, rendered services, and imports. Exports are exempted from the taxes.[62]

7.3.4 The Excisable Items

The International Monetary Fund recommends that countries limit the scope of goods that should be brought under the excise tax legislation to the following five groups: alcohol, tobacco, automobiles, petroleum, and automobile spare parts. It does not support the idea that excise taxes should support the general taxes by raising additional tax revenues.[63]

In the actual tax world, we do not find uniformity concerning the scope of excisable goods. Goods, which are subject to excise tax in one country, may become non-excised in another country. Since countries use excise taxes for different purposes, the lack of uniformity of excisable goods is expected. Bearing this in mind, we find different goods that are brought under the scope

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[60] With respect to indirect taxes, there are two principles that determine the jurisdictional reach of states: the origin and destination principles. The former principle urges that goods and services shall be taxed at the place where they are produced while the latter supports the imposition of the tax at the place where the goods and services are purchased or consumed. If a state adopts origin principle, it will tax exports and exempts imports. The opposite will occur if the state adopts destination principle. The choice between the two principles is to be made not only by national governments representing their states, but also autonomous regional states in federations. George Carlson, Destination and Origin Principles, in Joseph J. Cordes and Robert D. Ebel, Jane (editors),The Encyclopedia of Taxation & Tax Policy, The Urban Institute, 2005, p.82, 283

[61] There is an argument that as an exception excise taxes on environmentally harmful emissions by production units should be levied on an origin basis, i.e. in the country where the emissions take place. Supra note 18, p. 19

[62] Supra note 51, Articles 5(1)(a), 8(1)(b, c)

[63] Supra note 13, p. 102

of the Excise Tax Proclamation of Ethiopia. Some of them are conventional excisable products while others are not. Tobacco, beverages, and petroleum represent the former, and textiles, cotton, and salt represent the latter. The Excise Tax Proclamation categorizes the excisable goods and services as

- excisable goods manufactured in Ethiopia
- excisable goods imported into Ethiopia
- excisable services supplied in Ethiopia.[64]

More specifically, Part I of Schedule I contains the following classes of goods as excisable goods: (1) fats and oils, (2) sugar and sugar confectionery, (3) chocolate and food preparations containing cocoa, (4) soft drink powder, (5) beverages and spirits, (6) tobacco and tobacco products, (7) salt, (8) mineral fuels, oil and oil products, (9) perfumes, toilet waters, and beauty products, (10) fireworks, (11) plastic shopping bags, (12) rubber tires, (13) textiles and textile products produced by industries, (14) artificial flowers, foliage, fruits and articles made of artificial flowers, foliage, and fruits, (15) human hair and wigs, (16) asbestos and asbestos products, (17) natural or cultured pearls and precious or semi-precious stones, (18) video recording or reproducing apparatus, TV broadcast receivers, cameras, (19) motor passenger cars, station wagons, utility cars, Land Rovers, Jeeps, pickups, and similar vehicles.

Even though the Excise Tax Proclamation regulates excisable services in its different parts, such as Articles 5, 6, 7, and 9, no schedule specifies the services subject to excise taxes. The schedules attached with the Proclamation deal with only excisable goods. The author of this chapter has interviewed some tax officers in Addis Ababa City. He asked them whether or not they collect excise taxes from services. The officers responded that excise taxes are not being collected from services.

On the other hand, excises taxes shall not be imposed on those goods exempt by Schedule II of the Proclamation, exports of goods, and other items specified in Article 8 of the Proclamation.

[64] Supra note 51, Article 5(1)

7.3.5 The Tax Base (Excise Value), and Rates (tariffs) of Excisable Items

The excise tax regime of Ethiopia uses a mixture of specific and advolarem measurements of tax bases. The mixed-use of the tax bases is a common feature of the past as well as the present excise tax legislations. For the majority of the excisable goods, it is the value of the goods that serve as the tax base. There are a few cases whereby the tax base is measured according to the physical nature and value of the excisable good. For example, the excise tax base of vehicles is the cumulative of their engine capacity (cylinder capacity or in short CC) and the monetary value). The excise tax base of cigarettes is determined according to the excise value and quantity (pack) of the cigarettes. Plastic shopping bags are taxed based on their weight; 40 Birr per 1 kilogram of plastics. As discussed at the beginning of this chapter, the assessment of the value of goods is more difficult than their physical characteristics. It involves the computation of different types of costs and profits.

The components of the tax base and amount of tax rates are the major areas that distinguish the new proclamation from the repealed (2002) Proclamation. Under the repealed Proclamation, the basis for locally produced goods was the cost of production (the direct labor and raw material cost incurred in the production process, cost of indirect inputs, and overhead costs, but not including depreciation costs of machinery). Except for taxes paid on the import of inputs that are used to locally produce textiles, textile products, and vehicles, taxes paid on inputs were part of the cost of production. The basis for the excisable imported goods was the CFI value (the purchasing cost, freight/transport, and insurance costs) and the customs duty paid on such goods.[65]

The new Proclamation changed the above bases as follows.[66]

- For excisable goods imported into Ethiopia, the tax base (excise value) is the sum of the customs value of the goods and the amount of Customs Duty (if any) payable on the goods under the Customs Proclamation. The Customs duty includes surtax or any other similar tax imposed on the importation of goods.

[65] Excise Tax Proclamation (No. 307/2002), Articles 5, 2(8), Excise Tax (Amendment) Proclamation, (No. 570/2008), Article 2(2)
[66] Supra note 51, Articles 9, 2(5), 11

- For locally manufactured goods, including intermediate or uncompleted processes in the production of excisable goods, the tax base (excisable value) is the ex-factory selling price of the goods, which means the price paid by the purchaser to the manufacturer. If the purchaser is a related person to the manufacturer, the price is determined per the arm's length transaction rule. In other cases, the ex-factory selling price is the open market value of the goods. In terms of amount, the ex-factory selling price of goods is higher than their cost of production as the latter does not include marketing costs and the expected profit by the manufacturer. Hence, the Excise Tax Proclamation (No. 1186/2020) brought an increase in the excise tax bases for locally manufactured goods.

  Manufacturers may sell the excisable goods at places other than the manufacturing premises. It is common for them to sell their goods at sales offices located in different parts of the country. This raises the question of whether or not the transportation (from the factory to sales offices) and related costs should be included in the excise values (tax bases) of the goods.[67] According to the Ministry of Finance, the manufacturers must incorporate such costs in the ex-factory selling price of the goods. The excise taxes are calculated on the sum, including transportation costs.[68]

  It is to be noted that the following are excluded from the ex-selling price of the goods: a) the value-added tax payable on the supply of the goods, b) the cost of excise stamps, if any, and c) the cost of returnable containers.
- For the excisable services, the excisable value is the fee, commission, or charge payable for the services. If the excisable services are supplied by a related person, the arm's length transaction rule will apply to determine the value of the service. In any other case, the excisable value is the fair market value of the services. (Though the Proclamation talks about the excisable value for services, it does not specify the types of services that are subject to excise taxes)

The identification of the applicable tax rates/tariffs is the next important step to compute the excise tax payable by either the manufacturer or the importer. Under the repealed (2002) Proclamation, the minimum and maximum rates

[67] The Excise Tax Proclamation defines a factory as "any premises at which a licensed manufacturer is licensed to manufacture and store excisable goods, but does not include any part of the premises through which excisable goods are sold to the public." Ibid, Article 2(13)

[68] Explanatory Notes Concerning the Implementation of the Excise Tax Proclamation, Ministry of Finance, Ref. No.ገ/ኢ/1/2/87, Date Megabit 11, 2012, p. 3

were 10% and 100% respectively. Now, the rates range from 5% to 500% and they are subject to inflation adjustment by an amount not more than 10%.[69] The power to adjust the rates is given to the Ministry of Finance. As an example, the following presents a summary of excise taxes rates /tariffs of some excisable goods.

No.	Excisable goods	Excise tax rates
1	Fats and oils	
1.1	edible animal or vegetable fats and oils and their cleavage products; with a content of 40g or more saturated fat per 100g, or unable to a determinate level of saturated fat from label	30%
1.2	edible animal or vegetable fats and oils, partially or wholly hydrogenated, with a content of 40g or more saturated fat per 100g, or more than 0.5g of trans fat per 100g, or unable to a determinate level of saturated fat from label	40%
1.3	edible margarine with 40g or more saturated fat per 100g, or more than 0.5g of trans fat per 100g	50%
2	Sugar and sugar confectionery	
2.1	Any type of sugar (in solid or liquid form) excluding molasses, maple sugar, and maple syrup	20%
2.2.	Chewing gum, whether or not sugar-coated	30%
2.3	Sugar confectionery including white chocolate not containing cocoa	30%
6	Tobacco and tobacco products	
6.1	Tobacco leaf	20%
6.2	Cigarette	30% +8 Birr per pack (20 sticks)
6.3	cigars, cigarillos, pipe tobacco, snuff, any other tobacco product	30%+ 250 Birr per kilogram

[69] Supra note 51, Schedule I, Article 10

The key feature of the tax rates is that they vary depending upon the type and sub-classification of the excisable products. Different tax rates apply to the different categories of a given product. For instance, new vehicles are subject to lower tax rates than old vehicles. The rates do not vary based on the criterion of whether or not the excisable product is locally produced or imported from a foreign market. The uniform application of the tax rates on locally produced and imported goods confirms the non-discrimination principle of the World Trade Organization (WTO). It is forbidden under the WTO rules to impose more excise taxes on imported products above the rates applied to like domestic products.[70] Within European Union, the principle of Non-Discrimination has become part of the case law of the European Court of Justice. Member states shall impose an identical excise on locally produced products and products produced in other member states. The principle/rule applies not only to identical goods but also to similar goods.[71]

Given the changing economy and the real value of money in Ethiopia, it is the right decision to adjust tax rates to inflation with the new proclamation. Inflation is a major problem in the Ethiopian economy. The prices (costs) of goods and services are increasing while the value of the currency (Birr) is declining. These changing economic circumstances hurt the tax system. Unless the tax rates are adjusted (increased) in equivalence with the increase in inflation, the government cannot collect tax revenue in its proper amount (real value). The continued increase of inflation brings a decline in the real value of money (tax revenues).

7.3.6 The Taxable Events and taxpayers of Excise Taxes

Excise tax legislation specifies the taxable event that shows the occurrence of the legal condition/s necessary for the excise tax to become chargeable. The excisable products are not subject to excise taxes unless the taxable event occurs.[72] Under the excise tax system of Ethiopia, an excise tax liability is established when one of the following taxable events occurs.

[70] General Agreement on Tariffs and Trade, Article III(2).
[71] Supra note 1, p. 254
[72] Ibid, p. 256

- For locally manufactured excisable goods, it is when the goods are removed from the manufacturer's factory.[73] The removal of the goods from the factory implies the release of the goods for consumption. As long as the goods remain in the factory, the duty to pay excise tax does not arise. If the goods leave the factory, the manufacturer must pay the tax. The mere removal of the goods even without a sale triggers the tax liability.[74] The Proclamation presumes that there is a removal of the excisable goods from the manufacturer's factory if the goods are consumed in the factory. On the contrary, there is no presumption of removal of goods concerning: goods that are exempt from excise taxes, the export of excisable goods, excisable goods that are destroyed under the supervision of the tax authority, and other grounds as mentioned by the law.[75]
- For excisable services, the duty to pay excise taxes shall arise at the time of the supply of the services. At the moment the service is rendered to the client, the law assumes the creation of the legal obligation to pay excise tax. Like the case of excisable goods, there is no excise tax obligation concerning exported and exempt services.[76]
- For excisable imported goods, the duty to pay excise taxes shall arise at the time of importation to Ethiopia.[77]

Until the occurrence of one of the above taxable events, there is no obligation to pay excise taxes. The taxable events do not only create the duty to pay excise taxes, but they also serve as a point of reference for the counting of the deadline for the payment of excise taxes. This can be inferred from the payment deadlines mentioned in Article 37 of the Excise Tax Proclamation (No. 1186/2020).

The excise taxes of Ethiopia are imposed on manufacturers, service providers, and importers. Wholesalers and retailers do not have the legal obligation to pay or collect the taxes. According to Article 6 of the Income Tax Proclamation, the following persons must pay excise taxes to the government.

[73] Supra note 51, Article 7
[74] Excise Tax Proclamation Implémentation Directive (No. 67/2013), Ministry of Finance, Article 23
[75] Supra note 51, Article 7
[76] Ibid, Articles 4(2) and 7
[77] Ibid, Articles 4(1), 7 and 37(4)

- Licensed manufacturers - with respect to locally produced excisable goods
- Registered Persons - with respect to excisable services
- Importers - with respect to excisable imported goods: unless required to do so by a directive to be issued by the Minister of Finance, importers are not required either to get licensed or registered for excise tax purposes.[78]

Since excise taxes are indirect taxes, the above persons have the opportunity to shift the excise tax burdens to ultimate consumers of the excisable items through their prices.[79]

7.3.7 Assessment and Payment of Excise Taxes

For excisable products that are taxed on an ad valorem basis, the excise taxes are calculated by multiplying the excise tax base (value) by the applicable tax rates (tariff). For instance, a sugar factory sells 100 quintals of sugar to a wholesaler at a total price of 400,000 Birr (4000 Birr per 1 quintal). According to the Excise Tax Proclamation, the excise tax rate for Sugar is 20% of the excise tax base (value). The payable excise tax is 80,000 Birr (i.e 400,000 x 20%).

For excisable products that are taxed on a combination of ad valorem and specific (unit) bases, the computation of the excise tax is illustrated as follows. Cigarettes are subject to an excise tax at the rate of 30% + 8 Birr per pack (20 sticks). Assume that a businessman imports a total of 100,000 packs of cigarettes. The businessman pays 2 million Birr as the CFI and 1 million as a customs duty for the imported cigarettes. The payable excise tax is 1.7 Million Birr, which is the sum of

- 30% of 3 million Birr = 900,000
- 8 x 100,000 packs = 800,000

There are circumstances whereby the same excisable goods may be subject to two or more excise taxes when they are supplied to the market in different outputs. For example, rubber tires are finished products for their manufacturers or importers. When the tires are locally produced or imported, there will be

[78] Ibid, Article 15

[79] If the person that is liable to pay excise tax is an importer that assigns the imported good for home or personal use, the excise tax will remain with the importer.

excise taxes equal to 5% of their excise value. For vehicle manufacturers, rubber tires are raw materials that are used to produce their finished products: the vehicles. When the vehicles' manufacturers purchase the tires from their manufacturer, they pay excise taxes that could be regarded as excise taxes on inputs of the vehicles. This raises an interesting issue of whether or not the excise taxes on the input are included in the ex-factory selling price of the vehicles. The Excise Tax Proclamation provides the following answer. In principle, the excise tax paid on the raw materials is offset against the excise tax payable on the finished goods.

As an exception, the offset rule does not apply concerning alcohol, tobacco, and sugar.[80] A tobacco company that uses tobacco leaf as an input to produce cigarettes will not be allowed to deduct excises taxes paid on the leaf from the excise taxes due on the cigarettes.

The Excise Tax Proclamation (No. 1186/2020) obligates persons that engage in the production of excisable goods and supply of excisable services to prepare and submit excise tax returns to the tax authority.[81] This obligation implies that self-assessment is the rule concerning excise taxes. The excise taxes are assessed and submitted to the tax authority by the excise taxpayers themselves (i.e the manufacturers of the excisable goods and suppliers of the excisable services.

When it comes to the excisable imports, the assessment modality changes to a withholding system. Excise taxes on imports are assessed and paid to the tax authority in accordance with the rules that are applicable on custom duty. [82] Generally speaking, customs officers take the charge of assessment and collection of taxes on imports, including excise taxes.

Under the repealed Excise Tax Proclamation and directive, an excise tax on locally produced goods should be paid to the government within the month that comes after the month of production and it is at the time of customs clearance for imports.[83] The new Excise Tax Proclamation (No. 1186/2020) maintains the

[80] Supra note 51, Article 14
[81] Ibid, Article 36
[82] Ibid, Article 37(4)
[83]Excise Tax Proclamation (No. 307/2002), Article 6(2); Directive issued to define the Payment Period for Excise Tax on Locally Manufactured Goods, No. 18/2009, Article 3(2)

above payment periods except for a few changes. For the locally manufactured goods, the 30-day payment period is counted from the previous month of removal of the goods from the factory, not from the date of production. If the excisable good is produced in December but removed from the factory in January 2014 E.C., then the manufacturer is required to pay the tax to the tax authority within the 30 days of February 2014 E.C. The payment of excise tax on excisable imports is made at the time and like the payment of customs duty. When the tax authority assesses and collects customs duty on imported goods, it also assesses and collects other taxes (Excise taxes, VAT, Sur Tax, and Withholding income tax).[84]

Finally, the Excise Tax Proclamation introduced a new rule for an excise tax refund. Under the Income Tax and VAT laws of Ethiopia, taxpayers are entitled to tax credits and refunds when they pay an amount of tax above their actual tax liability.[85] As per the Excise Tax Proclamation, the refund rule is applicable not because there is over-payment of excise taxes, but because the excisable products are either not consumed or are used for a non-excisable purpose. For example, if excisable goods are damaged or stolen while under the excise control of the tax authority or the goods are used by a licensed or registered manufacturer to manufacture unexcisable goods after excise tax has been paid, the tax authority shall refund (return) the excise taxes paid on that product. The claim of refund is made per the form, time, and procedures laid down by the Proclamation.[86]

7.3.8 The Controlling Mechanisms introduced by the Excise Tax Proclamation (No. 1186/2020)

Due to the ever-increasing role and importance of excise taxes, many countries regard the effective enforcement of the taxes as their top tax priority.[87] Different control mechanisms are used to ensure the effective enforcement of the taxes. Among others, the licensing or registration of excisable activities, preparation of records, and reporting of those excisable activities to the tax administration

[84] Supra note 51, Article 37
[85]Federal Income Tax Proclamation No. 979/2016, Article 98; VAT Proclamation (No. 285/2002), Article 27
[86] Supra note 51, Article 30
[87]Rob Preece, Key Controls in the Administration of Excise Duties, World Customs Journal, Vol. 2, No.1, p. 73

are considered key controls in excise tax systems. Excise tax legislation provides that it is an offense to engage in excisable activities, such as manufacturing of excisable goods, without compliance with the key controls' obligations.[88]The Excise Tax Proclamation (No. 1186/2020) introduced the following control mechanisms to enforce excise taxes effectively.

- Licensing/Registration: To engage in the domestic production of excisable goods, importation of excisable goods[89], or supply of excisable services, a license shall be issued by the tax authority.[90] The licensing allows the tax authority to have full knowledge on those persons that engage in the excisable activities and to check whether or not they comply with their tax obligations. The licensing has a supervisory role. Among other things, the tax authority has the power either to suspend or cancel the license; a person who engages in excisable activities without a license shall pay the excise taxes (due on such activities), interest, and a penalty; the license is not transferrable and cannot be used by another person (third party) to engage in the excisable activities, and one of the immediate effects of the suspension or cancellation of the license is the cessation of the excisable activities.
- Excise Control: In relation to domestically produced excisable goods, the Excise Tax Proclamation (No. 1186/2020) gives important power to the tax authority. The latter shall have the right to control the excisable goods stored in the manufacturer's factory.[91] The excisable goods are subject to a physical examination by the authority. The Proclamation imposes some obligations on the manufacturers. The installation of a metering (measuring) device at the factory is one example.[92]
- Excise Stamp: An excise stamp is a piece of paper or mark that is affixed on the excisable products to indicate that the required excise taxes have been paid. In addition to evidencing the payment of the tax, the stamps are used to fight illicit trade by guaranteeing the genuineness of the product. They deter consumers from purchasing unstamped products.[93] Usually,

[88]Ibid, p. 77
[89] Subject to the conditions of Article 15(1(b)
[90] See Supra note 51, Articles 15-24
[91] Ibid, Article 25
[92] Ibid, Article 26-28
[93] Nicola Sudán, The Evolution in the Role of Excise Tax Stamps for Specific Consumption

excise stamps are sold by the government to persons that engage in excisable activities.

Counterfeiting is the major challenge in the use of excise stamps. Simple stamps can be easily counterfeited while high-security stamps not. For excise stamps to be effective, the tax authority needs to use high-security stamps so that excisable products are not supplied in the market with counterfeit stamps. Like banknotes, excise tax stamps should use highly specialized design features to guard against counterfeiting.[94] The Excise Tax Proclamation (No. 1186/2020) defines an excise stamp as a mark or an object affixed on excisable goods to indicate that Excise Tax has been paid on such goods. It empowers the Minister of Finance to issue a directive on the use of excise stamps.[95] The directive is expected to list out the excisable goods to which excise stamps shall be affixed, and the place and time of affixing excise stamps. The Minister had not issued the directive before the writing up of this textbook. Hence, the implementation of the excise stamp is yet to be seen.

- Keeping of records: The Proclamation requires taxpayers to keep records of the excisable items in a form and manner that are specified by the applicable laws.[96]

Summary

Excise taxes are distinguished from other indirect taxes in their objectives, scope of application, and assessment methods. The levying of excise taxes is imposed to raise tax revenue for the government, discourage the consumption of undesired goods, correct negative externalities, improve vertical equity, and exclusively benefit the taxpayers (benefit principle). Unlike general consumption taxes such as VAT and ToT, excise taxes apply to a few goods and services. Alcoholic beverages, tobacco products, petroleum products, automobiles, wagering, sports betting, and advertisement are the main examples of excisable goods and services. The computation of the excise tax liability is

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Goods, p. 93, available at https://www.ciat.org/Biblioteca/Revista/Revista_39/Ingles/Sudan_eng.pdf, last accessed on Nov.3 , 2021

[94] Doug Godden and Elizabeth (Liz) Allen, The development of modern revenue controls on alcoholic beverages, World Customs Journal, Volume 11, Number 2, p.5

[95] Supra note 51, Article 2(16), 29

[96] Ibid, Articles 26(1)(c)(d), 35

not complex. Hence, the administration of excise taxes is simple. Based on the tax assessment method, excise taxes could be categorized as specific and ad valorem taxes. Specific excises taxes are assessed based on the physical unit of measurement of the excisable goods, such as their weight, length, or volume. Ad valorem excise taxes are computed as a certain percentage of the value or price of the excisable goods. Based on the type of the market channel where the tax is imposed, we may classify excise taxes as manufacturers and retail excise taxes. Manufacturers' excise taxes are imposed on the producer or importer of the excisable item. Retail excise taxes are imposed on retailers.

The existing excise tax system of Ethiopia consists of the main and chat (khat) excise tax regimes, which are established by the excise tax proclamation (No. 1186/2020) and chat excise tax proclamation respectively. Ethiopia's excise taxes are intended to raise revenue for the government, discourage consumption of harmful, non-essential, and luxurious products, and correct negative externalities. The Excise Tax Proclamation categorizes the excisable goods and services as excisable goods manufactured in Ethiopia, excisable goods imported into Ethiopia, and excisable services supplied in Ethiopia. For the majority of the excisable goods, it is the value of the goods that serve as the tax base. There are a few cases whereby the tax base is measured according to the physical nature and value of the excisable good. The excise taxes are imposed on manufacturers, service providers, and importers. Wholesalers and retailers do not have the legal obligation to pay or collect the taxes. The Excise Tax Proclamation (No. 1186/2020) introduced licensing/registration, excise control, excise stamp, and keeping of records as control tools to enforce excise taxes effectively.

Review Questions

1. What are the similarities and differences between excise taxes and other forms of consumption or indirect taxes?
2. Discuss the different objectives of excise taxes.
3. Explain the different types of excise taxes
4. What are the features, pros, and cons of Pigouvian-excises taxes?
5. Why do you think that wholesalers and retailers are exempted from payment/collection of excise taxes in Ethiopia? Is it justifiable?
6. How far are Ethiopia's excise taxes effective in discouraging the consumption of harmful and luxury goods?
7. What are the legal and practical problems relating to excises taxes in Ethiopia?

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Chapter Eight

Customs Duties Law in Ethiopia

Introduction

As also indicated in chapter one and two of this book, customs duties and related taxes are forms of indirect taxes in the tax system of Ethiopia. Yet, in addition to revenue generation, customs regimes are organized to regulate the flow of goods into and out of a country by setting what is known as customs procedure. In Ethiopia, an ancient independent state, customs operation is an old work process that has been around for centuries. Currently, Ethiopia is a land-locked country, where most exports and imports are entertained through Djibouti (90%), the airport at Addis Ababa (5%), and Sudan.[1]

One can note three major problems in the Ethiopian customs administration and revenue collection system.[2] First, Ethiopia is one of the countries with the highest set of challenges (such as trade facilitation problems) in cross-border trade. There is a delay in custom operations, which leads to higher transaction costs, and trade facilitation remains a serious policy and academic concern. Second, illicit trading activities across a border such as contraband and smuggling are invasive socio-economic perils deep-rooted in the Ethiopian cross-border trading system. Importers, exporters, and their agents are commonly involved in these activities violating the law that governs the customs procedures and avoiding the payment of all applicable taxes and duties. Such problems in the import-export trade threaten the legal industry, restrain innovation and investments, reduce government revenues, fuel transnational organized crime, and hamper the health and safety of consumers.

Third, despite the fact that there is a high reliance on taxes and duties on foreign trade, the revenue collection performance remains low and unproductive. Historically, like in other developing countries, there is high substantial reliance on foreign trade taxes in the Ethiopian revenue system. According to empirical studies in the field, revenue that comes from taxes on foreign trade constitutes

[1] World Customs Organization, Customs Reform and Trade Facilitation in Ethiopia, 3 February 2011

[2] Abraha Hiluf, Challenges of Customs Law Enforcement in Ethiopian Revenues and Customs Authority: The Case of Moyale Branch, Journal of Economics and Sustainable Development, Vol.8, No.1, 2017; Tekeba Girma, Assessing the performance of Ethiopian Customs Commission in Reference to Import Trade Facilitation: Perspective of Wheat and Palm Oil Importer, Addis Ababa University Msc Thesis, 2022

44 % (1960s), 37 % in (1980s), 22.6% (1990), 47.3 (2000), 40.23% (2011) of government revenue in Ethiopia. Currently, Ethiopia levies five kinds of taxes on import items (customs duty, excise tax, VAT, surtax, and withholding tax) and these taxes provide considerable revenue to the government.[3]

As such, Ethiopia has been undertaking various reforms to modernize the revenue collection and facilitate international trade. Recently, Customs Proclamation No. 859/2014 (and its amendment Proclamations No. 1160/2019) has been enacted with the general goal to establish modern customs legal framework compatible with the contemporary international trade practice, and international, continental, and regional trade agreements to which the country is a member. Ethiopia is a member state of international and regional intergovernmental organizations and economic communities such as the World Customs Organization (WCO) in 1973, the Common Market for Eastern and Southern Africa (COMESA) in 1994 and trying to become a member of the World Trade Organization (WTO).[4] Thus customs regulations of the country related to international trade are obliged to comply with the requirements of these organizations and economic communities. Recently, the Ethiopian Custom Commission is organized (by Proclamation No. 1097/2018) with the task of providing expeditious customs service, controlling the import and export, and collecting duties and taxes.

This chapter is devoted to discussing the Ethiopian customs regime. To this end, the chapter is divided into some relevant sections focusing on an introductory discussion on customs and custom duties, developments in the Ethiopian customs law, import and export procedures, customs operations and formalities, prohibitions and restrictions, payment of customs duties, and taxes, customs control, and law enforcement and complaints and appeals.

8.1 Understanding Customs and Custom Duties

Hinkelman, in his illustrious dictionary of international trade, defines customs as "a government authority designated to control the flow of goods to/from a country and to collect duties levied by a country on imports and exports and the procedures involved in such activities".[5] In the same way, the Revised Kyoto

[3] Ethiopian Revenues and Customs Authority, Ethiopian Customs Guide, March 2017
[4] Ibid
[5] Edward G. Hinkelman, Dictionary of International Trade, World Trade Press, 8th ed, 2015, P.52

Convention defines it as "the government service which is responsible for the administration of customs law and the collection of duties and taxes and which also has the responsibility for the application of other laws and regulations relating to the importation, exportation, movement or storage of goods".[6] From both definitions, it's possible to understand that the term custom refers to both the legal and institutional arrangement to control the flow of goods in and out of a country (import and export) and collect duties and taxes levied thereon. Customs duties are one of the oldest forms of indirect taxation and are paid on goods when they cross international borders or are transported between countries.[7] Although today the most widespread form of customs duty is on imports, it can nevertheless be paid on export and transfer products. Dutiable goods are statutorily defined and a specific duty rate is applied based on factors such as where it is acquired and made, and what it is made of. [8] The types and amount of duties differ from country to country depending on their level of engagement in international trade, their commitments to trade-related international or bilateral agreements, and economic circumstances.[9]

With the advent of trade liberalization countries' participation in international trade has increased. Yet, there has been a growing consensus on the point that imports and exports have to be systematically administered and regulated if a country is to benefit from them and promote its public policy.[10] Thus countries develop their own domestic customs laws, which encompass the various legislations on customs procedures and payment of duties and taxes.[11] Customs laws serve various revenue and non-revenue objectives and functions. According to David Widdowson, the main functions and roles of customs are revenue collection, insuring trade compliance, facilitation of trade, interdiction of prohibited substances, protection of cultural heritage, enforcement of intellectual property laws, and collection of trade statistics.[12] In the literature,

[6] World Customs Organization, General Annex: Chapter 2 of the Revised Kyoto Convention, 17 April 2008
[7] Charles Francis Bastable, Public Finance, Macmillan and Co. Limited, London, 3rd ed, 1932 P. 551 ff.
[8] Japan International Cooperation Agency (JICA), Project on Capacity Development for Trade Facilitation and Border Control in East Africa, October 24, 2017
[9] Ibid
[10] The International Convention on the Harmonization of Frontier Control of Goods, United Nations General Assembly, 21 October 1982
[11] Supra Note 7
[12] David Widdowson, The Changing Roles of Customs: Evolution or Revolution, World Customs Journal, January 2007, P.31; See also Supra Note 3

unlike the case in the majority of taxes, revenue generation is secondary or incidental and the primary role of custom duties lies in the foreign and trade policy of a country.[13] For this purpose, countries design custom duties as basic customs duties, additional customs duties, special countervailing duties, safeguard duties, anti-dumping duties, protective duties, and the like.[14] Thus, the import or export of some goods may be restricted or forbidden entirely, and penalties can be imposed against those who break the law. In the majority of cases, customs duties are imposed to protect domestic production by making imported goods more expensive.[15] Custom duties have also a corrective role to play.[16] For instance, if the consumption of some good generates pollution, increasing its price by imposing a tariff on imports may increase social welfare. Despite these benefits, customs duties are criticized for being barriers to trade, limiting consumer choice and hence, reducing the standard of living.[17] In developing countries like Ethiopia, which for the most part, rely on international taxes and duties for their revenue, customs organizations are primarily tasked with the collection of duties and taxes.[18]

Customs duties can be classified into two forms based on the base it is levied: *ad valorem* and specific duties.[19] *Ad valorem* duties are taxes, duties, or fees that vary depending on the value of products, services, or property on which they are levied. They are expressed as a percentage of the value and most the countries apply this system. The *ad valorem* duty rate is not a recent invention but dates back to the middle ages, but what seems to have been lacking at that time was the application of precise, standard methods of valuation. The preference for *ad valorem* duties re-emerged during the industrial era when it was realized that the system offered greater protection than specific duties, as it was more adaptable in the face of price fluctuations and differences in the quality of goods. Specific duties are duties, taxes or fees levied based on specific measures of goods such as number, weight, volume, area, capacity, etc.

[13] The Institute of Chartered Accountants of India, Background Material On Customs and Foreign Trade Policy, 2nd ed, 2018, preface
[14] David Widdowson, Supra Note 12 P.2
[15] Ibid
[16] Supra Note 7
[17] Ibid.
[18] Alemayehu Geda and Abebe Shimeles, Taxes and Tax Reform in Ethiopia (1990-2003), UNU-WIDER Working Paper 65/2005, 2005
[19] Supra Note 7

A specific sum is imposed on each article regardless of its individual value, for example, price per liter of fuel.

8.2 Developments in the Ethiopian Customs Law

In Ethiopia, taxes, including customs duties, were levied on internal and external trade, both at the numerous markets and at a series of customs posts all over the country.[20] A Portuguese writer Pedro Pais states that at each customs post the traders were obliged to surrender one-tenth of all imported goods; the tax on local produce, on the other hand, was much less but yielded a substantial revenue as there was much commerce in slaves, ivory, salt, wax, and other goods. [21] When we come to the modern Ethiopian customs operation law, customs duties were levied and collected around the 1st century in the Kingdom of Axum on the Red Sea coast.[22] Nevertheless, it was established during Menelik II as a legal governmental structure in 1889, to collect government revenue. Beginning from 1889-1923, it was under the Ministry of Finance and Treasury.[23] The first major change in Ethiopia's tax system was initiated in the post-Second World War period and the first customs duties law was issued in 1943.[24] In the same year, the government introduced export duties although it was not as extensive as the import duties.[25] Since then customs duties have been frequently revised. In particular, the tariff schedules have kept changing time after time. The 1943 law covered both import duties and export duties. For duties on imports, a tariff schedule was attached with a long list of goods classified into categories and applicable rates that ranged from 'free' to duties as high as 70% at the time. The rates were both ad rem (based on the unit of the good charged) and *ad Valorem* (based on the value of the good charged). Apart from the customs tariffs, imports are a convenient route for imposing various forms of taxes. The imperial government had relied on indirect taxes (customs, excise, and sales) to generate revenues Under the emperor of Haile Selassie I,

[20] Richard Pankhurst, Economic History of Ethiopia: 1800-1935 (1968), Haile Selassie University Press, Addis Ababa, Ethiopia
[21] Ibid.
[22] Ibid
[23] Ibid
[24] See Customs and Exports Duties Proclamation No. 39/1943. For the history of modern customs duties, see Taddese Lencho, Towards Legislative History of Modern Taxes in Ethiopia (1941 2008), Journal of Ethiopian Law, Vol. 25, No.2, 2012 PP.104-105
[25] See Customs and Export Duties Proclamation No. 39/1943. In 1951, the range of commodities subject to the export duties was broadened. See The Customs Revised Imports and Export Regulations, Legal Notice No. 153/1951

Customs matters were administered under the Ministry of Finance (1923- 941) and the Ministry of Trade (post-1941).[26] In 1955, the consolidated customs law was issued. [27] Later, the revolutionary government changed the tax structure including taxes on exports and imports in 1976. Among imports, intermediate goods were taxed on a scale ranging from 0 to 35 percent, consumer goods on a scale of 0 to l00 percent, and luxuries at a flat rate of 200 percent.

With the downfall of the Derg regime and the coming into power of the now-dissolved EPRDF in 1991, the customs duty regime has continued to be the major area of tax reform and legislation change along with liberalization reforms.[28] According to Art 96(1), the Federal Government has the power to levy and collect customs duties, taxes and other charges on imports and exports. This is attributable to the fact that import and export businesses are licensed and regulated by the Federal Government. The custom tariff reform that took place between 1993 and 2002 grouped imports into 97 categories based on the Harmonized System of Tariffs Classification Code. An *ad valorem* rate ranging from 0 to 35 percent was introduced. An important development in the export sector was the abolition of all export taxes, with the exception of coffee. Similarly, to encourage exports, schemes for duty drawbacks and duty-free imports were implemented. The reform program to date has resulted in the rationalization of tariff rates, reduction in documentary requirements, simplification of procedures and computerization. This has achieved a dramatic reduction in clearance times and an increase in revenue collection.

The enactment of Customs Proclamation No. 622/2009 can be taken as a departure compared to the legal reforms made so far in addressing modern custom developments in international trade. A cursory look at the Customs Proclamation preamble indicates that there has been recognition of customs' crucial role in trade operations, revenue collection and protecting society and national security from cross-border movements of prohibited or restricted goods. The prescription of customs procedure principles that were aimed at trade facilitation, custom valuation rules compatible with the WTO Valuation Agreements, the use of modern IT technologies and computerization of core customs processes, tax review and dispute settlement mechanisms outside

[26] The customs department remained under ministry of trade until 1996.
[27] See a Proclamation to Consolidate and Amend the Law Relating to the Customs Proclamation No. 145/1955
[28] Supra Note 18

regular courts, and provision for modern customs systems and procedures (risk management, audit-based control) were the major ones.[29] In 2014, the current customs proclamation is enacted. [30] The law was enacted in a relatively effective way that guarantees transparent, predictable and prompt customs procedures buttressed by legal provisions that prescribe internationally accepted standards. In 2019, Customs Proclamation No. 859/2014 is amended. [31] Thus, as far as the legal framework is concerned, the current applicable customs laws are Customs Proclamation No. 859/2014 and Customs Amendment Proclamation No. 1160/2019 which have repealed all the previous laws. As such, they regulate the import of goods, export of goods, goods in transit any goods subject to customs control including rights and obligations of persons that take part in customs formalities.

In addition to domestic laws, though Ethiopia is not a member, the International Convention on the Simplification and Harmonization of Customs Procedures (entered into force in 1974 and revised in June 1999), also known as the Revised Kyoto Convention, was made to provide a source of an excellent blueprint for the most part of modern customs provisions included in the proclamation.[32] This Revised Kyoto Convention was developed to standardize customs policies and procedures worldwide and it consists of the Body of the Convention, the General Annex, and the Specific Annexes.[33] Prominent principles of the convention such as risk management, audit-based control, transparency and predictability, coordinated interventions and cooperation with other agencies, and self-assessment principles, which promote minimum necessary control and maximum use of IT, have been made the foundational principles upon which custom procedures should be based on.[34]

The reforms in the customs area include changes in the tax administration organizational structure and legal reforms in simplification of procedures and computerization.[35] To begin, the merging of the three revenue collection

[29] See Customs Proclamation No. 622/2009
[30] See Customs Proclamation No. 859/2014
[31] See Customs Amendment Proclamation No. 1160/2019
[32] Supra Note 3
[33] Supra Note 6
[34] See Arts.5-6 and 88 of the Customs Proclamation No. 859/2014
[35] Demirew Getachew, Tax Reform In Ethiopia & Progress To Date, Paper Presented on the Ethiopian Economic Association Sound International Conference on the Ethiopian Economy June 3 - 4, 2004 Addis Ababa, P.3

institutions: Federal Inland Revenue, Ethiopian Custom Authority, and the National Lottery Administration in 2008 is a notable tax administration organizational reform.[36] The Ethiopian Custom Authority was established through The Re-Establishment and Modernization of Customs Authority Proclamation No. 60/1997 which also governs all the main tasks of customs. In 2008, the Ethiopian Revenues and Customs Authority (ERCA) was established by proclamation No. 587/2008 as an independent entity merging the above three institutions. In 2018, the Ethiopian custom commission has come into existence separate from ERCA Headed by a Commissioner accountable to the Ministry of Revenues by possessing its own vision and mission.[37]

8.3 Import and Export Procedures in Ethiopia

Activities in relation to import and export are done under a process called customs procedure carried out in compliance with the customs law and internationally accepted standards. In this regard, the customs proclamation has included relevant customs procedures. Most of the operations and procedures apply the rules and principles common in international trade law. Even though Ethiopia has not yet acceded to the WTO, most of the rules are domesticated and applied through various legislations including the customs proclamations.

As mentioned above, customs laws do not only refer to customs proclamations but rather a wide range of regulatory laws. The Ethiopian Ministry of Trade and Regional Integration is the major body of the government to regulate all import and export goods. In particular, it issues import and export release permits. Differently, the Ethiopian investment commission issues and renews investment permits, which serve also as import permits, as well as custom duty-free permission letters. The other major organ is the National bank of Ethiopia (NBE) which regulates the foreign currency aspect of import-export. The responsibility of the NBE includes registration of sales contract agreement; issuing Export Bank Permit; issuing Foreign currency Approval; and issuing Bank import permit for Letter of Credit, (Open L/C), Advance Payment, approving Purchase, and order for cash against document (CAD). There are also other regulatory bodies that specifically issue import and export permits for specific goods. For example; the Ministry of Agriculture and Live Stock issue

[36] Ibid

[37] Definition of Powers and Duties of the Executive Organs of The FDRE Proclamation No.1097/2018; See also Definition of Powers, Duties and Organization of the Customs Commission Regulation No. 437/2018

import permit for plants, seeds, plant products, pesticides and fertilizers, and export permit for animal feed, live animals and meat products; the Ministry of Mines and Petroleum issue permit for the exportation of mineral products; the Food, Medicine and Health Care Administration and Control Authority (FMHACA) regulates the import and export of drugs, medical supplies or instruments, baby food, supplement food, and cosmetics; and the Information Network Security Agency (INSA) issue Import permit for communication and security equipments.

How do import and export goods in Ethiopia? Look at the following summary of the steps that an importer or exporter has to pass through.[38]

Steps to import goods[39]	Steps to Export goods[40]
1. Obtain an import license/investment license[41] 2. Obtain a pre-import permit (for certain restricted goods only)[42] 3. Arrange payment issues (a) Foreign currency approval (b) Obtain bank	1. Obtain an export license 2. Arrange payment issues 3. Collect documents 4. Obtain export permit (for goods restricted for export only)

[38] See Ethiopian Customs Guide, 2017 pp. 15-34

[39] Imports to Ethiopia require: Agency agreement; A bank permit; A bill of lading or airway bill; Certificate of origin; Commercial invoices; Customs import declaration; Foreign exchange authorization; Import license; Insurance certificate; Packing list; Tax identification number (TIN) certificate; Pre-shipment inspection clean report of findings; Transit document; and Value Added Tax (VAT) Certificate. Moreover, Medicines, medical supplies, and medical equipment must be registered with the Ethiopian Food and Drug Authority (EFDA). A Certificate of Analysis (COA) is also required for processed food and pharmaceuticals. For some items depending on their type, specific agency permissions may be required. Plants or plant products, including seeds, agricultural inputs such as chemicals, pesticides and fertilizers cannot be imported to Ethiopia unless registered and duly authorized for import by the Ministry of Agriculture.

[40] An application must be submitted to the NBE that is accompanied with the export contract, seller's invoice, export license of seller, TIN, export permit application, letter of seller stating that consignment will be settled within 90 days maximum and any other relevant document.

[41] According to Article 43 of the Commercial Registration and Business Licensing Proclamation No. 980/2016, the Ministry of Trade give permission for persons who have no import or export license to import or export goods upon the submission of a completed application form and required documents.

[42] The import of certain goods into Ethiopia is restricted for safety, security, environmental, health and other reasons, i.e. they must not be imported without permission. For example, the import of certain goods is prohibited, such as worn clothing, illegal narcotic substances or pornographic materials.

permit/arrange mode of payment or Franco valuta permit 4. Collect commercial documents required for customs declaration 5. Prepare the customs declaration 6. Submit the customs declaration 7. Obtain import customs clearance and goods release note 8. Pay service charges, exit goods from a customs warehouse, and receive final import customs declaration 9. Submit clearance declaration to NBE	5. Prepare customs declaration 6. Submit customs declaration 7. Obtain export customs clearance and ship goods 8. Pay service charges and receive final export customs declaration 9. Submit clearance declaration to NBE

8.4 Prohibitions and Restrictions

As an initial remark under this general part, it is important to have a glimpse of what goods are. According to Art. 2(1) of the proclamation "goods" means any kind of corporeal chattels and other incorporeal chattels deemed to be corporeal chattels by law including natural forces and resources of an economic value which are employed to use including money. Almost all goods, except certain prohibited goods as defined below, are allowed to enter or exit from Ethiopia and are subject to the usual common custom procedures such as presenting declarations of goods, transit of goods, clearance of goods, and customs warehouse procedures. Prohibited goods are defined under Article 2(30) of the proclamation as goods of which the importation, exportation or transit is prohibited by Ethiopian law or international agreement ratified by Ethiopia. These prohibitions are aimed at protecting society from harm such as to health, environmental concerns e.tc. In addition to the customs proclamation, similar prohibitions can be read from other laws. For instance, the grant of a permit for the manufacture or importation of any non-biodegradable plastic bags with a wall thickness of 0.03 millimeters and less than 0.03 millimeters and the importation of used tires into Ethiopian territory for the purpose of disposal is prohibited under Article 8(2) and 9(1) respectively of the Solid Waste Management Proclamation No.513/2007 because of environmental concerns. Illicit narcotics are prohibited from trafficking across borders by the International Single Convention on Narcotic Drugs of 1961 to which Ethiopia is

a ratifying country. Similarly worn clothes are forbidden from importation by the Tariff book enacted by councils of Ministers.

On the other hand, there is a class of goods not totally banned that are described as restricted goods. As can be construed from the definition provided under article 2 (31) of the customs proclamation, restricted goods are goods whose importation, exportation, or transit is restricted by a competent authority in accordance with legal procedures. Such goods are made subject to certain certification of quality or standard for regulatory reasons. Laws other than the customs proclamations also require the fulfillment of certain conditions to import or export some goods. For example, the importation of food, cosmetics, medicine, medical equipment, and tobacco are subject to licensing and certification under Food and Medicine Administration Proclamation No.1112/2019. Materials that emit x-rays or microwaves which are not exempted can be imported only in accordance with the requirement and on the basis of a safety assessment established by the Ethiopian Radiation Protection Authority.[43]

8.5 Customs Operations and Formalities

Customs operations involve the administration of customs law relating to the importation, exportation, movement or storage of goods and the collection of duties and taxes. The major procedures are found stipulated under the Customs Proclamation No. 859/2014 (as amended) and directives issued by the Customs Commission, Ministry of Revenues and Ministry of Finance. Those who are interested in these issues are advised to consult all relevant laws pertaining to customs proceedings and this section provides only the highlight.

8.5.1. Goods Declarations[44]

Goods declaration is a statement made in accordance with the provisions of the Customs Proclamation, by which the declarant[45] indicates the customs procedure to be applied to import, export, or transit goods and by which the declarant furnishes the particulars of the goods which the customs administration requires for its application.[46] In principle, all import, export, or

[43] Radiation Protection Proclamation No.571/2008
[44] Article 8-15 of the Customs Proclamation No. 859/2014
[45] A declarant is normally the importer or exporter that can be a natural or a legal person and can be represented by a customs agent. See Article 2(21) of the proclamation No.859/2014
[46] Article2 (20) of the proclamation No.859/2014

transit goods need to be declared.[47] Yet there are some goods that are exempted from requiring a goods declaration depending on their nature or use.[48] For example, non-commercial goods imported or exported for personal and home use, and Goods related to the security and defense of the country are not required to pass through the steps of declaration.

The declaration is a very crucial initial step for the smooth flow of the goods through customs procedures. It is evidence and details about the identity and legal entry status of goods to Ethiopian customs territory.[49] The intentional entry made with the view to evade duty and tax may entail criminal or civil liability.[50] However, a declarant can amend some of the particulars in the declaration before it is accepted and taxes and duties are paid on it.[51] It can also be canceled.[52] The importation also requires supporting documents that need to be attached with it and which become a single indivisible legal instrument upon acceptance of the declaration.[53] There are four forms of goods declaration through which declaration of goods may be made.[54] These are in written form, orally, by bodily action, and electronic. Bodily action is when a traveler passes either through the green or red channel, whereby the former denotes that no taxable good is carried. A traveler's verbal declaration to a customs officer is accepted as an oral declaration. However, when the good has a commercial nature, a written or electronic declaration must be made.

Finally, once the goods declaration is submitted, it can be accepted or rejected.[55] A declaration is said to be accepted when it has been registered in the customs system. If the Customs Commission has to reject a declaration, the declarant will be notified in writing, and the reasons for rejection will be

[47] Art. 16 of Proclamation No.859/2014
[48] Pursuant to Articles 4 & 5 of the Directive issued for determination of conditions for implementation of Customs Declarations No. 118/2016
[49] See for details Directive to Determine the Application of Customs Declaration Directive No. 118/2016
[50]Article 13(4) of the Proclamation No.859/2014
[51] Article 14 of the Proclamation No.859/2014
[52] Article 15 of the Proclamation No.859/2014
[53]Article 10 of the Proclamation No.859/2014. The law requires documents such as transportation document, invoice, banking permit, packing list, certificate of origin, and other documents necessary to ensure compliance with custom laws
[54]Article 9(1) of the Proclamation No.859/2014
[55] Article 13 of the Proclamation No.859/2014

explained. Possible reasons for rejection include missing required documents or errors in completing the declaration.

8.5.2. Customs Transit and Transshipment[56]

Customs transit refers to customs procedures under which goods are transported under customs control from one customs office to the other. The Customs Proclamation contains provisions related to the application of customs transit operations in Ethiopia. These include the basic transit terms and concepts such as goods declaration for customs transit, sealing and identification of consignments, customs seal, procedures en route, and termination of customs transit. [57] Importantly, according to Article 16(2) of the Proclamation, goods being carried under customs transit shall not be subject to the payment of duties and taxes provided the conditions laid down by Customs Commission are complied with and security has been furnished for this purpose. The Customs Commission, when permitting a transit operation to be carried out, requires security, usually a financial guarantee or security, with a view to securing the duties and taxes of goods in transit, thereby reducing the risk of the goods being diverted for inland consumption without duty and tax payment.

In practice, however, the procedure applied distinguishes between transit under multimodal and unimodal transport. Article 16 of the Proclamation provides that there are four types of customs transit procedures allowed in Ethiopia: through transit (office of entry to office of exit), import transit (office of entry to inland customs office), export transit (inland customs office to the office of exit) and internal transit (one inland customs office to another). A national customs transit procedure covers only transit in one customs territory with the offices of entry and departure in the same customs territory. This is purely domestic movement, such as movement from a border station, port, or airport to a customs office or bonded warehouse in the interior of the country. Multilateral transit procedures (bilateral, regional, or international) on the other hand cover transit across several customs territories. For the purposes of customs control, transit goods must enter or exit through prescribed customs ports or customs crossings and be transported through prescribed routes. As prescribed by Article 140(2) of the Customs Proclamation, customs ports, customs crossings, and transit routes are determined by the Customs Commission through public

[56] Article 16-22 of the Proclamation No.859/2014
[57] Articles 16-22 of the Proclamation No.859/2014

notice. Accordingly, though not in a kind of public notice, a Directive to Determine the Custom Transit Procedure Directive No. 117/2016 has been issued pursuant to the proclamation. As per this directive, customs entry, transit routes, and the pre-requirements for the different kinds of transit based on the kind of transport contract used (that is whether uni-modal or multi-modal transport contract is used), the types of declaration to be presented, and other document required are stipulated.

Customs transit operations are terminated when the goods are presented at the office exit of a customs territory or the office of the final destination, where customs authorities should verify that no unauthorized interference with the goods has occurred. If goods in transit are not presented to the customs station of destination within the prescribed time limit and the declarant has failed to report the reasons, the guarantee secured will be forfeited to the government. Customs authorities normally only release the operator from his financial liability subsequently, when it has been verified that the transit operation has actually been correctly terminated and discharged. In case of detected irregularity, interference, or fraud the customs proclamation normally require that the responsibilities of the persons involved in the transit operation be determined and lost duties and taxes subsequently recovered, principally from the person(s) engaged in the unlawful practice or, as a last resort, from the guarantee provided as security. Pursuant to article 158, article 160, and article 162 of the customs proclamation acts related to the interference of custom transit such as removing or disconnecting the customs seal affixed on means of transport or container, opening packages or breaks in bundles of goods, failure to comply with the obligation of the carrier such as giving access to any unauthorized person to the means of transport are considered customs offenses and entails civil liability. Some of the acts are also considered custom criminal offenses as per articles 170 and 171 of the proclamation. These, for instance, include the opening of parcels and removal of marks if they are done with the intent to remove, mix up, damage, steal the goods or in any manner procure undue advantage. In addition to this, acts done by the carrier such as unloading, loading, or attempting to do one of them in the absence of a force majeure constitute a criminal act.

The following is a map showing transit routes in Ethiopia according to the Directive No. 117/2016;

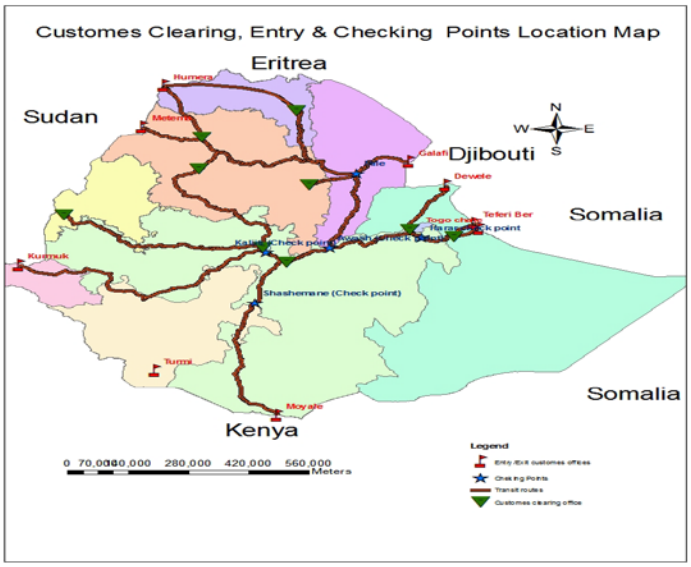


Figure 1 A picture of the transit routes determined

One of the most important concepts in customs transit is transshipment.[58] Transshipment is the customs procedure under which goods are transferred under customs control from the importing means of transport to the exporting means of transport within the area of one customs port, which is the port of both importation and exportation. Although a goods declaration has to be submitted, no duties and taxes are paid on goods being transshipped. Any commercial or transport document setting out clearly the necessary particulars can be accepted as the goods declaration for a transshipment operation. In addition, the Customs Commission may fix a time limit for the exportation of goods declared for transshipment.

8.5.3. Customs Warehousing[59]

Customs warehousing is defined as the customs procedure under which goods are stored under customs control in a designated place (a customs warehouse) without payment of duties and taxes.[60] The main purpose of the customs

[58] Article 2 (19) of the Proclamation No.859/2014
[59] Article 50-64 of the Proclamation No.859/2014
[60] Supra Note 3 P.53

warehousing procedure is to facilitate trade. Since goods deposited in a customs warehouse are not liable to the payment of duties and taxes (until the goods are cleared), it allows the owner of the good to negotiate the sale or manufacturing. The Ethiopian rules on customs warehousing incorporate many of the specifications and standards set in the Revised Kyoto Convention.[61] The custom proclamation introduces three kinds of custom warehouse classifications based on the purpose and the legal status or the custom procedure attached to the goods in question.[62] These are temporary customs storage, bonded customs warehouses, and government customs warehouses. In accordance with Article 175(1) of the Customs Proclamation, certain groups of persons can establish temporary customs storage and bonded customs warehouses for rental or private use upon obtaining the necessary permits issued by the Customs Commission. As per Articles 4 and 8 to 11 of the Customs Warehouse License Issuance Council of Ministers Regulations No. 24/1997, the commission will inform the applicant in writing about the decision of granting or rejecting the license within thirty (30) days from the date of receipt of the application. While Article 132 of the Customs Proclamation provides what the customs warehouse permit holders shall do or shall not do, Directive on Customs Warehouse Administration Implementation No. 40/200245 describes the particular requirements for the different kinds of warehouses.

Temporary customs storage are enclosed or open premises in which import, export, or transit goods are stored under customs control until either the completion of customs formalities or transfer to bonded customs warehouses or government warehouses, as the case may be.[63] They also include dry ports established and Ethiopia has 8 dry ports so far. These are which are Modjo, Gelan, Mekelle, Kombolcha, Semera, Diredawa, Kality, and Woreta dry Ports. Bonded customs warehouses are warehouses where goods are stored under customs control without payment of duties and taxes.[64] Important examples are duty-free shops (which are established in international airports or, where necessary, in other places in which duty and tax-free goods are sold to international travelers and other duty-free privileged persons) and bonded factories (bonded factories produce goods under customs control using raw

[61] Ibid.
[62] Articles 2(9) cum Arts 50-64 of the Proclamation No.859/2014
[63] Article 2(10)(a) of the Proclamation No.859/2014
[64] Article 2(11) of the Proclamation No.859/2014

materials and accessories acquired without payment of duty and taxes.) [65] These types of warehouses are licensed as duty incentive schemes under article 3 of Export Trade Duty Incentive Schemes Proclamation No.768/2012). Generally, goods are stored in bonded customs warehouses for a longer period of time than under temporary customs storage where they only stay until the completion of documentation and other formalities with production and export. The Customs warehouse License Issuance Council of Ministers Regulation No.24/1997 and article 175 of the customs proclamation prescribes that custom warehouses may be established for general use (public customs warehouses) or private customs warehouses for the use of specified persons (for the warehousing of goods imported or exported by a particular licensee) only. A temporary customs warehouse and bonded customs warehouse may be established for rental or private use upon obtaining permits from the Customs Commission. Goods are released from temporary customs storage or bonded warehouses in any of the following situations:[66]

- Released for home use upon payment of taxes and duty due thereon;
- Transferred to a factory under customs control;
- Transferred to another customs warehouse or released for transit;
- Released for export; or
- Released for sale in the duty-free shop.

Government customs warehouses are warehouses where goods seized or forfeited for violating customs law are stored under customs control until they are sold or disposed of.[67] Abandoned goods can also be stored in government customs warehouses. Unlike the other two types of warehouses, government customs warehouses are run by the Customs Commission. Generally, the main purpose of the customs warehousing procedure is to facilitate trade and, specifically, the next customs operation. Since goods deposited in a customs warehouse do not become liable to the payment of import duties and taxes until the goods are cleared, it allows the owner of the goods sufficient time to negotiate their sale or to arrange for the goods to be processed or manufactured provided that the owner does so within the time prescribed under the proclamation. The custom proclamation chapter eight entirely deals with

[65] Article 2(11& 12) of the Proclamation No.859/2014
[66] Article 52 of the Proclamation No.859/2014
[67] Article 2(13) of the Proclamation No.859/2014

customs warehouse procedures such as the warehousing of goods, time limit of storage in a customs warehouse, removal of goods from a customs warehouse, customs control on customs warehouse, warehouse fee, and transfer of ownership p of goods in a customs warehouse. A directive that gives further details of the administration and custom warehousing procedure has been issued. Customs Warehouse Administration Directive No.154/2011 gives detail of procedural and administrative matters in relation to a customs warehouse.

8.5.4. Customs Clearance[68]

The Revised Kyoto Convention defines customs clearance as "the accomplishment of the Customs formalities necessary to allow goods to enter home use, to be exported or to be placed under another Customs procedure" and release as "the action by the Customs to permit goods undergoing clearance to be placed at the disposal of the persons concerned''.[69] The definition provides for two core customs operations as part of customs clearance. One is the completion of legally laid down formalities that the specific goods in question are required to undergo based on the purpose for which the goods have been imported, exported, or to be placed under another customs. The other one is the release of goods for free circulation or for the purpose they have been brought in.[70]

These procedures relate to cargo importation into Ethiopian territory according to the customs proclamation. According to Article 2(2) of the Customs Proclamation, the term "cargo" includes any goods imported or exported by any means of transport other than stores for the purpose of transport (i.e. goods to be consumed during the journey, such as spare parts or food items) for commercial use and for baggage of travelers. The term cargo importation clearance procedures mean the accomplishment of the customs formalities necessary to allow cargo to enter into the customs territory and to release it for the purpose for which it has been imported. Accordingly, the clearance procedure includes submission of the goods declaration, acceptance or rejection of the goods declaration, and checking the goods declaration against the

[68] Article 23ff. of the Proclamation No.859/2014

[69] World Customs Organization, General Annex: Chapter 2 of the Revised Kyoto Convention, 17 April 2008

[70] Article 27 of the Proclamation No.859/2014. Accordingly, goods which have been verified to have complied with customs formalities shall acquire the status of domestic goods.

documents produced (invoice, bill of lading, certificate of origin, permits, etc.).[71]

One might reasonably ask, should customs perform all these procedures for all goods imported or exported? What does the international practice show in this regard? The international trading environment has been concerned with the speed of transactions and with the sheer volume of goods now being traded around the globe.[72] This, together with mounting pressure from the international trading community to minimize government intervention, has caused customs authorities to place an increasing emphasis on the facilitation of trade.[73] In an effort to achieve an appropriate balance between trade facilitation and regulatory control, customs administrations are generally abandoning their traditional, routine "gateway" checks and are now applying the principles of risk management, with varying degrees of sophistication and success.[74]

As with any endeavor or with any government function, the task of customs administration is surrounded by myriad risks that go against its objectives. In seeking to achieve an appropriate balance between trade facilitation and regulatory control, customs must simultaneously manage two risks- the potential failure to facilitate international trade and the potential for noncompliance with customs laws.[75] The application of risk management principles provides the means of achieving this balance.[76]

It is with this view Ethiopian customs proclamation made risk management the foundational principle in the conduct of customs operations, including customs clearance.[77] Risk management is defined as a system of management by which different risk bands are categorized on the basis of their risk levels in light of fair customs service provision and control with respect to goods brought to or taken out of customs territory.[78] A further working procedure in this respect is issued as a directive. A Directive Determining the Risk Level of Goods

[71]Article 12-13, Article 2(41) of the Proclamation No.859/2014
[72] Luc De Wulf and José B. Sokol, Customs Modernization Handbook, World Bank, Washington, D.C. EC, 2007 P.91
[73] Ibid.
[74] Ibid.
[75] Ibid, P.92
[76] Ibid.
[77]Article 6 of the Proclamation No.859/2014
[78]Article 2(45) of the Proclamation No.859/2014

No.132/2010 laid down the whole procedures and principles determining the risk level of goods.

To define the term in a more granular way, risk management has been defined as a procedure conducted on goods imported, exported and in transit based on the risk level assigned to goods on the basis of criteria designed having in view the balancing of custom service and control. Among these criteria are such factors as the importers' profile, the imported goods' country of origin, and value. This has led to a classification of imported and exported goods in different risk levels. As stipulated under Article 2 (41) and 23 of the customs proclamation, examination of documents and goods are the main tasks performed in making sure that imported goods comply with the customs laws. Classification of risk levels based on the principles of risk management aids in this task.

As per the directive determining risks, a Blue Risk Level implies a channel through which imported goods reached destination is released or export goods at departure point are allowed to depart, as the case may be, upon the presentation of declaration entered for the goods without the need for examination of documents. This risk level is assigned to Authorized Economic Operators. In such instances, where goods are released without physical examination or examination of documents, or both, the control is to be accomplished through a post-clearance audit process which may be done after the release of goods within five years from the date a goods declaration has been accepted pursuant to Article 121(1)(4) of the custom proclamation.

Green Risk Level (Low) is similar to Blue Risk Level except that it applies to everyone meeting the requirement. Yellow Risk Level (Medium) prescribes only document examination for both export and import goods. This means that there is no physical examination of goods. Red Risk Level (High) refers to a channel that requires both the document and physical examination of goods for imported and exported goods as per the Directive Determining the Physical Examination and Priority Goods upon Which Customs Procedure is Performed No.159/2011. Once the risk level has been determined for both imported and exported goods and after the goods are subject to whether document examination or physical examination (or both) that is required, the next customs clearance procedure could be one of several results. These include the release of the goods if they are imported for home use, release for the purpose they are

imported for, releasing them for departure if they are goods meant for export, or subjecting the goods to another procedure as the case may be. Such a generalized procedure works for the goods imported as long as no violation of customs laws is proved or the provisions laid down in article 25 and article 27 of the custom proclamation are complied with.

8.5.5. Customs Valuation

Customs valuation is the procedure applied to determine the value of imported goods for the purpose of levying *ad valorem* customs duties.[79] Customs valuation is crucial because, without customs valuation, it is not possible to determine the customs duties and other taxes which are payable when goods are imported or exported. In Ethiopia, determining the true customs value allows us to determine the amount of withholding income tax at the time of importation as indicated in Art. 51 of the Income Tax proclamation, the amount of VAT to be collected in relation to the importation of goods (Art. 15 of the VAT Proclamation No. 285/2002), the surtax on the importation as per Import Sur-Tax Council of Ministers Regulations No.133/2007, and the excise duty as per the Excise Tax Proclamation No.1186/2020.

At the international level, the existence of different and unstable valuation systems was a major obstacle to the growth of trade. As a solution to this diversified practice, countries have agreed on international rules. One of the prominent rules is the WTO agreement on customs valuation, which aims for a fair, uniform and neutral system for the valuation of goods for customs purposes. [80] Although Ethiopia is not yet a WTO member, the Ethiopian customs valuation methods, which are laid out in Articles 89-100 of the Customs Proclamation and in the Customs Duty Paying Value Determination Directive No.158/2011, have been designed in line with the WTO Agreement. Article 89 of the proclamation lays down the conditions in which the customs valuation rules apply. The customs valuation rules and other related provisions listed in articles 90-101 are to be applied while determining a dutiable value for determining the customs tariff and import charges, as well as for applying non-tariff measures prescribed by laws governing foreign trade. The dutiable value for imported goods is to be the actual total cost of goods up to the first entry

[79] Dictionary of Trade Policy Terms, Fourth Edition, July 2003
[80] See the preamble of Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade, 1994

point to the customs territory of Ethiopia and it is the actual total costs of goods up to the final exit point from the customs territory of Ethiopia for export goods.

As a principle of customs valuation, ERCA (now the Customs Commission) has organized a database that enables it to determine the duties and taxes of imported goods based on the customs proclamation in cases where the duties and taxes cannot be determined based on transaction value. The commission recognizes six different customs valuation methods. The application of methods is so strictly hierarchical that method 1 is the default method and only if it is impossible to apply in the specific case that Method 2 can be tried, and so on. For the application of each method, evidence for the value of the good must be produced and any documents and information about an importation required by a customs officer must be provided. The following paragraphs provide discussions on each of the six valuation methods.

The first method (Method 1) is the "transaction value" method as provided under Article 90. According to this principle, the customs value of imported goods shall be the price actually paid or payable for the goods and costs. The fact that it can be adjusted where necessary is set forth in Article 99 of the Customs Proclamation. Thus, there are four key elements of the transaction value that include sale, price actually paid or payable, the goods sold for export to Ethiopia, and adjustments. In the latter case, where the buyer and the seller are related persons, the transaction value is considered as the basis of the valuation if it is accepted by the Authority. If the seller and the buyer are related as described above, they may stipulate a simulated price so as to evade the actual customs duties and taxes to be paid to the government. The question is when are a buyer and a seller deemed to be related. This question can be easily answered by consulting the tax administration proclamation.[81]

The second method (Method 2) is the "transaction value of identical goods" method, which is provided under Article 91. Where the transaction value of imported goods cannot be determined on the basis of Method 1, it is determined by taking the transaction value of identical goods sold for export to Ethiopia at the same commercial level, in substantially the same quantity pursuant to Article 91 and with adjustments a provided under article 8 of the directive cited

[81] See Tax Administration Proclamation No.983/2016

above. However, what does that means by identical goods? In order to properly apply this article, we need to understand the meaning of identical goods. Identical goods are goods defined in the customs proclamation as goods produced in the same country as those being valued.[82] They must also be the same in all respects, such as physical characteristics, quality, and reputation, and be imported within ninety (90) days of the goods to be valued.[83] Where two or more countries are involved in the production of a product, the origin of the product is the country in which the last substantial manufacturing or transformation process of economic value took place. The issue of country of origin will be dealt with in the subsequent sections.

The third method (Method 3) is the "transaction Value of Similar Goods" method as stipulated in Article 92. Where the transaction value of imported goods cannot be determined on the basis of Methods 1 or 2, it is determined by taking the transaction value of similar goods sold for export to Ethiopia at the same commercial level. This method is similar to method 2 except that the goods under consideration are similar goods defined as goods that differ in some respects from the goods being valued, but those are produced in the same country, have the same function, and are commercially interchangeable. One can pose some logical questions like what are similar goods and how do we determine whether goods are similar or not. Similar goods are defined by Art. 2(28) of the proclamation as:

> "similar goods means goods which, although not alike in all respects, have like characteristics, and component materials, perform the same functions, and to be commercially interchangeable; and the quality, origin, reputation and the trade mark of which are among the factors to be considered in determining their similarity".

The fourth method (Method 4) is the "Deductive Value" Method. When it is not possible to calculate the customs value of imported goods using the foregoing methods according to the order they have appeared, the customs value of imported goods can be determined by what is called the deductive value method provided under Art. 93 of the Proclamation. According to this method, where

[82] Article 2(27) of the Proclamation No.859/2014

[83] Article 2(27) of the Customs Proclamation No.859/2014; see also Article 8(1) of the Customs Duty Paying Value Determination Directive No.158/2011

the customs value of goods cannot be determined using the transaction value, identical goods or similar goods, the customs value of goods can be determined by using the unit price of identical or similar goods imported at or about the same time and which are sold in Ethiopia in their original state in the greatest aggregate quantity to persons who are not related to the seller. However, the price must be reduced by an amount of commission, expenses and profit equal to that usually reflected in sales within Ethiopia of identical or similar imported goods, and the usual charges for the transport, insurance and other related costs to be incurred within Ethiopia for identical or similar imported goods.

The fifth method (Method 5) is the Computed Value Method as stipulated in Article 94. If the customs value of imported goods cannot be determined by the foregoing methods, the Ethiopian customs proclamation contains yet another method called the computed value method. According to this method, the customs value of imported goods can be based on the sum of the cost of manufacturing or processing the goods in the country of origin, an amount representing the selling expenses and profit equal to that usually reflected in the sale of identical or similar goods by producers in the country of export; and the transport, loading, unloading, handling, and insurance costs associated with the transport of goods to the port of entry into the customs territory of Ethiopia. We need to bear in mind that the above elements should be met cumulatively. However, one may ask how the Ethiopian Government can know the above costs of the goods given the fact that these elements are beyond the jurisdictional limit of Ethiopia. Has Ethiopia put in place mechanisms that help the Authority to know the cost of manufacturing or processing the goods in the country of origin? In sum, can the computed value method be applied by the Customs Commission currently? Although applying this method seems to be difficult, Article 10 (1)(f) of the customs proclamation and article 24 of the Customs Duty Paying Value Determination Directive No.158/2011 requires the declarant to adduce all the evidence needed that substantiate his method of customs valuation. This goes in line with the principle of self-assessment in customs procedure envisaged under article 5 of the proclamation.

The final and the sixth method (Method 6) is the “fallback” method, which is regulated under Article 95. If the customs value of imported goods cannot be determined by the aforementioned methods according to the order they have appeared in the Proclamation, it can be determined based on the data available in Ethiopia and by using equitable methods. However, these methods should be

consistent with the general principles of this Proclamation although there are certainly worrisome and perplexing issues arising in relation to this method of determining the customs value of imported goods. For instance, it is doubtful that there are data that can be availed of by the Commission. Which organ of government is expected to maintain these data? What is the nature of these data? The other problem is that this method may open the door for corruption, mistreatment of the importer and the like since this method gives wide discretionary power to the Commission. Accordingly, article 12 of the Customs Duty Paying Value Determination Directive No.158/2011 provides the details and the requirements needed to use this method of customs valuation.

8.5.6. Tariff Classification

Once the customs value of imported goods is determined, the amount of customs duties payable can be read from the relevant tariff book, which consists of tariff classification numbers assigned to goods and a corresponding tariff rate in the form of tables.[84] Classification can be a difficult undertaking but is an essential part of customs and trade compliance. No international instrument, including the GATT, contains rules regarding tariff classifications.[85] In the past, countries had their own individual systems.[86] However, as trade expanded, countries recognized the need for more uniform classifications, which resulted in the drafting in 1988 of the "Harmonized Commodity Description and Coding System" (HS).[87] Thus, the Ethiopian import tariff is based on Article 102 of the Customs Proclamation, the internationally accepted Harmonized System and Coding System and Ethiopia's Ratification Proclamation No. 67/1993. The Customs Proclamation, apart from laying down the general principles, has defined duty under articles 2(3) and 102 as a charge levied and collected on any imported or exported goods in accordance with the Customs Tariff Regulation issued pursuant to the customs proclamation and the HS system. Since 1993,

[84] A customs tariff book essentially comprises two elements: a goods nomenclature and a list of tariff rates. The goods nomenclature is commonly based on the Harmonized System.

[85] Weerth Carsten, Basic Principles of Customs Classifications under the Harmonized System, Global Trade and Customs Journal, Vol. 3, Iss. 2, 2008, PP. 61-67

[86] Ibid.

[87] The Harmonized System Convention came into force on the 1st January 1988 and amended in 1992, 1996, 2002, 2007 and 2012. The structure of the Harmonized System (HS) Nomenclature is comprised of 21Sections and 99 Chapters. See Harmonized System (HS) Handbook for Customs Administration in the East African Region, Programme on Capacity Building of Master Trainers under the JICA Project on Capacity Building for the Customs Administrations of the Eastern African Region (Phase 2) Edition 2012

customs tariff revisions and amendments have been done based on the Harmonized System, and currently, the Ministry of Finance, by virtue of the power given to it according to article 3(2) of the Customs Tariffs (Amendment) Council of Regulation No. 153/2016, adopted the 2017 version of the HS. [88] In other words, the current version of the national tariff book is in accordance with the 2017 version of the Harmonized System.[89]

In short, tariff classification is the process of determining the particular tariff heading or sub-heading of a commodity. classification is done on the basis of the description of the commodity, composition and other technical specifications, manner of presentation (e.g. packing for retail sale), degree of manufacture and function or use. The most important function of tariff classification is its role in determining the duties and taxes to be applied. The declarant is legally responsible for goods' correct tariff classification. There can be of course binding information regarding tariff classification.[90] This is a written classification decision by the commission, given on request, which is legally binding, until revoked, on all customs branch offices within the customs territory. If the classification is done incorrectly a penalty may be applied at customs entry, arrears plus interest of duties and taxes that have been incurred over the previous five (5) years may be charged and goods may be delayed and/or seized.

8.5.7. Origin of Goods

Literally speaking origin of a good refers to the source place from which a good came or was found. Determining the origin of goods is important for the application of the customs tariff, quantitative restrictions, or any other measure related to trade. Duties and restrictions in several cases depend upon the source of imports. The Revised Kyoto Convention, which also guides Ethiopia's regime for the origin of goods, defines the country of origin of goods as the country in which the goods have been produced or manufactured, according to the criteria laid down for the purposes of the application of the customs tariff, tariff preference or of any other measure related to trade.[91] But how should the origin of goods determine? There need to be rules of origin (national or

[88] Supra Note 3
[89] FDRE Customs Tariff Amendment No.8/2017
[90] Article 103 (1-4) of the Proclamation No.859/2014
[91] RKC, Specifi Annex K, Chapters One to Three.

international) setting criteria to determine the national source of a product. Rules of origin have become a challenging topic in international trade, not only because they constitute a highly technical area of rule-making, but also because their designation and application have not been harmonized across the world. The lack of harmony is even more remarkable in the era of regionalism when more and more free trade agreements (FTAs) are concluded, creating the spaghetti bowl effect.

Rules of origin can be classified into non-preferential rules of origin and preferential rules of origin. [92] Non-preferential rules of origin are those primarily designated in order to sustain the most-favored-treatment (MFN) within the World Trade Organization (WTO). These rules of origin are deemed "non-preferential" because they are applied on a non-preferential basis to determine the country of origin for certain purposes of application within the multilateral trading system. Preferential rules of origin are those associated with "contractual or autonomous trade regimes leading to the granting of tariff preferences going beyond" the MFN application. rules of origin in FTAs and in the Generalized System of Preferences (GSP) are considered preferential because they help to determine the country of origin in order to grant preferential and special treatment to products originating in a contracting party or a beneficiary country. A condition for a good to benefit from any preferences accorded under such agreements is to prove that its origin is in a benefitting country.

In Ethiopia, the origin of goods is governed under the terms of Articles 104-108 of the Customs Proclamation. A declarant must submit documents proving the country of origin of goods, such as a certificate of origin. According to the non-preferential rule of origin in Ethiopia If goods have been wholly produced in one country, that country is the country of origin. Where two or more countries are involved in a good's production, the origin of the product is the country in which the last substantial manufacturing or transformation process of economic value took place. With regard to preferential Rules of Origin of Goods, in Ethiopia, special customs tariff rates are applicable to goods produced in and imported from COMESA member countries. The COMESA tariff rate has 10% deduction from regular rates. Zero customs tariff rates are applied to goods

[92] WTO's Agreement on Rules of Origin, 20 September 1986, Article 1

imported from Sudan. To benefit from these preferences, a good's origin in a COMESA member country, Sudan or Djibouti must be proven.

8.5.8. Temporary Importation, Exportation and Re-Exportation of Imported Goods[93]

There are situations whereby goods may be temporarily imported to Ethiopia.[94] For example, goods necessary for trade promotion, technology transfer, tourism and cultural exchange, construction works, and consultancy can be temporarily imported. In such cases, importers are not required to pay duties and taxes provided that the goods are re-exported at the time of completion of the tasks that justified the importation of the goods and security equivalent to the duties and taxes payable with respect to such goods is provided.[95] If they are not re-exported within the time limit, the security provided for temporarily imported goods shall be transferred to the government treasury. Sometimes laws prohibit the temporary importation of particular goods. For example, spare parts and consumable goods cannot be temporarily imported because it is not possible to re-export such goods. Importers are also prohibited from using such goods other than the purpose for which they are imported or to use them out of the locality where the activities are carried out or transferred to other persons.

Like the case in the importation, goods may be exported temporarily by completing customs formalities.[96] Where goods are temporarily exported for different purposes, such goods may be allowed to re-enter the country without payment of duties and taxes. However, some goods returning to Ethiopia pursuant can be subject to duties and taxes. Finally, some goods imported and declared for consumption in Ethiopia (home consumption), that are not prohibited or the entrance of which is not contrary to the law, may be re-exported at the request of the importer before completing customs formalities upon payment of 5% of the duties and taxes to be paid on the goods. By the same token, exported domestic goods that have been returned within one year because of their failure to meet the quality standards specified by the contract of sale or business relation that has been the basis for their export are relieved from customs duties and taxes. However, the one-year period may be extended

[93] Article 71-77 of the Proclamation No.859/2014
[94] Article 71 of the Proclamation No.859/2014
[95] Article 67 (1) of the Proclamation No.859/2014
[96] Article 75 of the Proclamation No.859/2014

at the request of the interested party on justifiable grounds. Goods imported for home consumption may be re-exported and replaced without additional payment of duties and taxes upon the request of the importer within the time specified under the warranty certificate before their release for free circulation.[97] This is possible when it is provided that the goods imported are incompatible with their intended purpose, defective, affected by an error of consignment, or incomplete.

8.5.9. Securities to Guarantee Compliance and Payment

Customs departments often require the provision of security to guarantee the payment of duties and taxes or compliance with the customs requirements and procedures.[98] The Kyoto Convention from which Ethiopian customs law adopted many concepts recognizes the procedure or practice of securities. Since providing security is often expensive and the costs of obtaining the security are normally added to the cost of the international movement of the goods, it is essential that provisions relating to security be clear and transparent for traders. The Ethiopian customs proclamation chapter five deals with security to guarantee payment of customs duties and taxes. The proclamation under article 116 provides for the general conditions under which security may be required. Security is to be required to guarantee the payment of duties and taxes or compliance with the requirements related to duty and tax exemption privilege. The lists of the conditions which require security have been provided under article 117 of the customs proclamation. Such conditions are: when additional time is required to produce complete documents necessary for the completion of customs formalities; to ensure the re-exportation of goods imported on a temporary basis; to ensure transit goods exit through the approved customs routes or arrive at the predetermined customs point of destination; to ensure that goods which are produced by duty relieved imported raw materials are exported.

Ethiopian Customs Proclamation articles 118-120 specify the forms under which security is provided, the manner in which the amount of security is determined, and the discharge of the security once the obligations are fulfilled. Forms of security include cash deposits, bank guarantees, insurance bonds, and

[97] Article 76 of Proclamation No.859/2014

[98] In Ethiopian case one can see provisions such as Article 16 (2), 40 (2), 71, and 116-120 of Proclamation No.859/2014

any undertaking provided for ensuring the fulfillment of an obligation to customs. In this regard, the Ethiopian Customs Commission requires only one security to be furnished in respect of one payment of duties, taxes, and service charges. The person required to furnish security is allowed to choose any acceptable form of security. However, the commission may reject security where it is incompatible with the applicable customs procedure.

Regarding the amount of security, the principle is that the amount of security to be furnished shall not be less than the amount of duties, taxes and service charges. In cases where the amount of duties, taxes and service charges cannot be established with certainty, the amount of security will be equal to the maximum amount estimated by the commission. If the security furnished does not cover the debt due to any cause, the debtor will be required to furnish additional security or replace the original security with a new one. The duration of security may vary according to its type and purpose and is decided by the commission.

Finally, it's important to understand the role of the debtor and guarantor. If the debtor fails to discharge his/her obligations, the guarantor will be requested to effect the payment immediately. The guarantor and the debtor will be jointly and severally liable for the secured amount of debt, including interests and costs incurred. If the guarantor fails to effect payment, ERCA may apply the procedure prescribed under the Tax Administration Proclamation to seize the property of the debtor or the guarantor for the payment of the debt.

8.6 Payment of Customs Duties and Taxes

We have already said that one of the inherent functions of Customs is revenue collection through the payment of customs duties and taxes. According to proclamation number 1097/2018, one of the missions of the Ethiopian custom commission is to collect timely and effective tax revenues generated by the economy. With the same understanding, Articles 109-115 of the Customs Proclamation clearly prescribe how the payment of customs duties, taxes and service charges are to be effected.[99] Accordingly, this section is devoted to providing information about obligation, assessment, correction, refund and other issues related to the payment of customs duties, taxes and service charges.

[99] Article 93 of the Proclamation No.859/2014

Unless otherwise provided by law, treaties, or decided by the Ministry of Finance, duties and taxes shall be payable for any imported or exported goods.[100] The declarant who makes goods declaration or in whose name such a declaration is made shall be liable for payment of the duties and taxes.[101] A custom clearing agent is also liable jointly and severally with the declarant when he commits fault for the non-payment of duties and taxes.[102] The duties and taxes are imposed and assessed on the goods on the basis of the law in force on the date of acceptance of the goods declaration.[103] These duties and taxes have been defined under the Customs Proclamation. Accordingly, *'duty'* is a charge levied and collected on any imported and exported goods in accordance with the Customs Tariff Regulations issued pursuant to the Customs Proclamation and the Harmonized System.[104] Whereas, *'tax'* means payment collected in accordance with the existing tax laws on imported and exported goods.[105]

Currently, Ethiopia levies five kinds of duties and taxes on import items that provide considerable revenue to the government. These taxes and duties are assigned priority levels and are calculated in sequential order. These taxes, in their sequential order, are customs duty, excise tax, VAT, surtax and withholding tax.

The first of the five taxes levied on import items is customs duty. Accordingly, once the imported goods have been classified and thereby the customs tariff is determined. And the dutiable value is determined as per the custom valuation rules; the next step would be to determine the customs duty payable on the good. The tax base for customs duties is the actual total cost of the goods up to the first entry point to the customs territory of Ethiopia.[106] Thus, Customs duties are normally calculated as a percentage of the duty-paying value, also known as cost, insurance, and freight (CIF) value. This is the sum of the transaction value (cost of goods), cost of transporting the goods from the original port of loading to the port of entry in Ethiopia, transport insurance, and other charges, such as

[100] Ibid, Article 109
[101] Ibid, Article 110
[102] Ibid, Article 110(2)
[103] Ibid, Article 111(1)
[104] Ibid, Article 2(3)
[105] Ibid, Article 2(4)
[106] Ibid, Article 89(2)

loading and unloading charges, port charges, etc.[107] The duty rates to be imposed on the CIF vary across goods. The Standard duty rates vary between 0% and 35%. As a member of the Common Market for Eastern and Southern Africa (COMESA) preferential trade area, Ethiopia grants preferential customs treatment for goods originating from COMESA member states – a 10% reduction in the regular customs duty rates.

Excise tax is the second of the five taxes levied on import items and it is one of the most well-known forms of tax in Ethiopia. It is a tax levied on selected goods such as luxury goods and basic goods which are demand inelastic i.e. goods that shows no change at all in quantity demanded when the price goes up or down. Moreover, the excise tax is also applied to goods that are considered hazardous to health and that may cause social problems. Additionally, the government uses excise tax as a revenue-producing device. Excise duty rates now range from 0% to 500% and are levied on imported goods (of either the ex-factory price or CIF value plus customs duties), with the tax being applied to certain demand-inelastic and luxury items, as well as to goods that are assumed to have negative externalities (e.g. fuel, alcohol, tobacco). VAT is the third of the five taxes to be levied on import items. In Ethiopia, VAT is levied at a flat percentage rate. To the exclusion of goods detailed in article 8 of the proclamation No. 285/2002 and goods exempted from VAT by the directive, VAT is levied on every imported item. Importers are liable to pay at a flat percentage rate of 15% on the sum of the CIF value, customs duty, and excise tax.

The surtax is the fourth of the five taxes imposed on import items. The surtax was introduced in the Ethiopian tax system on April 9, 2007. The council of Ministers issued a regulation to levy 10 percent surtax on imported goods. The imposition of a surtax was necessitated to build the financial capacity of the government for interventions to solve the rise in the cost of living which is affecting consumers with low and medium income levels. The amount payable is calculated on the sum of the CIF value, customs duty, excise tax, and VAT.

The fifth of the five taxes imposed on import items is withholding tax. This is an income tax collected on the import of goods for commercial use. The collected amount is treated as a tax that is withheld and is creditable against the

[107] Ibid, Article 89(2)

taxpayers' income tax liability for the year. Thus, it is not a tax in itself, but rather a (partial) guarantee on the payment of income taxes. The Income-tax proclamation made effective a withholding tax of 3 percent on import items. The amount collected on imported goods shall be three percent of the sum of cost, insurance and freight (CIF value).

Illustration of Computation of import duty and taxes

Duties are calculated as follows:

Customs duty = [Duty-paying value * Customs duty rate]
Excise tax = [(Duty-paying value + Customs duty) * Excise tax rate]
Value added tax = [(Duty-paying value + Customs duty + Excise tax) * 15%]
Surtax = [(Duty-paying value + Customs duty + Excise tax + Value added tax) * 10%]
Withholding tax = [(Duty-paying value) * 3%]

For example, assume that Item "A" has been imported to Ethiopia and has a duty paying value of Birr 200,000.00, a customs duty of 35%, excise tax 60%, value added tax 15%, surtax 10% and withholding tax 3%. The duty and taxes are calculated as follows:

Customs duty= [200,000.00 * 35%] = Birr 70,000.00;
Excise tax = [(200,000.00 + 70,000.00) * 60%] = Birr 162,000.00;
Value added tax= [(200,000.00 + 70,000.00 + 162,000.00)] * 15%= Birr 64,800.00;
Sur tax = [(200,000.00 + 70,000.00 + 162,000.00 + 64,800.00)] * 10%= Birr 49,680.00; and
Withholding tax= [200,000.00 * 3%] = Birr 6,000.00
Total duty and tax is the sum of customs duty, excise tax, value-added tax, surtax and withholding tax, i.e. Birr 352,480.00.

Duties and taxes can be assessed on the basis of advance information submitted by the declarant before the goods enter the customs port and where the commission finds an error in the assessment of duties and taxes, it will correct the error without prejudice to the legal liability of the person causing the error.

Customs duty and other taxes on export items are waived purposely to encourage export. However, the government levies an export tax on specific semi-prepared hides and skins of animals. This export tax includes taxes on wet

blue skin of an ox, wet blue hides of sheep and goat, and pickled hide of a sheep. The tax is 150 percent of the selling price of the hides and skins to be exported. This tax is introduced on 1 January 2010 by a directive no. 25/2009 issued by Ministry of Finance and Economic Development. The government imposed an export tax on these items as a method to curb the exportation of the items and to increase domestic leather products such as shoes, purses, ready-made garments, etc.

In addition to taxes and duties, there are various service Charges that must be paid with respect to importation, exportation, and licensing. Warehouse licensing and renewal fees and scanning fees can be mentioned as good examples. According to the Customs Warehouse License Issuance Council of Ministers Regulations No. 24/1997, license and renewal fees for customs warehouses will be paid and all goods subject to examination with a scanning machine are charged 0.07% of duty paying the value for scanning.

Finally, let us see the possibility of a refund of duties and taxes. A refund of duties and taxes may be claimed for overcharged duties and taxes[108], invalidated goods declaration[109], deteriorated, spoiled, damaged, destroyed goods, or short-landed goods. A claim for refund of duties and taxes will be considered only if it is submitted within one year after the goods have been imported or exported. The payment of duties and taxes shall be in cash or any other legal means of payment.

8.7 Customs Control and Law Enforcement

In tune with international practice, the entry and exit of goods into and out of Ethiopia are regulated by customs law. The primary task of Customs is to ensure compliance with Customs law. The Customs Proclamation No.859/2014 is the basic law that governs and regulates the entry and exit of different categories of vessels, crafts, goods, etc., into or outside Ethiopia. In addition to Customs Proclamation, the Customs Commission also works to ensure compliance with various other national and international laws and

[108] In such cases, a refund will be granted if the overcharge is a result of an incorrect commodity classification, tariff setting, valuation, or other calculation mistakes.
[109] In such cases, duties and taxes will be refunded where a goods declaration is cancelled after duties and taxes have been paid and an application is submitted by the person concerned within the prescribed period.

regulations.[110] It is the responsibility of the Customs to handle international traffic speedily and effectively while ensuring that all movement of goods across the national borders is in conformity with the laws of the land. Essentially all goods brought into the country or taken outside the country must pass through authorized entry/exit points, be reported to Customs, and the importers/exporters must fulfill the prescribed legal and procedural requirements laid down under Customs Proclamation and allied laws including payment of the duties leviable if any. Accordingly, the Customs Proclamation lays down in detail provisions to deal with acts and omissions that violate the law and provide for penalties that can be imposed by authorities and punishments that can be imposed by courts of law. The law also empowers Customs officers to carry out searches, seize goods, documents, and conveyances, and forfeiture of goods and means of transport involved in such offenses.[111] But it is to be noted that the power of the Customs Commission to investigate and prosecute Customs offenses has been transferred to the Federal Police Commission and Federal Attorney General respectively.[112]

The Customs Proclamation also lays down the procedural requirements to be followed while exercising such powers and imposing the various administrative measures or penalties for violations so as to ensure that due process of law is followed before action is taken against offending goods or persons or conveyances involved in the violations.[113] The Customs Proclamation envisages two types of Customs offenses and their consequential punishments. The first is a penalty for violation of statutory provisions involving a penalty of money and confiscation of goods, which can be imposed by the Customs Commission. Chapter one of the Customs Proclamation (Article 156 to 165) deals with the confiscation of goods and conveyances and the imposition of penalties. The second is criminal punishment is imprisonment and fine; which can be granted only in a criminal court after prosecution. Both penalty and punishment can be imposed for the same offense.

[110]Art. 2(39) Customs Proclamation No.859/2014 defines customs law as that includes other laws the Customs Commission enforces in addition to the customs proclamation and the subsidiary laws enacted under it. Such other laws include international treaties to which Ethiopia is a party.
[111]See Chapter 2 of Proclamation No.859/2014
[112]See Federal Attorney General Establishment Proclamation, Proclamation No. 943/2016, Art 22 (4 & 5)
[113] Ibid.

Customs offenses and administrative penalties under Chapter one refers to the frequently occurring minor irregularities in trade and customs operations. The penalties are designed to rectify and punish offenses with minimal disruption of trade, as long and costly criminal proceedings would be disproportionate burdens on trade and on the flow of customs operations.[114]The same Chapter also provides for self-executing mechanisms for enforcing administrative penalties.[115]Accordingly, the Customs Commission has the power to enforce administrative fines by holding the release of goods that are related to the offense until the fine is paid. In case the value of the goods is not sufficient to settle the fine, the Customs Commission may size the property of the importer in accordance with the Income Tax Proclamation.[116]

Customs criminal offences and penalties under Chapter two are higher offences that mostly carry imprisonment for those convicted. The general principles embodied in the Criminal Code of 2004 are applicable for criminal offences[117]unless the Customs Proclamation expressly provides otherwise. Some customs offences and the corresponding administrative penalties they entail are the following ones: Importing, exporting or trying to export restricted goods without approval and also failing to get such authorization within one month is punishable with a fine no less than Birr10, 000 and no more than Birr50, 000(for a first offence the penalty is Birr 10,000, for a second offence Birr25, 000 and for a third offence and more, Birr 50,000).[118] If the penalty is on an import good, it shall be re-exported by the importer within one month, while export goods shall be prevented from being exported.[119]Importing or exporting concealed goods not registered in the customs declaration or goods in respect to which no accurate information is provided without paying duties/taxes will be subject to a fine equivalent to twice the amount of such duty and tax, on top of the settlement of the duty and tax payable provided that the duties and taxes that should have been paid on the concealed goods does not

[114] Supra Note 3 P. 132
[115] See Article 148 of Proclamation No.859/2014
[116] Ibid, Art 148(1)(2).The Income Tax Proclamation No. 286/2002 referred in the article has been repealed and replaced with The Federal Income Tax Proclamation No.979/2016; the seizure procedures provided under the repealed Income Tax Proclamation are now provided under the Federal Tax Administration Proclamation No.
[117] See FDRE Criminal Code Proclamation No. 414/2004, Article 3
[118] As per Article 4/1 of Administrative Penalties for Customs Offences and Forfeiture of Goods Implementation Directive No. 112/2016
[119] Art 156(1) of Proclamation No.859/2014

exceed 50% of the taxes and duty payable on declared goods and is less than one million Birr.[120] However, if the duties and taxes that should have been paid do not exceed 5%ofthetotaldutyand tax paid on the declared goods and the act is committed for the first time in a year the penalty will be waived for the importer. If concealed items account for more than 50% of the value of the goods described in the declaration, the matter will be criminally investigated under Article 169 of the Customs Proclamation (as amended).[121]

Some of the customs criminal offences and corresponding penalties are the following ones: Obstructing or hindering the duties of a customs officer[122] entails a penalty of simple imprisonment for no less than six months and no more than one year and a fine nolessthanBirr5, 000 and no more than Birr 10, 000.[123] If force is used or when the offence is committed by an organized group, the penalty shall be from one to five years of rigorous imprisonment.[124] Importing, exporting or attempting to export prohibited or restricted goods subject to customs clearance is punishable with rigorous imprisonment from five to ten years and a fine not less than Birr 50 thousand and not exceeding Birr 200 thousand without prejudice to the forfeiture of the goods.[125] This criminal offense is commonly known as 'contraband' which literally means illegally smuggling goods across the border. And it is the most frequently committed custom offense.

8.8 Complaints and Appeals

The availability and quality of a fair, impartial, and independent dispute settlement procedure is fundamental to the proper operation of the customs regime. It's already pointed out that customs have the powers, and duties of collecting duties and taxes on imported or exported goods, seizing contraband and unaccustomed goods and means of transport. In Ethiopia, this power and duties including implementing customs laws and international agreements approved and ratified by Ethiopia are given to the Ethiopian Customs

[120] Customs Proclamation (Amendment) Proclamation No.1160/2019, Article 2(39)
[121] Ibid, Art 45(2)
[122] This includes the offence in relation to the custom officers duty of seizing documents, searching warehouse, and means of transport, business premises or a dwelling house
[123] Art 166(1) of Proclamation No.859/2014
[124] Ibid, Art 166(2)
[125] Ibid, Art 2(44)

Commission.[126] The Customs Proclamation further widens and explicitly provides the power of the Customs Commission. As per the customs proclamation, the Customs Commission has the power to conduct a post-clearance audit after the release of goods within five years from the date a goods declaration has been accepted and demand payment of additional duties and taxes, impose administrative penalties for violation of duty-free privileges and other customs offences which it can enforce through a tax foreclosure mechanism in case of default to pay and forfeiture of goods and means of transport.[127]

Achieving and exercising the above objectives and powers especially collecting duties and taxes and enforcing them when the taxpayer is in default, seizing and forfeiting contraband goods, means of transport, or goods violating custom laws in general will not always be achieved smoothly and disputes normally arise in the administration of customs as they would arise in any other social interactions. Hence, it is evitable that the Customs Commissions' decisions directly affect the private rights and obligations of citizens and the taxpayers at large. This demands that disputes in tax collection and other customs enforcement endeavors have to be addressed in a proper manner. For one thing, given the amount of revenue that the Customs Commission is raising, it is in the best interest of all to have an independent, impartial dispute settlement procedure accessible to all taxpayers. There is now a wealth of international evidence that links taxpayers' morale (or voluntary compliance) to their perception of tax equity (or procedural) equity which is related to the fairness of the procedures involved in tax audits and disputes, and the perceived treatment the taxpayer receives from the tax authority.[128] Hence, it means that taxpayers' compliance has to do with the perception of the taxpayer that the dispute resolution mechanism in place is fair. The extent of compliance with the legal obligations it imposes powerfully affects the revenue yield, efficiency and fairness of any tax system.[129]In addition to this, a well-designed internal administrative process for reviewing tax decisions can contribute to economic

[126] See Definitions of Powers, Duties and Organization of the Customs Commission No. 437/2018, Art 5

[127] See Arts.122,147 & 148 of Proclamation No.859/2014

[128] Michael Walpole and Binh Tran-Nam, Access to Tax Justice: How Costs Influence Dispute Resolution Choices, Report to Australasian Institute of Judicial Administrators January 2012 P.4

[129] IMF, Current Challenges in Revenue Mobilization - Improving Tax Compliance, Policy Papers, 29 January 2015

efficiency, competitiveness, and growth by accurately identifying errors in tax administration, lowering compliance costs for taxpayers, and enhancing the credibility and popular legitimacy of the tax regime.[130] Furthermore, enhancing the tax-review process can encourage investment and promote economic growth and diversification. This is because investors value certainty and predictability in tax administration.[131] Secondly, citizens need to have better protection of their constitutional guaranteed rights to property and should not be deprived of such rights without having a procedural due process of law and access to justice in case disputes arise or they are aggrieved by administrative decisions.

8.8.1. Grievance Handling at the Customs Commission

The Customs Proclamation provides for an internal two stages of complaint review sections. These review sections are established both at branch offices and head office. A taxpayer or any person in dispute should appeal to these internal review institutions before taking an appeal to the external review of executive-branch tax tribunals (the Tax Appeal Commission) and review process conducted by a court of law.[132] The organization of the complaint review sections, the selection and appointment of officials, complaint lodging procedures by the taxpayer and others, and the working procedures of the complaint review sections have been listed in a directive.[133]

The powers and duties of the two levels of complaint sections have been stipulated and the types of the complaint subject to their jurisdiction are provided in the Customs proclamation.[134] Accordingly, the review power of complaints related to decisions of the Customs Commission on the origin, valuation, description, and tariff classification of goods; decisions given following post-clearance audit and other administrative decisions given in respect of customs formalities are that of the compliant review section at branch offices.[135] The compliant review section established at the head office has the power to review and decide on appeals on the diffenrt types of complaints. It has also a primary review power of rejection of objections against the forfeiture

[130] World Bank Group, The Administrative Review Process for Tax Disputes: Tax Objections and Appeals in Latin America and the Caribbean: A Toolkitblic, 2019
[131] Ibid, P.13
[132] Articles 153-155 of the Customs Proclamation No. 859/2014
[133] See The Directive Determining Complaint Review Sections No.107/2007
[134] Article 153 of the Customs Proclamation No.859/2014
[135] Ibid, Art.153(1)

of goods or means of transport given by relevant departments of the Commission and submitting recommendations to the Commissioner or any officer.[136]

With respect to the complaint handling procedure, any complaint or an appeal to the above-mentioned internal two stages of complaint review sections has to be submitted in writing 15 days from the date of the written decision causing grievance.[137]And the complaint review sections have the obligation to communicate their decisions in writing to the complainant and his /her right to lodge an appeal.[138] Some of the matters subject to review and appeal at both complaint review sections are related to payments of taxes and duties. The taxpayer as a matter of procedural requirement is not obliged to pay the disputed taxes and duties to have his grievance settled. But, he may get a release of the goods upon which additional taxes and duties are required by furnishing securities such as cash deposit, bank guarantee, and insurance bond and have his complaint reviewed by the internal complaint review sections.[139] In all cases, the outcome of the above internal review process is not final and is appealable. The Customs proclamation provides for two appeal venues to be followed in order.[140]

8.8.2. Appeal Before the Tax Appeal Commission and Courts

The first one is the appeal venue available at the Tax Appeal Commission to which any person aggrieved by the internal review decisions could lodge his grievance within a month from the date of such decision.[141] In order to lodge an appeal to the Tax Appeal Commission in matters related to decisions made with respect to payment of duties and taxes, the taxpayer is required to pay the disputed duties and taxes.[142] And the Tax Appeal Commission may not admit lodging of the appeal before such prepayment obligation is met. [143] Secondly, any person dissatisfied with the decision of the Tax Appeal Commission on the ground of error of law may appeal to the Federal High Court.[144] The procedure

[136] Ibid, Art.153(2)(b)
[137] Ibid, Art. 154(1)
[138] Ibid, Art..154(4)
[139] Ibid, Article 117(5)
[140] Ibid, Article 155(1)(3)
[141] Ibid, Article 155(1)
[142] Ibid, Article 155(2)
[143] Ibid
[144] Ibid, Article 155(3)

to be followed while entertaining appeals at the two venues is that of procedures provided under the Income Tax Proclamation except that the pre-payment requirement to lodge before the Tax Appeal Commission and the requirement of ground of error to appeal before the Federal High Court.[145]The Income Tax Proclamation, which was in force at the time of the enactment of the Customs Proclamation, has been repealed and replaced by another.[146] The appeal procedure and the establishment of the Tax Appeal Commission cross-referred by the Customs Proclamation are now provided under the Tax Administration Proclamation.[147] In addition to such appeal procedures provided under the Tax Administration Proclamation, there are subsidiary laws through which the Tax Appeal Commission conducts its work and the procedures it follows.[148] Sub-article (4) provides that the President of the Tax Appeal Commission may delegate authority to a Regional Tax Appeal Commission to hear any appeal under Article 88. This is necessary because the Tax Appeal Commission will not normally sit in the Regions.

An appeal entertained at the Tax Appeal Commission may again be taken by way of appeal before the Federal High Court on the grounds of error of law.[149] An appeal seems to end at Federal High Court as per article 155 of the Customs Proclamation but an aggrieved party could further take his case to the Federal Supreme Court and its cassation bench pursuant to the same article.

Chapter Summary

In any state, customs departments are organized and customs laws are enacted to regulate the flow of imports and exports, and collect duties and taxes therefrom. Customs is an old work process that has been around for centuries in Ethiopia. In the history of modern taxation, there have been customs laws and institutions during the imperial, Derg, and EPRDF regimes. The reform of taxes on international trade is one of the major post-1991 tax reforms. Recently, the customs proclamation is amended and Customs Commission is organized as an autonomous boy responsible to the Ministry of Revenue.

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[145] Ibid, Article 155(4); See also Income Tax Proclamation No.286/2002 which has been repealed and its appeal procedure provisions have been provided under the Tax Administration Proclamation No. 983/2016

[146] See Income Tax proclamation No.979/2016

[147] See Tax Administration Proclamation No.983/2016

[148] See Council of Ministers Federal Tax Administration Regulation No. 407/2017

[149] See Art.155(3) of Customs Proclamation No.859/2014

In this chapter, an attempt is made to discuss the various prohibitions, restrictions, and customs procedures. It, in particular, provides an overview of the major procedures in custom operations including goods declarations, customs transit, customs warehousing, customs clearance, customs valuation, tariff classification, and origin of goods as stipulated under applicable customs laws of the country. The chapter also discusses issues in temporary importation, exportation and re-exportation of imported goods as well as the provision of securities to guarantee compliance and payment. Unless otherwise provided by law, treaties, or decided by the Ministry of Finance, duties and taxes shall be payable for any imported or exported goods. The declarant who makes goods declaration or in whose name such a declaration is made shall be liable for payment of the duties and taxes. Currently, Ethiopia levies five kinds of taxes on import items (customs duty, excise tax, VAT, surtax, and withholding tax) and these taxes provide considerable revenue to the government.

The chapter also highlights the powers and functions of the Customs Commission, the Federal Police Commission, and the Federal Attorney General in customs control and law enforcement. In parallel, an attempt is made to identify and discuss the civil, administrative and criminal liabilities of delinquent taxpayers. The availability and quality of a fair, impartial, and independent dispute settlement procedure are fundamental to the proper operation of the customs regime. Accordingly, the Customs Proclamation provides that a taxpayer or any person in dispute can lodge complaints to internal review institutions and appeal to the external review by the Tax Appeal Commission and court of law.

Review Questions

1. Discuss the concept and development of customs duties in Ethiopia.
2. What is the importance of determining the origin of a given
3. Identify and discuss rules of customs restrictions and prohibitions in Ethiopia? Provide examples of goods that are prohibited or restricted at import and export.
4. Explain the concept and legal basis of the following important procedures in custom operations in Ethiopia.

a. Goods Declarations
b. Customs Transit
c. Customs Warehousing
d. Customs Clearance

5. How do you understand valuation and its importance in Customs administration? What are the specific types of valuation recognized in the Ethiopian Customs regime?
6. What is Tariff Classification? What is the importance of tariff classification in facilitating customs administration and collection of taxes and duties?
7. What is Tariff Classification? What is the importance of tariff classification in facilitating customs administration and collection of taxes and duties?
8. Identify and discuss duties and taxes collectible on imports and export in Ethiopia in their sequential order.
9. Identify and discuss institutions, with their respective roles, in charge of customs control and law enforcement in Ethiopia.
10. Discuss custom dispute settlement procedures. Is it similar to or different from the conventional tax dispute procure?

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Chapter Nine

Stamp Duties Law in Ethiopia

Introduction

Stamp duty comprises one of the most common revenue sources for governments. It is one of the legal obligations that people face in daily activities. A legal practitioner would come across stamp duties in the course of incorporating a company or concluding contracts such as sales, mortgage, leases, loans, etc. relating to immovables and securities. He/she also would be acquainted with stamp duties in the course of arbitration as a means of tying up an arbitral award. The average man on the street would probably come across stamp duties receiving advice from a lawyer, in the course of perfecting title to a property, contracting power of attorney, or where he/she is suddenly penalized for failure to pay stamp duty on a document or the document is rejected as inadmissible before a court of law.

This chapter is designed to address several vexing legal issues that help to understand stamp duties and the governing law in Ethiopia. What is stamp duty? Why we should pay stamp duty? Whose power is it to levy and collect stamp duties? What is its impact on the economy particularly transactions on immovable properties and securities? What documents (and at what rate) attracts stamp duty liability? What is the legal effect of a document duly stamped? Where and how to pay Stamp Duties? How can one evidence that he/she has paid stamp duty on a document? In what circumstances can one be exempted from paying stamp duty? What is the time limit for stamping a document and what are the penalties for exceeding the time limit? What are the modes of stamping? Is electronic stamping recognized commensurate with e-contracts and e-commerce? This chapter attempts to answer these and related questions.

Thus, this chapter, which is organized in seven sections with the exclusion of this introduction and the chapter summary, intends to address points such as the concept of stamp duty, its development in and outside Ethiopia, the governing legal regime, the power to levy and collect stamp duty, chargeable instruments, applicable rates, modes of valuation, time and manner of payment, exemptions, consequences of delinquency, and the need to rethink e-stamping. In Ethiopia, these areas are currently governed by proclamation No 110/1998 (as amended) and regional proclamations. The administration of Stamp Duty also requires the

application of the provisions of other laws such as registration of instruments and transfer of property laws. For clarity, an attempt is made to bring the experiences of other countries and the literature into the discussion.

9.1 What is Stamp Duty?

The term stamp duty is a compound word that consists of two parts (stamp and duty) that work together as a unit to express a specific concept. Black's Law Dictionary defines 'stamp' as an official mark or seal placed on a document especially to indicate that a required tax or duty has been paid, in which cases it is also known as revenue stamp or stamp tax.[1] The stamp can be either an embossed stamp (impressed above the surface document) or a rubber-stamp seal (ink-stamped onto documents).

The other important term is 'duty'. What is the difference between tax and duty? Under the Ethiopian system of taxation, some obligations are described as taxes (for example, employment income tax, business income tax, value-added tax, and turnover tax) and others as duties (for example, customs duty and stamp duty). In its most usual signification in jurisprudence, the term duty refers to an obligation of legal, moral, or contractual character as the correlative of right. In the revenue sector, the term duty is mainly associated with imposts, customs, and other government charges.[2] The laws in Ethiopia and the literature are no exceptions. Both taxes and duties are sources of revenue necessary to cover public expenditure and governments use them to play their economic and social roles. The main difference between tax and duty is that the scope of tax generally is wider in comparison to duty and the latter is the subtype of the former in most cases. A duty is a compulsory financial charge like other taxes but it's often target-specific rather than being imposed on individuals' or corporations' income or property taxes. It is often associated with and commonly includes customs duty, excise duty, stamp duty, estate duty, etc. that apply to selected goods, services, instruments, or properties. Except for their narrow coverage, duties share the characteristics of taxation discussed in chapter one of this book. Some sources also provide that it is both the central

[1]Black's Law Dictionary (8th ed.), 2004, P.4397

[2] Ibid, PP. 594-595. Customs duties (sometimes also called a tariff) are a type of tax on cross-border goods or shipments to or from other countries with the goal of raise revenue, protect domestic companies from foreign competitors, control the flow of certain products or satisfy other economic reasons. Hence, such duties are imposed on commodities or financial transactions instead of individuals.

government and state government can impose taxes but only the central government has got the authority to levy duty.[3] As a result, arguments or explanations that question the tax nature of customs and stamp duties don't seem to hold water or are not relevant to the fundamental nature of the obligation.

A stamp duty (also known as a stamp tax or documentary stamp tax) is a tax a government imposes on selected documents that are legally required to be recorded.[4] Different countries adopt stamp duties in different forms and names. For example, Land Transfer Tax (LTT) and Stamp Duty Land Tax (SDLT) is famed in USA and UK respectively.[5]Stamp duties derive their name from the conventional method of enforcement of stamp duties, which is by affixing stamps. Stamp duties are invariably imposed on documents, although their impact ultimately falls on whoever benefits from the authentication and enforcement of those documents by the government. It's important to note that stamp duty is a kind of indirect tax because its incidence and burden fall on different persons.[6] However, stamp duty is a duty on instruments not on the transaction, subject matter, or the person.[7] In short, stamp duties are transfer taxes distinguished from many other taxes due to their close association with documents that contain certain legal rights or involve the transfer of certain legal rights over the property.

It is also important to note some salient features of stamp duties as different from other taxes. First, there is always an element of 'quid pro quo' unlike the case in other taxes where the element of 'quid pro quo' between the taxpayer and the public authority is unlikely. There is a government department in charge of selling or affixing stamps and recording selected instruments (written documents) as a perpetual revenue source. Paying stamp duty is the legal recognition of documents and is an integral part of transactions such as the

[3]Surbhi S, Difference between Tax and Duty, 26 July 2018 available at https://keydifferences.com/difference-between-tax-and-duty.html (Last Viewed on 05/26/2022)

[4] Supra Note 1, PP.4397 & 4566; OECD, Glossary of Tax Terms, available at https://www.oecd.org/ctp/glossaryoftaxterms.htm(Last Viewed on 05/26/2022)

[5] Chris Philp and Guy Miscampbell, Reforming Stamp Duty: New ideas to promote home ownership, UK Onward Thinktank Ltd, 2020

[6]Amit Sethi and Sunita Mishra, Stamp Duty: What Are Its Rates & Charges On Property? February 18, 2021 available at https://housing.com/news/stamp-duty-property/ (Last Viewed on 05/26/2022)

[7] Ibid

purchase or sale of property, leasing of property, registering an insurance policy, and setting up a business. Second, the method of stamp duty enforcement is also different. Denial of any legal notice to documents that are not affixed with stamp duties is a common and trademark enforcement mechanism. Looking at this mode of enforcement, stamp duty can be perceived as a voluntary tax because the tax authority cannot directly enforce its payment. In practice, the stamp duty cannot normally be avoided because until a document is duly stamped and the appropriate amount of duty paid, it cannot be relied on in civil judicial proceedings or be used for other legal purposes.[8]

There are different types and forms of stamp duties and there is an appropriate balance between and among these variants in the tax system. This requires understanding and comparing the relative features, merits, and demerits of the forms. This has policy relevance in addition to intellectual interest. As far as stamp papers are concerned there are various types. For example, in relation to their connection to the judiciary, stamp papers can be Judicial and non-judicial.[9] Judicial stamp papers are used for legal and court work while non-judicial stamp papers are used for making contracts, agreements, registration of documents, leases, or sale-purchase transactions. Stamps also can be classified as adhesive stamps or impressed stamps and, in recent times, electronic stamps.[10] In terms of the basis of valuation or the way documents or instruments can be charged, stamps can be *ad valorem* and specific types.[11] A specific (or 'unit' stamp duty is a duty payable as a fixed amount per unit (the quantity, volume, or nature of the document or the instrument) regardless of its value. For example, the law stipulates a fixed amount of tax on a particular document (also known as per-unit tax). On the other hand, an *ad valorem* (according to value) stamp duty is imposed as a proportion of the assessed value of the document or instrument. This is a duty on the value mentioned in the documents/instrument or otherwise assessed. In some countries, there is a

[8] When for different reasons there is delinquency, penalties and interests on the unpaid stamp duty starts to run from the end of the period of some days after execution and there are penalties.

[9]Ashish Gup, Instruments of Stamp Duty, available at https://economictimes.indiatimes.com//et-realty/instruments-of-stamp-duty/articleshow/2673491.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst (Last Viewed on 05/26/2022)

[10] Ibid

[11] Alden L. Powell, National Stamp- Tax Laws and State Instrumentalities, The American Political Science Review, Vol. 29, No. 2, 1935 PP. 225-246

third category, where stamp duty is payable based either upon the value mentioned in the documents or is based on the true value market price, whichever is higher. This category is not common in Ethiopia.

Looking at the different types of documents listed in Schedule 1 of the Stamp Duty proclamation, some are *ad valorem* (duties are imposed on value and others are specific (fixed duties are imposed). How do you compare the two variants? Specific stamp duties are maintained for they are predictable, easy to understand, and administer. However, specific duties are more likely to be regressive because the duty paid is the same for different income groups unlike the case in *ad valorem* forms, where the duty is tied to the value in the instrument. That is, more duty is paid from the parties to expensive instruments. On the other hand, *ad valorem* stamp duties are less predictable, difficult to determine the amount payable and require strong tax administration capacity.

9.2 Why Stamp Duty?

The first reason for the imposition and collection of stamp duty is revenue generation. Many countries recognize stamp duty as an important source of government revenue.[12] Indeed, in some cases, fiscal legislation that levies stamp duty on specific documents is enacted with the sole purpose of revenue generation. Yet, stamp duty laws realize the goal of revenue generation by making documents legally valid and authentic to be used as valid evidence in a court of law. This is another and perhaps the main objective to levy and collect stamp duty. The payment of proper stamp duty on instruments bestows legality on the documents or instruments so that they have evidentiary value and can be admitted as evidence in a court of law.[13] Unstamped or a not duly stamped instrument is inadmissible before a court of law except for criminal cases and where it is presented against the person whose fault the receipt was not stamped or stamped inadequately. Among the various levels and types of transactions and documents, government regulation is needed for some documents due to their importance to the parties and the state at large. It's common for national

[12] Supra Note 9. For example, in Nigeria, The Federal government projects that the revenue would grow to ₦71.8 billion in 2017 to ₦78.5 billion in 2018. In some countries however its importance has decreased through time as governments started to raise revenue through income, property and consumption taxes. In USA and Australia, stamp duties are kept in place as a reliable revenue stream for the states.

[13] Supra Note 6

legislation to provide for the mandatory registration of selected instruments and to regulate the consequences of non-registration thereof. Other instruments are left to the choice of the people. For example, the Registration Act (1908) of India provides a list of documents that have to be registered compulsorily (compulsory registration) and documents whose registration is optional (optional registration).[14] Accordingly, government authorities have no obligation to register a document that falls outside of the mandatory lists and no stamp duty is collectible.

Under the Ethiopian legal system, the civil code prescribes that certain transactions (such as relating to immovable properties, made with public administration, guarantee or suretyship, insurance, and others as required by the law) are required to be made in written form.[15] In addition, these instruments must be signed by the parties and attested by witnesses[16], and authenticated and registered by the public authorities[17]. Moreover, the law stipulates that where a special form is prescribed bylaw, there shall be no contract but a mere draft of a contract where this formality is not observed.[18] According to Authentication and Registration of Documents' Proclamation No. 922/2015, documents required by law to be authenticated and registered (e.g. power of attorney or revocation of power of attorney, memorandum and articles of association of business organizations and other associations, and amendments thereof) shall be authenticated and registered under the pain of losing legal effect.[19]A notary shall authenticate and register documents other than those specified if requested by the concerned parties.[20] This is the case of voluntary registration. In the case of both mandatory and voluntary registration, the notary shall make sure the payment of stamp duty and service fee pursuant to the relevant law is made

[14] See generally Indian Registration Act, 1908, Section 17 and 18. Registration of instruments of the gift of immovable property, mortgage deed, sale deed, lease, transfer of decree or order or award, and authority to adopt a son is mandatory. On the other hand, registration of instruments other than wills and gifts of a value less than rupees hundred, instruments acknowledging the receipt or payment of any consideration of value less than one hundred to or in immovable property, leases of immovable property not exceeding one year, instruments transferring or assigning any decree or order of a court of value less than one hundred rupees, instruments pertaining to movable property and wills is optional.

[15] Ethiopian Civil Code, 1960, Arts. 1723-25

[16] Ibid, Art. 1727.

[17] Ibid, Arts. 1723 (1) & 1185; Urban Landholding Registration Proclamation No.818/2014, Part V; Rural Land Administration and Land Use Proclamation No. 456/2005 Art. 6

[18] See for example Ethiopian Civil Code, Art. 1720(1) and 2877

[19] Authentication and Registration of Documents Proclamation No. 922/2015 Art. 9 (1)

[20] Ibid Art. 9 (2)

before authenticating and registering a document.[21] The stamp duty proclamation also provides that some twelve instruments are chargeable with stamp duty although how they are identified and for what purpose remain researchable. Legal systems have constructed safeguards for these transactions and instruments because of their importance to the parties and the society at large. It is with this purpose in mind that selected documents and instruments are required to be in written form, authenticated or adjudicated, registered, and stamped.

Some argue stamp duty safeguards property rights because the payment of stamp duty (and the adjuvant registration fees) in a transaction complements the legal and evidentiary value of selected instruments together with other legal requirements such as written form, signature, attestation, authentication, and registration.[22] This is, in particular, true for stamp taxes that are common on instruments that transfer homes, buildings, copyrights, land, patents, and securities. For example, the stamp duty proves the transfer of rights from the seller to the buyer in a court of law. These acts of recording, depositing, and stamping a document with the relevant authority notify third parties, have evidentiary value, prevent frauds and forgeries, prevent disputes, and generally provide safety and security to the relating transactions. However, the role of the stamp duty in the security of property rights is not without limitations. Stamp duties can be seen as unattractive from an economic point of view.[23] This lack of attractiveness stems from the fact that any tax on transactions will reduce expected welfare by discouraging mutually beneficial trades. Welfare is maximized when assets are owned by the people who place the highest value on them. The tax effect on transactions will affect who owns an asset, and so can disrupt the efficient pattern of ownership. The value of goods or services is determined by the flow of benefits that are derived from ownership. For example, a study in the UK found that the effect of stamp duty as a transaction tax on house prices is large and that dynamic adjustment to changes in taxes is very fast.[24] On the other hand, stamp duty holidays stimulate the housing market during economic downturns. The success of this stamp duty stimulus is a result of the large distortions created by the tax in the first place. According to

[21] Ibid Art. 34
[22] Michael Carlos and Henrik Jacobsen, Housing Market Responses to Transaction Taxes: Evidence From Notches and Stimulus in the UK, September 2013
[23] Ibid
[24] Ibid

Chris Philp MP and Guy Miscampbell, stamp duty creates an effective barrier to homeownership and private share ownership both directly and indirectly because it adds considerable transactional costs to the process of both buying and selling.[25] With this considerable effect affecting millions, they recommend the government abolish stamp duty with respect to instruments related to land, house, and shares. The only reason for maintaining stamp duty in its current form is that it raises a lot of money for public services.

Finally, it should be noted that neither of the above rationales is mentioned by the Ethiopian stamp duty proclamation as objectives. The first paragraph of the preamble emphasizes the contribution of stamp duty to the development of art, the activities of financial institutions, and the transfer of capital assets.[26] The question is how a stamp duty law can realize these objectives. Normally the development of art might relate to the various portraits marked on printing stamps. The role of the stamp duty in facilitating the activities of financial institutions and the transfer of capital assets can be implied from the nature of some of the instruments chargeable with stamp duty. Yet, it is apparent that the grand preambular devotions are not directly reflected in the binding clauses and operative parts of the law. This requires understanding which instrument is particularly dedicated to which objective. The question is how this desire came true while the stamp duty collecting body doesn't check the substance or the validity of the instruments. Secondly, most expected dutiable instruments are not listed as chargeable or explicitly exempted. It would be commendable for the law to include provisions necessary to realize its objectives.

9.3 Historical Development of Stamp Duty in Ethiopia

Stamp duty was introduced in the early 1940s as part of modernizing the Ethiopian system of taxation through Stamp Duties Legal notice 24/1943, which is later replaced by Proclamation No. 41/1953.[27] The proclamation introduced a schedule containing a list of chargeable documents and respective rates. According to Proclamation No. 41/1943, stamp duties chargeable documents included affidavits, articles of association, awards, bills of exchange, bonds, cheques, conveyances, customs bonds, leases, mortgages, notarial acts, powers of attorneys, petitions, receipts, share warrants and tickets of admission

[25] Supra Note 5
[26] Stamp Duty Proclamation No. 110/1998, Preamble
[27] Stamp Duties Legal notice 24/1943; Proclamation to Provide for Stamp Duties No. 41/1953

to places of public entertainment along with the respective rates. The rates imposed were 15% on leases and 2.5% on mortgages, 30 Birr on companies, 0.10-0.50 Birr on bills of exchange, 0.10-3 Birr on bonds, 0.10-1 Birr on contract agreements, 1-2Birr on conveyances, 1-10 Birr on powers of attorney, and 10% on tickets of admission. In 1957, Stamp Duty Decree No. 26/1957 was enacted to replace proclamation 41/1953.[28]Different rates were imposed on the award, power of attorney, bill of exchange, bond, and contract agreement, transfer of immovable property or motor vehicle. The rate was 9-2160 Birr on annual income less than 15000 Birr, and 360-480 Birr on annual income of 14,400-15,000 Birr. The Decree also provided for the obligatory use of stamped paper for many legal documents, such as contracts or papers in court proceedings; and further provided requirements that stamps be affixed to other documents, such as property titles, power of attorney, notary acts, etc. In 1959, new stamp duty legislation was enacted as Stamp duty Legal notice 221/1959. Both Decree No. 26/1957 and Legal notice 221/1959 served for a long time under the Derg regime until 1987 when Stamp duty Proclamation 334/1987 came into force.[29] This proclamation made some basic changes to the instruments chargeable with stamp duty, mode of valuation, time and manner of payment, and exempted items (in the amount which less than 10 Birr).This law had served long including during the EPRDF regime until its repeal by the current Stamp Duty Proclamation No. 110/1998.[30]

With the adoption of federalism and decentralization in post-1991 Ethiopia, many regional governments issued their stamp duty laws although in this, as in many other cases, they have simply copied the Federal Stamp Duty law of 1998 and their Constitutionality was debatable from the start.[31] According to the preamble of Proclamation No. 110/1998 stamp duty is levied on documents in a manner that would contribute to the development of art, the activities of

[28] Stamp Duty Decree No. 26/1957
[29] Stamp Duty Proclamation No. 334/ 1987
[30] Stamp Duty Proclamation No. 110/1998
[31] see, for example, The Southern Nations Nationalities and Peoples' Regional State Stamp Duty Proclamation No. 25/1999 (amended by Proclamation No. 135/2010); Benishangul Gumuz Regional State Proclamation to Provide for the Payment of Stamp Duty No. 61/2006; Oromia Regional Government Stamp Duty Proclamation No 77/2004 (amended by 89/2005 and No. 137 of 2008); Proclamation to Provide for the Payment of Stamp Duty in Amhara Region Proclamation No 31/1998 (Amendment Proclamation No.192 /2011); Proclamation to Provide for the Payment of Stamp Duty in Tigray Region Proclamation No 124/2007 (Amendment Proclamation 181/2010 and No.298/2018)

financial institutions, and the transfer of capital assets.[32] It imposes a tax on memorandums and articles of association of any business organization, cooperative, or any other form of association, award, bonds, warehouse bond, contracts and agreements and memoranda thereof, security deeds, collective agreements, contracts of employment, leases (including sub-leases and transfer of similar rights), notarial acts, powers of attorney, and documents of title to the property. The rates were 5-300 Birr and 0.5-2% within any organization or business organization. In 2008, Proclamation No. 110/1998 was partly amended by Proclamation No. 612/ 2008.[33]

What is to be learned from these historical developments of Stamp Duty in Ethiopia? Although the stamp duties regime has been under continuous revision, there were no substantial changes made to the first Proclamation.[34] For example, with few exceptions, most ofthe documents that were listed as chargeable with stamp duties in 1943 have been retained over the years. It should be noted here that chargeable documents are by far the same under the existing federal and regional stamp duty laws. The important change made to the laws is a redefinition of the documents. For example, the document regarding the transfer of immovable property later became documents of title to the property; contracts in the early laws branched out into contracts in general, contracts of employment, and collective agreements in more recent stamp duties laws.[35] There were also changes to tax rates and the resulting amounts of tax chargeable to each document.[36] This requires further study into the content of the laws cited above.

Historically, the stamp duty proclamation is known to provide its own rules as distinct from other tax legislation. It's known that almost all tax legislation in Ethiopia has provided similar rules and procedures for a tax appeal. For example, in Article 9 of Proclamation, No 334/1987, a person dissatisfied with the decision of the stamp duty collector (the then Inland Revenue Administration) may make an appeal to the High Court within 21 days from the date of notification of the decision. The position taken by this proclamation was

[32]Stamp Duty Proclamation No. 110/1998, Preamble
[33] Stamp Duty (Amendment) Proclamation No. 612/2008
[34] Taddese Lencho, Towards Legislative History of Modern Taxes in Ethiopia (1941-2008), , Journal of Ethiopian Law, Vol. 25 No. 2, 2012 P. 144
[35] Ibid p. 144
[36] Ibid

not the same as other tax laws in the country. This is because the taxpayer did not have the opportunity to the Review Committee and Tax Appeals Commission. Moreover, the time limit for filing an appeal to the high court is 21 days, not 30 days, no stipulation of deposit of tax assessed as a requirement to lodge an appeal, and no provision limits the high court's jurisdiction to legal matters (questions of law).[37] These deviations from other laws have been preserved in Proclamation No. 110/1998. However, the amendment of Proclamation No. 612/ 2008 changed this trend by inserting Articles 2 (2) and 3.[38] While Article 2 (2) provides "a person who is dissatisfied with the amount of stamp duty assessed by the Ethiopian Revenues and Customs Authority may, within 30 days of the receipt of the assessment notifications, appeal to the Review Team or the Appeal Commission against the assessment", Article 3 allows the mutatis mutandis application of Income Tax Proclamation No. 286/2002 relating to appeals. The new Federal Tax Administration Proclamation No. 983/2016 has harmonized tax appeal and other administrative concerns in stamp duty by recognizing the stamp duty proclamation in the definition of tax law under Article 2 (36) and stamp duty offenses under Article 123, for example.[39]

Finally, although Ethiopia has a long history of stamp duty in law and practice, it is one of the underdeveloped types of taxes and its contribution to the national or regional revenue remains low. The following is the stamp duty collection performance of the government from the year 2002/03-2006/07.[40]

Table 1: Stamp Duty Collection

Level of Government	Stamp Duty Collection During the years (in millions of Birr)				
	2002/03	2003/04	2004/05	2005/06	2006/07
Regional	75	101	110	129	174
General	127	161	185	213	278

What does this stamp duty revenue collection growth by federal and regional governments (2002/03-2006/07) imply? Although the data seems too old to

[37] Aschalew Ashagrie, Tax Appeal Procedures in Ethiopia, Mizan Law Review, Vol. 8, No.1 September 2014, PP. 207-208
[38] Ibid, P. 212
[39] Federal Tax Administration Proclamation No. 983/2016
[40] International Monetary Fund, The Federal Democratic Republic of Ethiopia: Statistical Appendix, July 2008 IMF Country Report No. 08/260, P. 14 & 17

portray the current picture, it still shows the low performance compared to other tax revenue sources. There can be a number of legal and extra-legal factors for this low performance. This is contrary to the experience in other countries mentioned above. Finally, in addition to the low collection performance, teaching, research, court practice, and, more generally, the jurisprudence of stamp duty is not well developed in the country.

9.4 Power to Levy and Collect Stamp Duty

Determining the authority to impose and collect the stamp duty is one the most important questions in understanding stamp duties and the legal regime governing the same. Clarity with revenue sharing powers is particularly vital in maintaining federal systems and fiscal balances. It also answers where we can pay stamp duty (to the federal or regional government), which is a crucial question of certainty.

Ethiopia had been a centralized and unitary state since the adoption of the first stamp duty law in 1943. National stamp duty proclamations enacted during the Haile Selassie and Derg regimes were enforced throughout the country. The adoption of the federal system and decentralization programs in post-1991 Ethiopia recognizes the taxation power of federal, regional, and, by interpretation, local governments. As already mentioned in the second chapter of this book, the FDRE Constitution allocates legislative and administrative powers of taxation to the federal and regional governments by dint of four headings: the federal power of taxation, the regional power of taxation, the concurrent power of taxation, and the undesignated power of taxation.[41] The constitution also provides general directives that two tiers of government must ensure that any tax related to the source of revenue taxed and the tax imposed by them should not adversely affect their relationship.[42] Article 96 (9) of the FDRE Constitution stipulates that the federal government levy and collect Federal stamp duties. However, the constitution including Article 97, which lists down state powers of taxation, is silent about the power to levy and collect regional stamp duties. Is it a silence that led to Article 99 of the FDRE Constitution as undesignated power of taxation? It was considered as such.

In 2004, the joint meeting the House of Federation and the House of Peoples' Representatives held a joint meeting and decided that Article 96 (9) did not

[41] FDRE Constitution, Arts. 96-99
[42] Ibid, Arts. 100(1) & (2)

imply that state governments could not impose their own stamp sales tax and that regional governments have the power to levy and collect stamp duties on instruments executed in/ by the regional states.[43]

The decision reads;

> **"ህገመንግስቱ በአንቀፅ 96 (6) የፌዴራል መንግስት የፌዴራል ቴምብር ሽያጭ ቀረጥን እንደሚጥልና እንደሚሰበስብ ተደንግጓል። ሆኖም ይህ አንቀፅ የክልል መንግስታት የራሳቸዉን የቴምብር ሽያጭ ቀረጥ መጣል እደማይችሉ ስለማያመለክት እንዲሁም የቴምብር ሽያጭ ቀረጥ በሰነዶች ላይ የሚጣል በመሆኑ የክልል መስተዳደሮች በሚሰፈፅሟቸዉ ሰነዶች ላይ የቴምብር ቀረጡን የመጣልና የመሰብሰብ ስልጣን ለክልል መስተዳደሮች እንዲሰጥ ተወስኗል።"**

What do "instruments executed in/ by the regional states" mean? This requires reading from legislation that regulates the authentication and registration of documents in the country. It is generally agreed that for the sake of convenience stamp duties fees and other service charges shall be collected at the place where the service is rendered. The Authentication and Registration of Documents' Proclamation No. 922/2015 provides for two authentication and registration institutions: the Federal Institution and a Regional Institution.[44] In practice, at the federal level, there are Federal Documents Authentication and Registration Agency and other institutions such as the Ethiopian Embassies and Consular Offices, Ministry of Foreign Affairs, commanders of divisions of the defense force, heads of federal prisons, and commanders of divisions of the Federal Police Commission in charge of authentication, registration, and retention of documents. At the regional level, these functions are carried out by document authentication and registration directorates under regional justice bureaus. Other regional government departments such as courts, trade offices, and transport offices also do the same. The general idea is that stamp duties are collected by government departments that render the service. However, the regional departments with these functions collect stamp duties by providing federal stamps. It is instructive to ask whether a regional government ever publishes its own stamps. The answer seems to be no; regional governments appear to be mere vending shops of the federal government rather than exercising their

[43] **የፌዴሬሽ ምክር ቤት ለገቢዎች ሚኒስቴር በቀን** 23/09/97 **በቁጥር** 2-3/ሀ1/አ21/12/1 **የተፃፈ ደብዳቤ**

[44] Authentication and Registration of Documents' Proclamation No. 922/2015, Arts. 4-6

power of taxation as decided by the joint session of the HoF and HPR. Moreover, regional stamp duty legislations are simple copies of the federal counterpart for the chargeable instruments and the rates are the same.

The power to levy and collect stamp duty shall also be seen in the light of the power of document registration and authentication. The combined reading of Article 3 with Articles 4-6 of the Proclamation No. 922/2015 provides that there are three institutions vested with the powers and duties to authenticate and register documents: a federal institution, a regional institution, and other federal government organs. The establishment of these institutions and their structure, powers, and functions are indicated under articles 4-6 and are awaiting detailed regulations under federal and regional laws. Hence, in addition to the various federal and regional institutions mentioned above, these institutions are in charge of stamp duty collection.

The experience from other countries is worth mentioning here. In Australia, stamp duties are levied by the Australian states and the federal government does not levy stamp duty.[45] As a result, stamp duty laws that define chargeable instruments and applicable rates differ significantly between state jurisdictions. In the USA, the federal government formerly imposed various documentary stamp taxes; however, there is no federal stamp tax today as it is only imposed by the states.[46] Nigeria and India have different experiences for taxation power are allocated based on the nature of the parties and the instruments respectively. Nigeria is a federal state with a three-tier type of government (federal, state, and local) whose functions and areas of fiscal jurisdiction are spelled out under the Constitution (1999).[47] It is the federal government that imposes stamp duties and there is only a federal stamp duty law. However, the collection and administration stamp duty is a mutual operation. Accordingly, the Federal Inland Revenue Service (FIRS) is the competent authority to charge and collect duties upon instruments relating to transactions or matters executed *between corporate bodies or between a corporate body and an individual, group, or body of individuals (Emphasis Added).* [48] The State Board of Internal Revenue (SBIR) collects duties in respect of instruments executed *between individuals at*

[45] Will Kenton, Stamp Duty, August 30, 2021, available at https://www.investopedia.com/terms/s/stampduty.asp (Last Viewed on 05/26/2022)
[46] Ibid
[47] Ibid
[48] Stamp Duties Act of Nigeria, 2004 Section 4(1)

such rate to be imposed or charged in agreement with the Federal Government (Emphasis Added).[49]Upon collection by state governments and the federal government under their respective jurisdictions, the proceeds are shared in accordance with Section 163 (a) and (b) of the 1999 Constitution (as amended). Accordingly, the duty collected by the state government is treated as part of the consolidated revenue of that state while the duty collected by the federal government is paid to each state at such times as the national assembly may prescribe a sum equal to the proportion of the net proceeds of such tax or duty that are derived from that state. One of the problems facing the stamp tax is the trespassing of federal agents who also tax individuals as opposed to companies only.[50] In India, under article 246 of the Constitution, stamp duties are mentioned in the union list and are levied by the union, but under article 268, each state in which they are levied collects and retains the proceeds.[51] Thus the Parliament prescribed the rates and some chargeable instruments (such as bills of exchange, cheques, and transfer of shares) through the Indian Stamp Duty Act of 1899, which prevails all over the country. Yet, state governments have powers to fix stamp duties on all other documents and, in such cases, the rates prescribed by individual states will prevail in those states. Although stamp duties can vary from state to state, there are standards such as the principle of 'market value' during an assessment. [52]

How do get the decision of the HoF cited above? Is there any experience that the Ethiopian stamp duty regime can learn from the experience of Australia, the USA, Nigeria, and India?

9.5 Designing Stamp Duty Law

a. Instruments Chargeable with Stamp Duty

As mentioned above, stamp duty is a duty on instruments of different kinds and nature during execution in accordance with the law. This section, as a matter of necessity, begins with explaining what an instrument or a document is and proceeds to answer what instruments attract stamp duty liability. This is made possible by referring to the laws on stamp duty and authentication and

[49] Ibid, Section 4(2)
[50]Supra Note 9
[51]Stamp Duties Act of India, 1899 Section 4(1) & (2)
[52] Ashish Gupta, Stamp duty: Whose responsibility is it? Oct 21, 2007 available athttps://economictimes.indiatimes.com/stamp-duty-whose-responsibility-is-it/articleshow/2477455.cms (Last Viewed on 05/26/2022)

registration of documents. According to Article 2(5) of the Stamp Duty Proclamation, an instrument is a written document by which any right or obligation is or purports to be created, recorded, transferred, extinguished, limited, or extended. Article 2 (1) of the Authentication and Registration of Documents' Proclamation No. 922/2015 defines a document as any contract, will, a document of power of attorney or revocation, a document translated from one language into another by a licensed translator, copy of a document, a document of a vital event, education and professional certificate, memorandum or/and articles of association, minutes, or any written matter submitted for authentication and registration. The Amharic "**ሰነድ**" is used for both instruments under the stamp duty proclamation and documents under the Authentication and Registration of Documents Proclamation.

Defining the term instrument is not sufficient in and of itself as stamp duty is collected only when it is registered, authenticated, and executed. Article 2 (2 & 3) of the Authentication and Registration of Documents Proclamation defines authentication and registration of documents and Article 2(9) defines the execution of an instrument. Accordingly, authenticating a document means signing and affixing a seal by witnessing the signing of a new or already signed document. Registration refers to recording a document in a register by giving the document an identification number and depositing it with the institution. On the other hand, execution is drawing, issuing, carrying into effect, or negotiating an instrument by the person or persons who are the parties to the transaction. These definitions are almost similar to the definitions in other countries except that recent legislation in other countries expands certain terms with the development of electronic documents, electronic execution, electronic stamping, and electronic payment of stamp duty.

As mentioned above, not all instruments are chargeable and stamp duty is imposed on selected instruments under the law. In Ethiopia, Article 3 of the Proclamation provides a list of twelve instruments chargeable with stamp duty. It is these instruments that are mentioned as dutiable in the schedule of the stamp duty proclamation that shall be stamped before or at the time of execution. However, on top of the general stipulations under the proclamation,

there is no subsidiary legislation providing the details of such instruments. This has been creating difficulties in practice.[53]

The first of such documents is the memorandum and articles of association of any business organization, cooperative society, or any other form of association. Because the stamp duty proclamation nowhere defines these two instruments, it is other laws such as the commercial code, the business licensing and registration proclamation, and the cooperative proclamation that can provide guidance.[54] While the purpose of a memorandum of association is to set out the constitution or foundation of the organization, articles of association include rules regulating the internal management affairs and the rights of members *inter se*. The law provides for the compulsory registration and deposition of these documents at the office of the registrar that is Ministry of Trade and Industry at the Federal level and the Trade and Industry Bureau at the regional level together with the prospectus (if any), the minutes of the subscribers' meeting, and all complimentary documents. Once validly registered by a competent registering authority, the documents become a public document although the organization retains a statuary right to amend both documents when a need arises. Thus, a business organization and an association acquire legal capacity upon registration in the books of the commercial register. The registering authority, among other things, must affix these documents with stamps as required under the law. However, the law lacks clarity as to whether delinquency to pay the stamp duty or the absence of affixed stamps can be a ground to question the legal personality of organizations or associations. If not, how stamps can be enforced? Yet, it would be such a startling idea if the purpose of the stamps is to affirm the legitimacy of transactions or corporate lives.

Documents bearing arbitral awards are also chargeable under the stamp duty tax. An award is defined under Art. 2(1) of the same proclamation as a decision in writing rendered by an arbitrator or arbitrators on a suit by parties to a compromise, conciliation, arbitral submission, or other similar matters. [55]

[53] Letter from the Ethiopian Revenue and Customs Authority, Internal Office Memorandum to Law enforcement division, 04 Meskerem 2007

[54] Please refer New Ethiopian Commercial Code Proclamation No. 1243/2021; Cooperative Societies Proclamation No. 985/2016; Ethiopia Civil Societies Proclamation Proc. No. 1113-2019.

[55]Proclamation No 110/1998, Art. 2 (1)

Bonds and security deeds are also dutiable instruments. Bonds include any instrument, whereby a person obliges himself to pay money to another, on the condition that the obligation shall be void, if a specific action is performed or is not performed, as the case may be; or any instrument attested to by a witness and not payable to order or bearer, whereby a person obliges himself to pay money to another.[56] For example, a warehouse bond is a financial guarantee that promises customers storing goods in a warehouse facility that any losses will be covered if the warehouse is unsuccessful in meeting the specified contract terms. On the other hand, a security deed is defined as any instrument whereby a borrower or guarantor gives to a lender a charge upon a part or the whole of his property.[57]

Other dutiable instruments include collective agreement and contracts of employment. A collective agreement means an agreement relating to conditions of work, concluded in writing between one or more representatives of trade unions and one or more employers or agents or representatives of employers' organizations.[58] A contract of employment means an agreement formed where a person agrees, directly or indirectly, to perform, work for a definite or indefinite period or, a piece of work in return for remuneration.[59] In addition, contracts and agreements and memoranda thereof, warehouse bonds, security deeds, contracts of employment, etc. are defined as dutiable instruments.

Yet another set of dutiable instruments includes notarial acts and powers of attorney. A notarial act is an act of attestation and certification performed by the person(s) authorized to perform such acts.[60] The other dutiable instrument is power of attorney. The stamp duty proclamation leaves the term undefined. Thus it's unavoidable to consult the agency provisions of the Civil Code despite the confusion and inconsistencies in usage. The Civil Code refers to a formal written document specifying the power of representation or in Amharic "**የእንደራሴነት ስልጣን**".[61] According to Ethiopian, a law agency may emanate from the law (for example, minor-tutor relationship), court decision, or by

[56]Ibid, Art. 2 (2)
[57]Ibid, Art. 2 (10)
[58]Ibid, Art 2 (3)
[59]Ibid, Art 2 (4)
[60] Ibid, Art. 2 (7)
[61]Civil Code of Ethiopia, Arts. 2181, 2195 & 2184(1)

contract, where the principal authorizes the agent to perform one or several legally binding acts on his behalf.[62] In the case of a contract, the agency must be made in writing and then registered where the act to be performed is required by law to be made in writing. However, in practice, all forms of agency, general or special, must be made in writing, and documents evidencing power of attorney must be registered with the competent authority.

Property titles are dutiable instruments. Under Ethiopian laws, a right over immovable property is said to be transferred when two requirements are met: the existence of a valid contract and registration in the registry of immovable property. The contract must be made in written form, authenticated, and registered.[63] Ownership will be transferred and the thing will be registered in the name of the buyer upon the payment of stamp duty and registration fee not upon the moment of conclusion of the contract. Furthermore, it is provided under the law that, since ownership rights can only be represented by the certificate, any transfer or assignment of ownership shall be effective only after registration. What if, in any way, it's found that the ownership is transferred and registered in the name of the transferee without the payment of stamp duty? Will it have the effect of nullifying the contract?

In general in Ethiopia, it is these 12 items described above that are defined to be dutiable both by the federal and regional governments. From the cumulative readings of articles 3 and 4 of the stamp duty law, instruments to be charged with stamp duty are exhaustively listed, and thus, except for these documents the bearers" of other instruments like checks and promissory notes, are not duty-bound to pay stamp duty charges.

b. Rates of stamp duty

In Ethiopia, the above-mentioned twelve types of documents are chargeable with stamp duty at varying rates based on their nature. Accordingly, article 4 (1) provides that the applicable rates of stamp duty for each instrument mentioned under Article 3 shall be those specified in the schedule attached thereto. The schedule forms an integral part of the proclamation. Article 4 (2) also provides that the rate payable at any subsequent execution of an instrument

[62] Ibid, Art. 2179

[63] Ibid, Arts. 1184, 1195, 1723, 2427, 2875, 2877 &2878; Federal urban Landholding and Registration Proclamation No. 818/2006; Authentication and Registration of Documents Proclamation No. 922/2008, Art. 9(1).

shall be as specified in the same schedule. In short, the following schedule provides dutiable instruments, a basis of valuation, and rates of stamp duty by which each instrument can be charged, levied, and collected.

Table 2: Instruments and Rates of Stamp Duty

Instruments chargeable with stamp duty	Basis of Valuation	Rates of stamp duty
Memorandums and articles of association of any business organization or any association:	Flat	350.00 Birr
(a) Upon first execution	Flat	100.00 birr
(b) Upon any subsequent execution		
Memorandums and articles of associations of cooperatives:	Flat	Birr 35
(a) Upon 1st execution	Flat	Birr 10
(b) Upon any subsequent execution		
Awards	On value	(a) with determinable value 1% (b) with undeterminable value Birr 35
Bonds	On value	1%
Warehouse bonds	On value	1%
Contracts and agreements and memoranda thereof	Flat	5 Birr
Security deeds	On value	1%
Collective agreements:	Flat	350 Birr
(a) on first execution	Flat	100 Birr
(b) On any subsequent execution		
Contracts of employment	Salary	1%
Leases including sub-leases and transfer thereof	On value	0.50 Birr
Notarial acts	Flat	5 Birr
Powers of Attorney	Flat	35 Birr
Register titles to property	On value	2%

Note that as the list of instruments and the rates are well associated with the basis of valuation, the table must be read with Art. 5 of the Stamp Duty Proclamation. The rates can be generally classified as *ad valorem* and specific rates. The schedule follows two types of approaches of modes of assessment in determining the rate that instruments with stamp duty obligations will be charged to pay. The two rates are a “flat” rate or the fixed fee where the bearers of the instruments are only required to pay the fixed amount of money

determined for each instrument, and "on value" or an *ad valorem* rate whereby the bearers of the instruments subjected to this rate will be paid a given percentage of the value stated in such instruments. Therefore, while the amount of payment for the fixed fee rates for all similar documents is the same, the amount to be paid in the case of *ad valorem* depends upon the values stated in the documents, i.e. two persons with two similar documents may pay different values if the value stated in each differs.

c. Exemptions

For a number of reasons, tax legislations provide for the exemption of some persons or items from tax obligations. The Stamp Duty Proclamation is no exception to this principle. Conceptually, some use the term relief or exclusion to make a distinction from exemptions. Have you ever heard about the distinction among the three terms?[64]The discussion over exemptions and reliefs is particularly valuable both because the administration of stamp duty is strengthened and because individuals or companies are going to face huge liabilities for stamp duty without a way to reduce costs.

In Ethiopia, the stamp duty proclamation provides that the following are exempted from stamp duty: public bodies to which the Federal Government of Ethiopia Financial Administration Proclamation applies and goods imported for sale by traders having import licenses when first registered in the name of the trader.[65] Documents may be exempted from payment of stamp duty in accordance with international agreements and conventions approved by the government, subject to reciprocity.[66]These treaties and agreements commonly and specifically state that documents relating to transactions by foreign private corporations, international organizations, or foreign governments are exempt from stamp duty. The aim of such exemptions could be to serve as an incentive to encourage foreign investors or other development undertakings in the country. Therefore, it is important to research agreements or treaties in the area whenever we want to study or take advantage of stamp duty exemptions. Embassies, consulates, and missions of foreign states may be also exempted in addition to share certificates. Finally, it should be noted that in the Schedule to

[64] Some associate exclusion to all documents outside the list of instruments, exemption to discharge given to the instrument that falls within the scope of stamp duty and relief to conditional release due to natural and manmade hazards.
[65] Proclamation No 110/1998, Art. 11
[66] Ibid

the proclamation, under most heads of charge listed therein there are also documents exempted from stamp duty in certain circumstances.[67]This requires identifying those documents that attract reduced stamp duty. For example, the schedule of stamp duty rates provides different rates for the first and subsequent execution of memorandum and articles of association of any business organizations or associations or cooperatives, and collective agreements. Finally, it should be noted that exemptions can be invoked based on other laws. For example, the new labor proclamation exempts workers from liability for payment of the registration of collective agreements.[68] Proclamation No. 867/2014 provides that no stamp duty or any other tax may be levied on transactions or documents relating to the Government Bonds issued by the Minister of Finance to borrow from the international capital markets.[69] The rationale behind the exemption is to encourage fund mobilization and meet foreign currency requirements necessary to finance infrastructure projects in the country.[70]

Let us see the experience of some countries. The UK stamp duty law provides an exemption to instruments transferring stock or marketable securities from failing financial institutions to public bodies and creditors (known as the financial bail-in exemption) and to low-value transfers (for example, transfers that do not exceed £1,000). [71] In Nigeria, the Company and Allied Matters Act provide an exemption from stamp duty on certain instruments (any assurance such as dead and assignments, encumbrances such as mortgage, and powers of attorney) relating to a company under liquidation by virtue of a compulsory winding-up order by a court or creditors voluntary winding up.[72] Another area in which instruments are exempted from stamp duty in Nigeria is by virtue of treaties or agreements that the federal government enters with other governments and sometimes with foreign private corporations and international organizations. The Nigerian Stamp Duties Act also specifically provides

[67] Ibid, Schedule
[68] Labour Proclamation No. 1156/2019
[69] Government Bonds Transacted in International Capital Markets Proclamation No. 867/2014, Art. 2 & 4. The Minister of Finance and Economic Development is authorized to borrow amounts not exceeding two billion United States Dollars on behalf of the country by issuing bonds to be transacted in international capital markets in one or more series.
[70] Ibid, Preamble
[71] There are also various exemptions and reliefs such as intra group relief, reconstruction relief, acquisition relief, intermediaries relief, stock lending, and repo relief.
[72]Company and Allied Matters Act of Nigeria, 1990 (amended in 2020), S.513

exemptions for unstamped bills of exchange used to prove the contents of another duly stamped instrument that is lost or destroyed, any conveyance of sale based on a decree or order on which duty is paid, a lease where documents are in the nature of a penal rent, loan capital where duty has been paid in respect of a mortgage or marketable security, and documents in reconstructions and amalgamations.[73] The law also provides a reduced duty for short-term marketable securities.[74] In particular, marketable security payable within a term not exceeding 3 (three) years after the date on which the duty is payable is reduced by 5k (five kobos) on every N20 (twenty nairas). However, where such marketable security is assigned, transferred, or negotiated, in Nigeria after the date stated on the face of the instrument as the date on which the amount to be secured is to be paid off, stamp duty will be charged at the full rate. On the other hand, the act also provides an incentive for Companies in the form of reimbursement of duty paid on a loan capital wholly or partially applied for the conversion or consolidation of the Companies existing loan capital.[75]

In Tanzania, according to the Section 30 of the Stamp Act, instruments executed by or on behalf of or in favor of the government, instruments that relate exclusively to immovable property situated out of Brunei Darussalam, loan instruments through a financing facility for the first house (including land) up to $250,000, tenancy instruments for the rental of a house with rental of up to B$2,000, and instruments involving the transfer of property or shares between the owner and his dependent (such as a spouse, parents, and children) are exempted from stamp duty.[76]In India, Section 3 together with Schedule I of the Indian Stamp Act specifies the instruments which are liable to stamp duty.[77] Instruments which are exempted from duty or not mentioned in the Schedule are not liable to duty. Cheques, demand drafts and bills of exchange drawn payable on demand or at a tenor (subject to certain stipulations) and wills are exempt from stamp duty. Promissory notes, bill of exchanges payable otherwise than on-demand and other instruments mentioned in Schedule I shall be duly stamped. In India, the government can reduce or remit the whole or part of duties payable. Such reduction or remission can be in respect of whole or part of territories and also can be for a particular class of

[73]Nigerian Stamp Duty Act, 1939, S.43, 52&55, 70, 102 & 104
[74] Ibid, S.79
[75] Ibid, S.103
[76]Tanzania Stamp Duty Act, 1972
[77]Indian Stamp Act, Schedule I

persons. Government can also compound or consolidate duties in case of the issue of shares or debentures by companies.

What do you learn from the experience of the UK, Nigeria, Tanzania, and India? Discuss if there are best takeaways for Ethiopia.

d. Establishing Liability, Time, and Manner of Payment in Stamp Duty

Who pays the stamp duty? In whose name stamps are required to be purchased? Answering these questions is important to establish liabilities under the law. Under the Ethiopian stamp duty legislation, the principle goes the beneficiary of an instrument is liable to pay the stamp duty in principle.[78] However, there are instances where other persons can be liable. For example, the person making (drawing) or issuing an instrument in Ethiopia, is also liable for the payment of the stamp duty upon the execution of the instrument.[79] However, when an instrument is made (drawn) outside Ethiopia, the person who is first executing it in Ethiopia is liable for the payment of the stamp duty.[80] In the context of leases, unless the lessor and the lessee agree otherwise (to the contrary), it is the lessee who is required to pay the stamp duty tax as a rule.[81] In the case of the lender-borrower relationship, the borrower is required by law to pay the stamp duty tax chargeable on security deeds.[82] With regard to documents transferring title to the property, the transferee is in principle required to pay such tax though the transferor can agree that he will pay the same tax.[83] In the case of contractual documents, parties to the contract are jointly and severally liable to the stamp duty.[84] In the case of employment contracts, the employer is liable for the payment of the stamp duty tax.[85] Regarding an award, parties to it are jointly and severally liable for the payment of stamp duty thereon.[86] Finally, as to collective agreement, the employer and employees are jointly and severally liable for the payment of stamp duty.[87] Thus, from the provisions of the Ethiopian law, in the determination of persons liable for stamp duty, parties to

[78]Stamp Duty Proclamation, Art. 6 (1)
[79] Ibid, Art. 6 (2)
[80] Ibid
[81] Ibid, Art. 6 (3)
[82] Ibid, Art. 6 (4)
[83] Ibid, Art. 6 (5)
[84] Ibid, Art. 6 (6)
[85] Ibid, Art. 6 (7)
[86] Ibid, Art. 6 (8)
[87] Ibid, Art. 6 (9)

the document may have unilateral or joint liability in respect of stamp duty. Liability seem allocated by considering beneficiaries from the transaction, ability to pay, and equity and fairness assumptions as it can be respectively reflected like transferee's liability during property transfer, employers liability for an employment contract, and joint liability in case of an award.

Time has a critical value in taxation. The time of payment is contingent upon the time when the instrument must be stamped in accordance with Authentication and Registration of Documents' Proclamation No. 922/2015. This is because, under Article 34 (1) of the same proclamation, the notary must make sure that the payment of stamp duty pursuant to the relevant law has been made before authenticating and registering a document. Article 7 (1) of the stamp duty proclamation provides a different time of payment for different dutiable instruments. Accordingly, the stamp duty shall be paid on memorandum and articles of association, before or at the time of registration; on awards, before or at the time of issuance of the award; on contracts or agreements, before or at the time of signature; on leases or sub-leases, before or at the time of signature; on notarial acts, at the time of issuance; on security deeds, before or at the time of signature; on documents of title to the property, before or at the time issuance is effected. However, the law provides times of payment for only seven instruments and when stamp duty shall be paid for the rest of the six instruments remain unclear. And, the other question is why the law prefers to use a list approach rather than the general approach common in other countries. In India, the laws provide that instruments executed in India must be stamped before or at the time of execution, and instrument executed out of India can be stamped within three months after it is first received in India.[88] Such explicit time limits help to easily establish liability in cases of delinquency. It is only where an instrument is not duly stamped within these time limits that the person liable to a penalty shall be guilty of an offense and liable on conviction to payment of the unpaid duty and a fine. The other experience is that legislations provide some later dates for any unstamped or insufficiently stamped instruments so that they can be stamped within some time from their first execution. Such explicit provisions are made to accommodate reasonable excuses for the delay.

[88] Indian Stamp Act, Section 17, 18(1) and 19

The other concern of this section is the mode or manner of payment of stamp duty. According to the stamp duty proclamation, the payment of stamp duty under 50 Birr is effected by affixing a stamp of appropriate value to the instrument. When the stamp duty exceeds 50 Birr or where the type and nature of instrument so requires, the tax authority may, by a directive, provide that stamp duty be paid by means other than affixing a stamp.[89] The person executing or receiving an instrument bearing an adhesive stamp shall, at the time of execution, cancel the same in such manner prescribed by the authority so that it cannot be used again.[90] The failure to cancel would make this person (not the person submitting the document for execution) responsible.[91] Any instrument bearing an adhesive stamp that has not been canceled as such shall be deemed, so far as such stamp is concerned, to be unstamped.[92] A stamp is any mark, seal, or endorsement by a competent authority to prove payment of a chargeable duty. There are various modes to 'stamp' a document and these various modes of affixing stamps (for example, adhesive stamps, impressed stamps, stamp duty by endorsement) are permissible in stamp duty legislation such as the Indian Stamp Act. However, in Ethiopia, what instruments can be affixed in what form is not clear from the law. For example, in India, bills of exchange, promissory notes, notarial acts, entry as an advocate or attorney in the High Court, and transfers of shares can be stamped with adhesive stamps.[93] The Stamp Duty Act and the Finance Act 2006 also recognize payment through impressed stamps[94] and electronic payment respectively.

Payment of stamp duty is simple and straightforward when one instrument covers only one matter. However, there can be instances where several instruments may be used to complete a single transaction or one instrument may contain several matters. How stamp duty can be paid in such cases? The law in Ethiopia is silent in this regard. Under the Indian law, where several

[89] Stamp Duty Proclamation, Art. 7 (2)
[90] Ibid, Art. 7 (3) (a & b) Cancellation can be done by drawing lines across the adhesive stamp by pen etc. in a way it prevent future use but letting the name of the person cancelling and the value of stamp affixed must be remain visible.
[91]Stamp Duty Proclamation, Art. 7 (3) (c)
[92] Ibid
[93] Indian Stamp Act, Section 11. See also James Alm et al, Stamp Duties in Indian States: A Case for Reform, World Bank Policy Research Working Paper 3413, September 2004
[94] Ibid, Section 13. 'Impressed Stamp' means stamp is impressed on the paper by mechanical means (these are the stamp papers we purchase from stamp vendor). Instrument should be written on the stamp paper such that the stamp may appear on the face of instrument and cannot be used or applied to any other instrument.

instruments are used to complete a single transaction, only the principal instrument shall be chargeable with the duty prescribed in the schedule and each of the other instruments shall be chargeable with a duty of one rupee instead of a duty prescribed for it under the schedule.[95] On the other hand, if one instrument relates to several distinct matters, stamp duty payable is the aggregate amount of stamp duties payable on separate instruments.[96] This is what is known as the composition or consolidation of duties.

e. Mode of valuation

As mentioned above, stamp duty can be designed to be specific or *ad valorem*. In cases of specific types of stamps, duty valuation is not required because the amount chargeable is fixed or specified in the Schedule.[97] Such specific rates are provided principally because the value of the right or obligation executed in the instrument cannot be (easily) determined. When stamp duty is payable on *ad valorem* basis there shall be an appropriate mode of valuing the instrument, the transaction, the property, etc. In this regard, the stamp duty proclamation provides that where the value of the right or obligation executed by means of an instrument can be determined, the rate chargeable on such instrument is the percentage of such value as specified in the Schedule.[98] How this value can be ascertained and what is the importance of such valuations to taxpayers, the government, and to the economy?

The valuation process is important because it determines the tax base and offers a means of raising revenue without impeding economic growth. The rules of stamp duty valuation and calculation are important because an incorrect value (i.e. over or undervaluation) could result in over or under taxation. Undervaluing the chargeable instrument (for example, property value on the agreement) for reducing stamp duty is a common practice and is legally defined as tax evasion. Legally speaking, the non-observance of the rules of valuation would mean that instrument is not duly stamped unless the contrary is proved. The stamp duty proclamation provides specific rules of valuation of instruments in respect of amounts expressed in foreign currency, stock or marketable

[95] Ibid, Section 4(1)
[96] Ibid, Section 5
[97] Stamp Duty Proclamation, Art. 5 (2)
[98] Ibid, Art. 5 (1)

security, several distinct matters, and transferring title.[99] In this regard, if the amount in the chargeable instrument is expressed in foreign currency, such amount shall be computed on the basis of the prevailing rate of exchange.[100] In some countries such as India, it is the rate of exchange on the date of the instrument (not the actual rate prevailing in the market) that is considered for finding value in national currency for stamp duty purposes.[101]

Where an instrument is chargeable with stamp duty in respect of stock or marketable security, such amount shall be computed on the average value of the stock or security prevailing at the time when the instrument is made.[102] Other countries also follow the same approach because of the volatile nature of the market. For example, in India, the value of stock or security is calculated on the basis of average the price thereof on the date of the instrument.[103] Thus, in the case of the transfer of shares or bonds, stamp duty is payable on basis of the market value of the shares or the bond on the date of the instrument not on the face value of a security. It should be noted that the valuation of stock and marketable securities is *especially important as the country is moving into* the capital market by enacting Capital Markets Establishment Proclamation No. 1248/2021 and organizing the Ethiopian Capital Market Authority as an autonomous regulatory body directly accountable to the Parliament.[104]

The stamp duty payable on documents transferring title is calculated on the value of the property involved as agreed upon between the transferor and the transferee provided that it's approved by the Authority.[105] When the value agreed between the parties is not acceptable to the Authority, the value of the property involved is determined by a special committee that is appointed for such purposes by the Board.[106] Stamp duty charges on property (especially land and buildings) transfers in general and applicable valuation rules, in particular, are essential and most controversial in the study of stamp duty. On this point, it's useful to appreciate the effects of stamp duty on the property market and the economy at large discussed in the second section of this chapter.

[99] Ibid, Art. 5 (3-4)
[100] Ibid
[101] Indian Stamp Act, Section 20
[102] Stamp Duty Proclamation, Art. 5 (3-4)
[103] Indian Stamp Act, Section 21
[104] Capital Markets Establishment Proclamation No. 1248/2021
[105] Stamp Duty Proclamation, Art. 5
[106] Ibid

This makes the valuation of property and instruments used to transfer even more imperative. Despite this imperative, the current stamp duty proclamation of Ethiopia provides no detailed rules of valuation unlike the experience in other countries.

In other countries, stamp duty charges during property transfers are emphasized and, in principle, calculated based on the total market value of the property. Although the market value of real property transactions is the biggest factor to levy stamp duty, various other factors are also used to determine the stamp duty. In India for example, the type of the property, location of the property (city area, rural area, metropolitan area, suburban, etc.)[107], age of the property (old or new building)[108], age of the owner[109], gender of the owner[110], usage of property (commercial or residential use)[111], type of property (flat or an independent house), and project amenities[112] are legally defined factors that must be taken into account in valuing instruments that transact real properties.[113] Of course, these factors are also used to determine not only stamp duty charges but also registration fees. In these countries, the law provides a range of factors that should be considered in determining the value of the instrument. This, in effect, determines the amount of stamp duty. Legally speaking, the fact that the property purchaser is female or the property is located outside the city is the legal way to reduce the stamp duty charges on property purchases. Some support that it would make the collection of stamp duties equitable although it adds administrative takes into the system. The

[107] Stamp duty charges are always higher for properties falling in the municipal limits of a city when compared to the properties falling outside the limits.

[108] The age of the property plays a crucial role in determining the stamp duty charges you will be required to pay. As stamp duty charges are calculated as a percentage of the total market value of the property, old buildings usually attract less stamp duty charges and new buildings attract a high charge. This is because the market value of old buildings would have depreciated.

[109] In some states in India discounts are available for senior citizens.

[110] Some states also offer concessions for female real estate owners. In order to promote property ownership among women, several states charge lower stamp duty, in case a house is being registered in the name of a woman. some argue men and women both have to pay similar charges for whether the property is registered in the name of one of them doesn't matter from gender perspective.

[111]The stamp duty in case of commercial properties will always be higher than the stamp duty on residential buildings.

[112] Some states of India charge additional stamp duty, if the housing project in which the unit is located is offering high-end amenities such as elevators, swimming pools, clubhouses, gyms, community halls and sports areas.

[113] Supra Note 6

stamp duty proclamation of Ethiopia doesn't incorporate detailed valuation rules with respect to instruments used in real property transactions nor does the country have other rules to be referred to except the general tax administration law which incorporates the fair market value principle.

Finally, it should be noted that the stamp duty proclamation doesn't provide rules of valuation for all the chargeable instruments under art. 3. When the value of subject matter cannot be ascertained from the instrument stamp duty can only be fixed on the estimated basis of valuation. In this regard, introducing detailed and clear rules of valuation would be a good idea.

f. Enforcement: The Fate of Inadequate Stamps

Enforcement is decisive in tax law and policy although it is not the answer to all the woes. Thus countries employ civil, administrative, and criminal enforcement mechanisms. Enforcement is crucial primarily to determine the fate of inadequate stamps. When stamps are said to be inadequate? What is the effect of not duly stamping instruments? Are there ways to rectify inadequate stamps? Are the existing laws in Ethiopia adequate to combat inadequate stamps, regulate consequences and provide mechanisms of rectification? How do courts and other registration offices practice these issues? A duly stamped instrument is an instrument that bears an adhesive or impressed stamp of not less than the proper amount, and that such stamp has been affixed or used in accordance with the law.[114] So an instrument not duly stamped includes instruments that bear a stamp that is lower than the amount fixed by law.[115]

In Ethiopia, the stamp duty law has regulated the consequences of non-payment of the stamp duty in a way it encourages compliance and discourages violations. For example, it provides;[116]

> "an instrument chargeable with stamp duty cannot be admitted in evidence for any purpose by any person having, by law or consent of parties, authority to receive evidence or shall be noted upon or

[114] Akash Shah, Effect of not Duly Stamped Instrument, Legal Services India, Oct 11, 2012 available at (http://www.legalservicesindia.com/article/article/effect-of-notduly-stamped-instrument-1333-1.html) (Last Viewed on 05/26/2022)
[115] Ibid
[116] Proclamation No 110/1998, Art. 10.

authenticated by any such person or public office, unless such instrument is duly stamped".

This effect is however depends on whether or not it is a document where registration is mandatory, documents where registration is optional, and documents executed outside Ethiopia. In the interest of the public, there is an exception to this prohibition to the effect that the validity of the instrument shall not be affected when unstamped instruments that should have been charged with stamp duty are submitted as evidence in any proceedings in a criminal court.[117] Moreover, any instrument inadmissible in evidence in accordance with the stamp duty law shall be admitted in evidence on payment of two times the amount due which shall not be less than 10 Birr.[118]

The imposition of these kinds of civil or administrative penalties doesn't bar the prosecution of any person in accordance with this stamp duty law or any other criminal law should the acts committed duly constitute a crime.[119] Any person who, with the intention to evade the stamp duty, executes or signs any instruments chargeable with stamp duty, without the same being duly stamped, shall, on conviction, be punished with rigorous imprisonment and fine. Moreover, the party executing it is required to pay the penalty for executing inadequately stamped documents. One can suggest other ways of enforcement mechanisms. First, the authority shall deny registration if an inadequately stamped instrument is presented for registration. Second, the court or registrar of the court can reject inadequately stamped pleadings for legal or technical insufficiency.[120] Other than this, no law in Ethiopia provides that inadequate stamping as a ground to invalidate a contract. Yet, the rights of the parties in question become affected through a lack of enforceability and admissibility. For example, the instrument can be inadmissible in a suit where the property in question is a disputed title or where there is a question relating to the subject matter of the document.

The Tanzanian Stamp Duty Act provides three different effects of unstamped or not duly stamped documents: an instrument may be impounded or confiscated by a public officer, an instrument cannot be admitted as evidence in any court

[117]Ibid, Art 12
[118] Ibid
[119] Ibid
[120] Civil Procedure Code, 1965, Arts. 229 & 230

of law and punitive measures will be imposed on any persons involved in fraudulent activities.[121] In India, an instrument not duly stamped will not be admissible as evidence as a rule but it can become immediately admissible once the remaining duty is paid along with a fine.[122] Such a quid pro quo kind of enforcement of stamp duty is debatable. A final issue is the rectification of inadequate and improper stamps. The Indian law provides instances where the inadequacy can be rectified. For example, when the insufficiently stamped document is already submitted before the court as evidence, the inadequately stamped documents and instruments become admissible as evidence once the remaining duty is paid along with a fine. In the same way, where instruments are inadequately stamped by accident or mistake, a person can correct them without a fine.[123]

9.6 Stamp Duty Administration: Some gaps in the Practice

Despite the historical and legal importance of stamp duty in the Ethiopian tax system, neither taxpayers nor tax authorities nor lawyers have any significant awareness of it. As a result, the charges are not properly collected, and the manner of levying and collecting the charge, in general, is not in line with the canons of taxation. There are many concerns, and serious legal and administrative issues are awaiting reform. The Ethiopian Revenue and Customs Authority (ERCA) identifies four major problems on the issue of stamp duty law and its enforcement: general stipulations of dutiable instruments and services, inconsistent enforcement in the country, lack of awareness from the side of tax authorities and taxpayers, and shortage of stamps that expose customers for unnecessary costs and troubles.[124] There are no regulations and directives necessary to facilitate stamp duty enforcement. The scope of the instruments and applicable rates must be revised to coup up with the current value of money. Awareness problems are common because stamp duty laws are not adequately addressed in tax law teaching and training processes. The other critical problem is a shortage of stamps. ERCA has provided various remedies to solve the shortage of stamps. For example, in its response to the Ethiopian Insurance Corporation, which requests a solution for the absence of a five birr stamp to post on insurance contracts, the ERCA allows the payment of

[121] India Stamp Duty Act Section 42, 45 & 47
[122] Ibid
[123] Ibid, Section 41
[124] Letter from The Ethiopian Revenue and Customs Authority, Internal Office Memorandum to Law enforcement division, 04 Meskerem 2007

the duty through "receipts" pending stamps published.[125]In addressing the same request from United Insurance Company the authority allow for the use of official stamps (postage stamps or embossed seal of a public authority) until stamps are published.[126] Through a letter dated 22 Megabit 2008 ERCA assign Addis Ababa Kality Customs, Addis Ababa Airport Customs, and Mojo Branch Office to collect the 35 birr customs duty on the agency contract for custom transit through official stamps in order to solve the shortage of stamps.[127]On the other hand, the fact that it was only a single branch of ERCA that had sold stamps to all litigants in the federal first instance court had exposed customers to high costs and trouble.[128] Although ERCA devolves the service to all branches in the ten sub-cities, there were no experts assigned for this purpose and the problem continued unsettled. Thus ERCA allows the sale of stamps and collection of duties by the cashier of the sub-cities.[129]

The other challenge comes with the valuation of instruments and transactions for stamp duties. This is a serious problem because values declared for stamp duty purposes are grossly understated. There are no appropriate rules of valuation and trained valuers in the country. Taxpayers would look for ways to avoid the tax burden through the exchange of properties of many different values, splitting of one property into smaller properties to avoid higher duties, and registering properties in other states having lower-tax rates are among the tax avoidance practices. Taxpayers evade stamp duty through the undervaluation of the transaction and avoid the duty by not registering the transaction. This can be due to high compliance costs and the non-availability of stamps as indicated above. There is also a lack of awareness as to the benefits of paying the duty or liabilities for failure. Moreover, the government and tax officials don't pay attention to stamp duty as they do to other taxes. Thus, there is a huge revenue loss in the sector, and stamp duty is not serving other purposes it intends to do.

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[125] Letter from the Ethiopian Revenue and Customs Authority to the Ethiopian Insurance Corporation, 10 Megabit 2008

[126] Letter from the Ethiopian Revenue and Customs Authority to the United Insurance Corporation, 24 Tir 2008

[127] Letter from the Ethiopian Revenue and Customs Authority to Addis Ababa Kality Customs, Addis Ababa Airport Customs and Mojo Branch Office, 22 Megabit 2008

[128] Letter from the Ethiopian Revenue and Customs Authority to the Ten sub cities small taxpayers branch offices, 26 Tikimt 2007

[129] Ibid

9.7 The need to Rethink Electronic Stamping in Ethiopia

The use and development of Information Communication Technology (ICT) and the internet have changed the way people conduct business and conclude contracts. In particular, it has created an opportunity for new forms of trading i.e. online provision of goods and rendition of services, which is known as e-commerce. Although currently, e-commerce is at an infant stage in Ethiopia, the number of internet users has increased and businesspersons have shown interest in online transactions. However, several legal and non-legal factors made some businesses reluctant to get involved in electronic transactions. The first challenge is the absence of online payment and an efficient delivery system. The other concern is the gaps in the existing legal framework to offer necessary guarantees for a trustworthy and secure online commerce.

Contrary to the experience of the rest of the world, the Ethiopian legal system provides no adequate guarantee of the legality and validity of electronic contracts, electronic signatures, and electronic stamping. With conventional transactions, the Civil Code states that certain contracts such as those with respect to immovable property, administrative contracts, and long-term contracts shall be written and signed by the parties and the witnesses.[130]These provisions make the signatures of the contracting parties a formal requirement.

There is a lack of law pertaining to e-commerce and e-signatures in the country except for the Ethiopian Commodity Exchange proclamation No. 550/2007, the National Payment System Proclamation No. 718/2011, and the Proclamation to Provide for a Warehouse Receipts System No. 373/2011. These have been pioneering legislation that has given legal recognition to electronic signatures and electronic documents. Recently, the most relevant and pertinent legislation i.e. the National Payment System Proclamation No 718/2011 and the Electronic Signature Proclamation No 1072/2018 have been enacted. These laws are aimed at creating favorable, accelerated, safe, and reliable conditions in electronic relations with users/clients, the business community, and the government.

[130] The Civil Code of Ethiopia, Arts. 1723-1725. Art. 2003 of the code states that a contract cannot be orallyproved or presumed when it is expressly prescribed by law that it must be in written form. Inaddition, a written agreement has greater weight when it comes to dispute resolution in a court oflaw. For instance, Art. 2005 states that a written document is conclusive evidence.

In order to ensure that the stamp duty laws keep pace with digitalization and the introduction of other laws in the area of e-commerce and e-signature, key amendments are required for the stamp duty to be levied on electronic records including those related to the transfer of an interest in immovable properties and shares. This move would safeguard the country's revenue base and enhance the evidentiary value of electronic instruments. In this regard, it should be noted that the digital world operates very differently from paper, and perhaps an entirely new framework of taxation might be more suitable to tax digital transactions. It's time to rethink electronic stamping in Ethiopia.

Summary

Stamp duty is one of the most common revenue sources for governments and that people face in daily activities. This chapter was designed to address several vexing legal issues that help to understand stamp duties and the governing law in Ethiopia. It begins with conceptualizing stamp duty and the governing legal regime. Accordingly, although it is adopted by different countries in different forms and names, stamp duty is (tax) governments impose on selected instruments or services that are legally required to be recorded. The chapter also identifies and discusses the various salient features of stamp duties as different from other taxes. Some of these features could lead to the conclusion that stamp duty is not a tax. As a matter of fact, the imposition and collection of stamp duty have several rationales beyond revenue generation. The often mentioned role of stamp duty is to make sure that documents are legally valid and authentic to be used as valid evidence in a court of law. Its significance in safeguarding property rights, and fostering the development of art, the activities of financial institutions, and the transfer of capital assets. Stamp duty was introduced in the early 1940s as part of modernizing the system of taxation and decentralized to the regional states in post-1991 Ethiopia. The chapter tries to raise several legal questions in determining the power to levy and collect and designing the stamp duty law in Ethiopia and other countries. Design options in determining chargeable instruments, rates, exemptions, liability and payment, valuation, and enforcement are discussed based on the laws of Ethiopia, other countries, and the literature. Finally, the chapter identifies and discusses practical gaps in administering stamp duty and the need to rethink electronic stamping in the country.

Review Questions

1. Identify and discuss the salient features of stamp duty as different from other taxes.
2. Do you think that the various rationales to impose and collect stamp duty are well articulated under the current stamp duty Proclamation?
3. Which tier of government shall impose and collect stamp duty? How does the division of revenue system in Ethiopia treat this issue?
4. Discuss the prevailing legal issues in determining chargeable instruments, rates, and exemptions in the stamp duty regime of Ethiopia.
5. Identify and discuss practical gaps in the Stamp Duty Administration.
6. Amidst the development of ICT and new forms of business such as e-commerce and e-signature, don't you think that it's time for Ethiopia to rethink electronic stamping?

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Chapter Ten

Property Tax and Reforms in Ethiopia

Introduction

Taxes and other forms of exactions on the property have a long and storied history in Ethiopia and all over the world. Property taxes on land and other valuable properties were used in ancient times and as feudal obligations owned to kings or landlords during the medieval ages. The tax was also prominent in colonial times in various structures and politico-economic contexts. Both feudal and colonial tax rates increased several-fold and taxation became a matter of heated debate, violence, and revolts. By the beginning of the twentieth century, criticisms against the uniform, universal (general) property tax had become more common and widespread.

Many countries had shifted their policies as well as legal and institutional emphasis toward income and consumption taxes. Later, with rapid urbanization and population size, the growing importance of local governments, and the increase in urban land and property values many countries in the west have started property tax reforms while those in the east abandoned property taxes as 'instruments of class exploitation. In this way, modern property taxes have grown well and in a variety of forms and uses in Europe and North America. Scholars support property taxation for its great revenue potential, its burden rests with middle and upper-income families and it has a less distortionary effect on business and consumer economic decisions. Policymakers have undertaken property tax reforms as part of other public sector reform programs such as decentralization and local government empowerment and land and property reforms. The importance of the property tax has expanded in developing and transition economies with the post-socialist land reforms of the 1990s in the former Soviet republics and administrative reform of local government. Currently, property tax is the largest source of revenue in many countries, especially for local governments. Yet, for various legal and non-legal factors, the fiscal and non-fiscal effects of property tax remain insignificant in developing and transition countries.

Ethiopia, which is one of a few whose histories as a nation-state can be traced back to antiquity, had passed through the same development property taxes under the different land tenure and public governance systems. Various

traditional forms of taxes and tributes were collected throughout the ancient and medieval history of Ethiopia. However, the attempt to modernize property taxes was only started in the 1940s through the introduction of land tax. However, the development of the property was halted with the coming into power of the military-socialist government, which nationalized all land and extra houses and put the major factors of production at the state's disposal. The Derg government restricted property tax as house tax and continued to collect only rent (permit fee) from land. The EPRDF, which upheld Derg's land and property policy with some modification, introduced no significant measures with respect to property tax except for the tortoise reform initiatives since 2011. In addition to problems in the land and property system, problems attributable to decentralization and recognition of local government have played their roles in weakening the property tax system in the country. Prosperity party, the current ruling coalition in Ethiopia, seems to put the kibosh on the long-overdue property tax reform agenda. Prime Minister Abiy Ahmed has repeatedly expressed the determination of his government to introduce property tax in urban Ethiopia.

Today one cannot find property tax in the daily task menus of tax administrations or annual plans and reports of local, regional, or federal governments. The tax has not been among the terms used in the language of judicial rulings over the past three decades. The subject of property tax is a forgotten agenda in the study of Ethiopian tax law. This chapter is designed to fill this gap. Obviously, property tax law is replete with technical concepts and rules borrowed from other disciplines such as federalism, constitution, land, and property laws. Despite the dearth in Ethiopia, there is a rich body of literature, jurisprudence, and country experiences to nurture the passion for studying property tax law and reform in Ethiopia. To the extent it is necessary to reflect on the Ethiopian experience, the previous property tax laws of Ethiopia (such as land tax proclamation no 8/1942 and Urban Land Rent and House Tax Proclamation No. 80/1976) and the Draft Property Tax Prototype Proclamation are consulted in the different sections of this chapter.

The chapter is divided into seven sections including this introduction. The sections discuss the concept and theories of property tax, justifications for the need for a property tax, and exploration of historical developments in property taxes in Ethiopia and the world. An attempt is also made to identify and discuss

issues in the allocation of the power to impose, collect and use property tax. The final section attempts to thematically elucidate the various issues in the design and administration of property tax law.

10.1 The Concept of Property Tax

Literally, property tax is a tax imposed on a property (real or personal; immovable or movable; corporeal or incorporeal) that belongs to and appropriated an individual or entity. The term property tax is known by different names in the literature. For example, it is known as "real estate tax", 'real property tax', "land and building tax", "immovable property tax" etc. for its commonly imposed on real properties. It is also known as "ad valorem tax" for it is assessed based on a property's value. Others call it "local tax" for it is imposed, administered, and used mainly by local governments. Black's Law Dictionary defines property tax as a tax levied on the owner of the property [especially real property] usually based on the property's value.[1] Joan M. Youngman has defined real property tax comprehensively as "a tax on ownership and other legal interests in land and buildings to achieve important fiscal, political and legal objectives."[2] Both definitions relate property tax with real properties or immovables. Unlike the former lexicon definition, which only includes a tax on ownership, the definition by Joan M. Youngman recognizes other bundles of legal rights such as possession, rent, and use vested in the immovables as taxable interest. In a technical sense, the property consists of a set of legal rights pertaining to a specific object, and a property tax is not imposed on the physical land and buildings but rather on intangible rights to them.[3]

Although it's commonly associated with real property, property taxes are also imposed on personal properties, movable assets, or intangible properties.[4] For example, in countries such as Armenia and United States**,** property tax is imposed on businesses, farm equipment, inventories, automobiles, jewelry, and

[1] Bryan A. Garner, Black's Law Dictionary, Seventh Edition, West Publishing Co., ST. PAUL MINN., United States ofAmerica, 1999, P.1526.
[2] Joan M. Youngman, Tax on Land and Buildings, in Victor Thuronyi (eds), Tax Law Design and Drafting, IMF, 1996, p.9
[3] Joan M. Youngman, Supra Note 2 P.267. It is with this understanding that countries that do not recognize private ownership of land but recognize private rights of use of land still have a system of private property appropriate for taxation.
[4] Riël Franzsen and William McCluskey, Property Tax In Africa: Status, Challenges, And Prospects, the Lincoln Institute of Land Policy, 2017 P. 4

furniture, and even such intangibles as bonds, mortgages, and shares of stock. The scope of property tax varies in different countries depending upon legal factors, administrative realities, tradition, availability of other sources of revenue, the organization of government (especially at the level of local government), and the public services provided. Some also broadly define property tax to include property transfer taxes. According to Riël Franzsen and William McCluskey, in addition to the recurrent or annual taxes, property taxes include taxes on the transfer (acquisition, alienation, or both) of property such as stamp duties, real estate transfer taxes, capital gains taxes, gift taxes, and death and inheritance taxes.[5] However, these are transaction taxes and such definitions are used mainly for purposes of national statistics.

Thus, the main focus of this chapter is recurrent property tax because other property-related taxes are covered by income and consumption taxes in Ethiopia. The draft Property Tax Prototype Proclamation adopts the narrow view and defines "property tax" as tax levied in respect of urban land use, including building and other land improvements located on urban land but chargeable from a taxpayer.[6]Like the case in other taxes, property tax policy, law, and administration should strike a balance between the interest of the taxpayer and that of tax authorities. For example, traditional forms of property taxation during the ancient and medieval ages were controversial and widely perceived to be unfair, regressive, and even oppressive. In this regard, early philosophers including Aristotle and Plato underlined that tax systems must be designed and enforced on the basis of an appropriate set of principles. In the 18th Century, Adam Smith tried to systematize the rules that should govern a rational system of taxation by setting down four general canons (equality, certainty, convenience, and economy) in his book, "The Wealth of Nations". Keeping in view the enormously increasing roles and functions of the government, some other scholars such as *Adolph Wagner*, David Ricardo, and Richard Musgrave have prescribed some other canons (such as productivity, simplicity, diversity, elasticity, buoyancy, flexibility, neutrality, etc.) as a measure of the good tax system. These are the necessary principles or attributes to which a good tax system should adhere while imposing and collecting taxes. For a long period of time taxes are levied in almost every country of the world primarily to raise revenue for government expenditures. It was in the 20th

[5] Ibid, P. 3
[6] FDRE, Modernized Property Tax System Prototype Proclamation (Draft)

Century that scholars such as Richard A. Musgrave instilled other purposes of taxation such as resource allocation, income redistribution, and economic stability. Thus tax systems should seek to balance the various purposes of property taxation and optimize tax collections while minimizing the burden on taxpayers to comply with tax laws.

There are two dominant theories regarding real property tax: the benefit approach (the benefit view) and the ability-to-pay approach (the new view).[7] According to the benefit view theory, property taxes essentially functions as a user charge on residents for the benefits they receive from the local policies funded by real property taxes. It posits that taxpayers pay real property tax for the services received from the local government and the services provided by the state commonly depend on the amount of tax paid. This way the one who benefits more from the activities of the state must pay more real property tax to the government. To identify which individuals benefit more from the activities of the state, zoning of the urban areas is very important according to this view. Benefit theory is challenged and criticized from different perspectives. In the first place, the connection between the benefits provided and the benefits derived is against the obligatory nature of taxation and the basic principle of "no direct quid *pro quo"* in taxation. Second, because expenditures are incurred for the common benefit of the general public, it is difficult to estimate the benefit an individual taxpayer received from public goods such as infrastructure and services. Yet, save the limitations, associating the tax with the local government and the benefit or services is not something to be ignored altogether.

The new view of the property tax is the outcome of the above criticisms against the benefit view and it puts property tax in a standard capital taxation framework. The theory ignores the benefits received by taxpayers with the belief that it has little relationship to the amount of taxes paid and focuses on its implications for income redistribution. The assumption is that the land tax is likely to be capitalized or absorbed in the future profit to be realized from the property to the extent that it is not offset by the benefits of public services. There is an assumption that property, especially immovable property, tends to

[7] John Douglas Wilson, Property and Land Taxation, in Richard J. Arnott and Daniel P. McMillen (ed), A Companion to Urban Economics, Blackwell Publishing, 2006, P.2-4; Herbert D. Simpson, The Changing Theory of Property Taxation, The American Economic Review, Vol. 29, No. 3, 1939, pp. 453- 467

be concentrated in the hands of relatively wealthy individuals and that therefore the capital portion of the real property tax is progressive. According to this view, the tax must be imposed based on the ability to pay principle not based on the benefit provided for the taxpayer.

10.2 Rationales for Property Taxation

Understanding why countries adopt property tax and why it has generally become a reform agenda worldwide is well worth a thorough discussion. Property taxes especially taxes on the immovable property have many virtues.[8] Firstly, in terms of efficiency, property tax has the potential to be a significant revenue producer, especially for subnational governments in rapidly urbanizing developing countries. The tax is difficult to evade, hide or shift because the base is immovable. The tax is also stable and resilient to external shocks due to various factors such as globalization and private investment decisions. It's also economically less distortive compared to consumption and income taxes. The reason is that changes in property taxes are easily capitalized over time into property values.

Secondly, property tax is said to be fair because an immovable property is often a primary repository of wealth and, in most societies, such properties are found concentrated in the hands of the few. Thus, the tax tends to fall more on those with the ability to pay and can be used as a means of distribution to pay for infrastructure, services, and welfare programs. On the other hand, some argue there is a clear public claim to some portion of the growing value or the unearned increment of property, and property tax enables the taxing authority to capture such value. The increase in values of land and building benefits a lot from services provided by the governments (such as fire and police protection and road maintenance), the public, neighbors, and the environs. Such value is an unearned increment for owners and holders and it's reasonable to evenhandedly capture parts of such value.

The third prominent justification in support of property tax is local government autonomy and accountability**.** In many countries, property tax is taken as an effective tool for decentralization and reducing local government dependence on fiscal transfers from higher tiers of government. Non-revenue objectives

[8] Merima Ali et al, Property Taxation in Developing Countries, CMI Brief, Vol. 16 No. 1, March 2017; Joan M. Youngman, Supra Note 2

such as encouraging investment or property development and combating property speculation have also local roles. There is also an assumption that as people perceive the connection between the tax and local public services and infrastructures, they are typically more willing to pay their property taxes. On the other hand, as a highly visible and politically sensitive revenue instrument, the property tax base can encourage more responsive, efficient, and accountable local governance and public service delivery. In most jurisdictions, property taxes are designed as local taxes i.e. levied, collected, and administered locally and used to finance local expenditures.

Fourthly, property tax is also used to promote efficient use of land and building and to counter speculation, price booms, and volatility. Immovables are the most important and scarce resources in every society. Property tax helps to improve land use and planning for it can be designed to encourage or shape real estate developments. Obviously, property tax enhances the protection and security of property rights across all types of properties.

At this point, it's plausible to pose a question that why many countries and cities especially in the developing and transition economies have poorly performed with property taxes. Why are property tax regimes so difficult to reform? Despite its virtues, property tax is not free from limitations and criticisms. Many agreed that property tax is not popular with taxpayers and politicians as Rosengard characterized it as the "tax everyone loves to hate".[9] Firstly, **a**s a direct tax, property tax is visible or noticeable and politically sensitive. The tax on the property is not withheld at source like the case in income tax or is it is not paid in small amounts with each daily purchase like the sales tax.[10] Moreover, the property tax finances services of which people are usually well aware, such as roads, garbage collection, and parks at the local government level.[11] Thus, taxpayers are more likely to complain about the tax if such services are found inadequate. Although public awareness of the tax is supposed to enhance accountability, it is usually one of the factors for the

[9]Jay K. Rosengard , The tax everyone loves to hate: Principles of property tax reform. In William J. McCluskey et als (eds.), A Primer on the Property Tax: Administration and Policy, WileyBlackwell, 2013, pp. 173–86; Enid Slack and Richard M. Bird, How to Reform the Property Tax: Lessons from around the World, IMFG Papers on Municipal Finance and Governance No. 21, 2015, PP. 13-17;
[10]Ibid, Enid Slack and Richard M. Bird P. 13
[11]Ibid, P. 13

unpopularity of the tax and the prevalence of property tax revolts in the history of many countries in the world.[12] In Ethiopia, anti-government revolts such as the Gojjam and Bale rebellions in the 1960s are associated with land taxes. The best approach to dealing with such a problem is by bundling tax reform with improvements in service delivery so that people become happy to pay taxes.

The second challenge with property tax is the cash flow or liquidity problem. Needless to mention that property tax is imposed on the imputed value and does not reflect a real cash flow or the taxpayer's real current situation. Sometimes taxpayers (especially elderly or senior citizens) can be asset-rich but cash-poor.[13] In such cases, the literature recommends tax systems provide tax reliefs or tax deferral schemes. Thirdly, the tax is criticized for regressivity and inequitably. This criticism is however rejected by others who believe that the tax is inherently progressive and equitable to tax richer households and unearned increments as discussed above. Yet, design matters most. It's advisable to understand when property tax becomes regressive or progressive. For example, if property tax is designed to tax housing services, it tends to become regressive because housing represents a larger share of consumption for poorer households and, on the other hand, if it is designed to essentially tax capital, it tends to be progressive because income from capital represents a higher share of income for richer households.[14] Moreover, the progressivity of the tax can be enhanced by introducing graduated rates (rather than flat rates), setting tax thresholds or exempting low-value properties, and allowing tax credits.[15]

Fourthly, it is argued that property tax revenues are inelastic compared to income or sales taxes. According to Enid Slack and Richard M. Bird, let alone area-based taxes, market-value-based taxes respond more slowly to changes in economic activity than do incomes or sales. [16] Thus, as the property tax revenues do not expand automatically, tax authorities must regularly update property values and tax rates in consultation with taxpayers.

[12]Ibid, P. 13
[13]Ibid, P. 14
[14] Ibid, P. 15
[15] Ibid
[16] Ibid, P. 15 some see the stability of property tax revenues as advantageous to local governments for it provides a more stable fiscal base in times of recession.

Fifth, volatility is also seen as a problem as the tax rise and fall quickly with changes in property values in the market. In particular, housing bubbles have called attention to this problem even in countries with well-run property tax systems.[17] The other reason taxpayers dislike the property tax is that they may not agree with or indeed understand the base of the tax. Property tax is inherently a presumptive tax because its value is determined by someone that serves as the basis on which to assess the tax.[18] There is no actual sale or generation of income. Thus, no matter how technically good taxpayers resist paying they don't trust or perceive the administrative process as unfair and arbitrary. Sixthly, there is also a fear that tax payments can be quite lumpy and often bear a little direct relationship to public service delivery. Tax administration can become costly, involving property information management, valuation, billing, collection, and enforcement. Property tax is also criticized for its negative effects on housing, land use, and urban development.[19]

Finally, there is a concern that although property tax is said to be local, the tax is not usually under full local control. In most jurisdictions, property tax is not truly local tax because local governments have no or less discretion for the levying (determination of tax base, rate, valuation, and exemptions rules) and administration (assessment, collection, enforcement, and dispute settlement procedures) of the tax. [20] Even when there is some local discretion in the law, higher-level governments often reserve some powers and oversee the design and operation of the local property tax.[21] Moreover, accountability works better through electoral democracy and robust intergovernmental relations than property tax as local electors would reelect local government for its success in obtaining more transfers.[22]

However, such criticisms cannot in any way bare the adoption of property tax in a country. It is also worth noting that, like other taxes, property tax has its own advantages and disadvantages. Effective property tax reform must, therefore, be designed and implemented to address these concerns in design and administration. A nation has to develop and implement the appropriate set of

[17]Ibid, P. 17
[18]Ibid, P. 17
[19] Ibid
[20]Ibid, PP. 5-7
[21]Ibid, P. 6
[22]Ibid, P. 6

policy and administration reforms with regard to the tax base coverage, tax rates, assessment and valuation, collection, enforcement, and taxpayer services tailored to the socio-economic, legal, political, and institutional contexts. In this regard, effective taxpayer and citizen engagement programs, linking revenues collected to improved services, reducing compliance and administrative costs, and adopting measures to ensure equity, efficiency, and transparency are commonly recommended in the literature.

As it will be discussed at length, there is no annual or recurrent property tax collected in Ethiopia. Rather various forms of non-tax revenues such as lease prices, rents, fees, and charges are imposed by regional states and collected by local governments. Do you think that such forms of revenues serve efficiency, equity, local government, value capture, and land and property governance considerations, as discussed here in this section, for property tax? Do you think also that the previous property tax laws and the current Draft Proclamation in Ethiopia adequately justify why property tax is needed? Answering such questions requires a critical reading into the preambles and objective sections.

10.3 Historical Developments in Property Taxes

a. Historical Developments in the World

Property taxes, particularly those taxes on land and landed properties, are almost as old as the age of ancient state societies to which Ethiopia is not an exception.[23] Various forms of property taxes were levied and collected in the ancient, medieval, and modern periods of history. In the history of the world, the first record of organized property tax, perhaps tax in general, goes back a long way to the time of ancient Egypt, Greece, Babylonia, China, and other

[23] In the study of history, it's common to divide time periods into three significant eras: ancient, medieval and modern history. The ancient history roughly covers the period where the earliest known human settlements have been found around 6000 BC to the fall of major empires (such as the Roman, Han and Gupta) around 650 AD. Medieval history, which is also known as post-classical history or dark ages in Europe, is said to have begun following the major cultural and religious upheaval around 500 AD and the 14th centuries. Finally the modern period covers the age of extra-continental expansions (like the exploration and colonization of Africa, Asia and North America by the Europeans) to the present day. It is agreed in the literature that the Enlightenment and Renaissance of the 15th and 16th centuries heralded the beginning of the modern period as we know it today. See generally Peter N. Stearns, The Encyclopedia of World History Ancient, Medieval, and Modern, 6th ed, 2000. Taxes in general and property tax in particular have been an essential revenue source for governments and seen many changes over time.

parts of the ancient world to generate funds for government expenditure and to maintain imperial armies.[24] This is so evident that it is mentioned in numerous historical sources including the Bible.[25] The Old Testament, for example, reads;

> "And Jehoiakim gave the silver and the gold to Pharaoh: but he taxed the land to give the money according to the commandment of Pharaoh; he exacted the silver and gold of the people of the land, of everyone, according to his taxation, to give it unto Pharaohnechok." [26]

The Book of Genesis also describes the property tax collection practices of the Egyptian kingdom by explaining that the Pharaoh would send commissioners to take one-fifth of all grain harvests from land as a tax.[27] In early agrarian societies, taxes were levied (10 percent of produce) against the value of grain, cattle, oil, beer, and also land to fund government activity and the conduct of wars. It was common for empires or kingdoms to establish a tax system that support or enable kingdoms to expand and made others pay taxes and tributes. In the ancient periods, taxes were typically paid by farmers. The sources of wealth were land and its production value and there was no monetary or marketing system to tax income and consumption. In early agrarian societies, property tax was the basis of the power and prestige of the kingdoms. In almost all systems, the tax was imposed based on the possible production value of the land and the areal size of the plot and was collected in kind in the form of harvest yields, other property, or labor. It should be also noted that the applicable tax law and tax obligation were not the same for all people in the taxing jurisdiction. For example, it was not the same for free citizens and slaves or nationals and residents of conquered territories in Greece and the Roman Empire respectively. The other point worth noting is about tax assessors. Tax assessors were highly valued people in ancient many ancient states. For example, a tax assessor was the only person buried along with the king with better tombs in Egypt and Syria, while in Greece a monument was built to the honest tax assessor near the Acropolis. Contrarily, assessors were not honored

[24] Richard Henry Carlson, A Brief History of Property Tax, Fair and Equitable, February 2005By Some sources attribute this historical credit to the ancient city-state of Lagash (currently Iraq) six thousand years B.C.
[25] Ibid
[26] Holy Bible, II Kings 23:35
[27] Holy Bible, Genesis 47: 33

but rather were considered evil and low-class people who often required military escort. Religious leaders had criticized Jesus Christ for associating with tax assessors but he said to them that "… the tax assessors and prostitutes are entering the kingdom of God ahead of you".[28] Christ also said, "[r]ender unto Caesar the things that are Caesar's and render unto God the things that are God's". [29]

In medieval times, many of these ancient taxes were replaced by a variety of obligatory services and a system of aids or gifts to the King.[30] In addition, political institutions were not the only bodies to impose a tax, but also religious ones as well. "Tithe" was taxation imposed on Christians, as Rome fell, which was a tenth of what members of the religion made.[31] In the same way, as Islam became more widespread, a religious tax known as the "Khums tax" was imposed on portable property looted from war.[32] According to Richard Willi, after the Roman Empire collapsed, Europe, in general, returned to less sophisticated class-based tax systems that varied from kingdom to kingdom through a muddled and uncoordinated feudal network.[33] Yet, it is during this time that property tax grew prominent to the extent that people accepted the tax as a necessary part of the social and political system i.e. feudalism. A feudal system is a social, economic, and political system in which landlords provide land to the tenants in exchange for their loyalty, service, and tribute. Some sources also indicate that property taxation became codified during the Middle Ages. In the feudal system, the average peasant paid one-tenth (a tithe) of the value of crops to the Lord who then passed on a percentage to the king. One never owned the property outright and if she/he was not productive or couldn't pay his property tax, the feudal lord (the government) would throw the delinquent out and replace another.

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[28] Holy Bible, Matthew 21:31. Bible the apostle Matthew was a tax assessor.
[29] Holy Bible, Mattthew 22:21; Markos 12:17; Lukas 20:25
[30] Tsebo Moses, The History of Taxation Around the World From Ancient to Modern Times, 22 August 2021. available athttps://www.yoair.com/blog/the-history-of-taxation-around-the-world/(last visited on 06/01/2022).However, despite all developments in the ancient history, the word "tax" had not even existed and it was used as an official word only in the 14th century as derived from the Latin word "*taxare*" which means "to assess".
[31] Ibid
[32]Ibid
[33]Richard Willis, A Brief History of Taxation, University of Sussex, January 26, 2021; Esteban Ortiz-Ospina and Max Roser, Taxation, 2016, available at https://ourworldindata.org/taxation (last visited on 06/01/2022)

During the later Middle Ages countries such as Germany and Italy had introduced several direct taxes such as head taxes for the poor and net-worth taxes for the rich.[34] Taxes on land and houses gradually increased and were administered through self-assessment and an oath taken before a civic commission. In England, as it was lords and the king who owned the land, peasants paid taxes by way of annual rent. Thus taxes on land were paid by peasants who rented the land from its owner and paid one-tenth (a tithe) of the value of crops to the Lord who then passed on a percentage to the king. Peasants were also required to give either an additional one-tenth of their crop to the church or spend one-tenth of their labor working for the church. In the 1600s, the Spaniards had developed two types of property taxes: a one percent tax on the value of a real estate and a 5% tax on the selling price of real estate transfers. In France, people were subject in varying degrees to levies from three main sources: the king, the church, and the landlord.[35] Such onerous inconsistent and arbitrary taxation had finally caused the French Revolution of 1789.

During the colonial period, the colonial masters had to introduce several taxes on land, buildings, animals, and personal properties to raise funds to run the colonial territories.[36] In Africa, people were generally assessed at a higher rate, and taxes were paid in the form of grain, labor, and sometimes money.[37] Highly detested taxes such as hat and poll taxes were also introduced and people complained bitterly about harassment and abusive collection of taxes in general.[38]With its establishment in 1776, America had raised revenue mostly through property taxes. Colonial regimes generally succeeded in raising substantial funds from this source by using a substantial degree of coercion. This finally led to the American Revolution (1765-1791), where American colonists revolted against British rule under the slogan of “no taxation without representation” and "taxation without representation is tyranny".[39] After independence, the US Congress enacted a national property tax (also known as

[34] Richard Henry Carlson Supra Note 24
[35]Gerri Chanel, Taxation As A Cause of the French Revolution: Setting the Record Straight, Studia Historica Gedanensia Tom VI (2015)
[36] Richard Henry Carlson Supra Note 24
[37]Bas De Roo, Colonial taxation in Africa. A Fiscal History of the Congo through the Lens of Customs 1886-1914, Afrika Focus, Vol. 30, No. 2, 2017, PP. 61-65
[38] Ibid
[39] Richard Henry Carlson Supra Note 24

the "window tax") apportioned by the population to finance and resist the war with France under the leadership of John Adams in 1797. In the same way, in Africa, local governments had continued to rely heavily on most colonial direct taxes such as *poll taxes* in the form of forced labor and development levy, for example. However, the importance of the taxes for revenue generation has substantially declined over the years due to a lack of vigorously and consistent enforcement, increasing political competition, and revolts against the coercive poll tax system.

The turn of the 20th Century marked quite a new and unpleasant episode in the history of property taxation. Problems in the international economy such as the Great Depression (1929-1939), the rise of socialist movements and the resultant economic restructurings, the growing interdependence of economies, and the internationalization of markets (globalization) have brought fiscal reform movements to implement sales and income taxes and parallels movements towards property tax cut.[40] However, the end of the 20th Century has brought a new era in the history of property tax for several reasons befall in history. First, the development and expansion of property tax reform around the world is associated with the dissolution of the Soviet Union (1988–1991) and the collapse of the Communist regimes in other parts of the world. These countries have undertaken radical measures in the areas of privatization, land and property rights, and political and fiscal decentralization. The past thirty years have led to advances in assessing practices through the use of statistics, cadastral maps, advances in technology, and various refinements of old ideas. This has created opportunities for the expansion of real property markets and the development of land registration systems to support legal and fiscal cadasters.**[41]** Second, in the 21st Century, the planet earth has featured two major demographic changes. The global population had reached a staggering 7 billion milestone (2011) and the number of people living in urban areas exceeded the

[40] Odd-Helge Fjeldstad and Ole Therkildsen, Mass Taxation And State-Society Relations in East Africa, in Deborah Braütigam et al (eds), Taxation And State Building In Developing Countries. Cambridge: Cambridge University Press, 2008 PP.114 – 134; Cheryl W. Gray, Tax Systems in the Reforming Socialist Economies of Europe, Communist Economies and Economic Transformation, Vol. 3, No. 1, 1991; Léonce Ndikumana, International Tax Cooperation and Implications of Globalization, CDP Background Paper No. 24, December 2014; Sally Wallace, Property Taxation in a Global Economy: Is a Capital Gains Tax on Real Property a Good Idea?, Lincoln Institute of Land Policy, 2007

[41] Riël Franzsen and William McCluskey, Property Tax In Africa: Status, Challenges, And Prospects, the Lincoln Institute of Land Policy, 2017 P. 3

half (50%) mark (2007) for the first time in history. Despite the many potentials and opportunities, rapid population growth and urbanization give rise to several developments and governance challenges. In developing countries of Asia and Africa, where the population continues to boom and is urbanizing at an unprecedented rate, the demand for various public services and infrastructure is growing rapidly although governments are unable to meet it due to limited revenue sources, especially at a local level. Although many countries have introduced various forms of income and consumption taxes, they have faced many challenges in administration and collection (for example, sophisticated tax evasion and avoidance strategies by corporations), and most countries especially in the developing world attain a very low tax-to-GDP ratio. On the other hand, as prices of land and properties increase and property owners become passive beneficiaries, there grows an eagerness among policymakers to capture land and property values either through the mainstream tax system (income, sales, and property taxes) or through special levies, charges, and other instruments.[42] Conventional local sources of financing such as intergovernmental transfers and non-tax revenues (for example, service charges, registration fees, licenses, permits, royalties, etc.) couldn't raise adequate revenue or unpack what is called the "getting richer while sleeping" effect. [43] Property tax is thus become widely considered the most appropriate local revenue tool to capture the value and finance local public expenditures. The third factor relates to the increasing importance of local governments. In the last decade of the 20th century, many countries undertake decentralization programs toward autonomous, responsive, and accountable local governments. Property tax has been posited as the ideal source of income for local governments, given the association between taxes raised locally and the delivery of municipal services and infrastructure.

Thus, over the past 30 years, several developed and developing countries have strengthened property taxes reforms as a critical component of tax reform discourse and as part of land reforms, urban policies, decentralization, and local government reforms. Yet, the property tax performance of most developing and transition countries remains low. For example, the property tax generates 0.3–0.6 percent of GDP for developing and up to 2–4 percent of GDP for OECD

[42] Musonda Kabinga, Principles of Taxation, 2016
[43] Ibid

countries.[44]Looking at the comparable shares of the property tax in local government revenues, it accounts for about 100 percent in Australia, 80 percent in Thailand, 72 percent in the United States, 56 percent in New Zealand, 40 percent in Poland, and 25 percent in Kenya.[45] This low performance of property tax collection is mainly attributed to problems with the current system and inappropriate tax policies including poor coverage, inequities between taxpayers, outdated valuations and lack of revaluations, and inappropriate basis of valuation.[46] Countries are undertaking strategic reforms with the need to generate additional revenue, support fiscal decentralization, redress the imbalance in fiscal transfers, and improve inequities in the current system are among the main reasons behind the rush to property tax reform around the world. Property tax reform, in one form or another, is a global phenomenon that is happening in both developed and developing countries.[47] The continent of Africa has also seen extensive work on property tax reforms in more than half of the 54 countries during the last 20 years as part of land reforms and local government reforms. Thus, a key design strategy for successful property tax reform could be to position the property tax as an integral element of the broader tax and decentralization reforms in a country. Fjeldstad and Heggstad summarized property tax reforms in Africa (1995-2015), both successful and not so successful, as follows; [48]

Table 1: Property Tax Reforms in Africa

1995 – 2000	2001 – 2010	2011 – 2015
Cape Verde	Cameroon	Ethiopia
Liberia	The Central African Republic	Lesotho
Malawi	Congo	Kenya
Swaziland		Nigeria (Abuja Capital

[44] Roy Kelly, Implementing sustainable property tax reform in developing countries, in Richard M. Bird and Jorge Martinez-Vazquez (eds.), Taxation and Development: The Weakest Link?, Studies in Fiscal Federalism and State-local Finance series , 2014; Merima Ali et als Supra Note 8. For most low-income African countries, property tax contributes to less than 0.1% of their GDP.

[45] Merima Ali et als Supra Note 8; Richard F. Dye and Richard W. England, Assessing the Theory and Practice of Land Value Taxation, Lincoln Institute of Land Policy. 2010 p. 4

[46] Ibid

[47]William J. McCluskey and Riël C.D. Franzsen, Property Tax Reform In Africa Challenges And Potential, 2016 World Bank Conference On Land And Poverty"The World Bank - Washington DC, March 14-18, 2016

[48] Odd-Helge Fjeldstad and Ole Therkildsen Supra Note 40

Zambia	Egypt	Territory)
	Madagascar	Rwanda
	Mauritius	Somalia (Puntland)
	Mozambique	South Africa
	Namibia	Zimbabwe (Harare)
	Nigeria(Lagos State)	
	Rwanda	
	Senegal	
	Sierra Leone	
	South Africa	
	Tanzania	
	Uganda	

b. Historical Developments in Ethiopia

Ethiopia, which is one of a few whose histories as a nation-state can be traced back to antiquity, had passed through various forms of property tax under the different land tenure and political administrations. History tells us that, as is the case in other parts of the world, its tax system**,** especially land and agriculture taxation, dates back to ancient times. However, there is a lack of literature and detailed record pieces of evidence about the type, structure, collection, and more generally the evolution of taxes in Ethiopia over the long historic period. In the Aksumite kingdom, like other dynastic kingdoms of the time, kings resorted to compulsory tributes and other traditional forms of taxes from conquered peoples and kingdoms.[49] Some other sources argue that it was during Zerayacob's time that the first tax system was introduced in Ethiopia.[50] Central and provincial rulers compelled subjects to provide compulsory service to the kingdom. Shreds of evidence found in some inscriptions attest that particular property taxes, such as taxes on crops, livestock, livestock products (such as butter, milk, and wool), hunting products (ivory and honey), and handicraft products were imposed and collected in the ancient and medieval periods in Ethiopia. Although there is no record evidence as to what type and how taxes were levied, the tax system was generally traditional and in-kind criticized as excessively burdensome, arbitrary, and oppressive.

From the beginning of the middle-ages to the early 20th century, the state becomes politically decentralized with a feudalistic economic structure. The king was at the center of his imperial rule, while there were powerful provincial

[49] Addis Chamber –Alliance Professionals, Tax System Manual, 2004
[50] Addis Chamber –Alliance Professionals, Tax System Manual, 2004

lords who had substantial power over the lands and the people in their respective provinces. The tax regime, which necessarily reflected the political economy tradition, was operated at two levels: at the provincial or regional level by the respective rulers, and at the center by the power of "kings of kings". Like the case in the ancient period, taxes were paid in kind from the production of livestock or crops in the form of cattle, sheep, goats, wool, honey, and butter, as well as from non-agricultural properties such as minerals, salt, and handcraft products produced by carpenters, blacksmiths, weavers, and tanners. However, as the period was dominated by a feudalistic mode of production, the land was the main source of power and revenue. As provincial and local rulers possessed both the political power and the land, they collected a substantial part of the production of farmers or tenants. In addition, the Church also collected what is known as tithe, traditionally called *asrat* (one-tenth of the produce).

Thus, although it seems complex and uneven across time and place, the tax system of medieval Ethiopia was determined by the nature of the land tenure. The traditional system of land tenure in Ethiopia is essentially based on the concepts of *Rist* and *Gult.*[51]In the former case, the land was given to peasants based on their pedigree, and the right was permanent and inheritable on the condition that they fulfilled obligations including payment of tax. In the latter case, the land was given to landlords and governors who had the task of administering it and who could extract tributes from tenants. Tenants were expected to pay one-third to one-half of the produce and labor services to the landlord who, in turn, paid a certain amount to the *ras*/king of the province, who in turn transferred a certain amount to the Emperor at the center. This system created a clear distinction between peasants and landlords that some regarded as exploitative. There also had been other land systems such as *Gabbar* lands (land in the hands of tenants), *Rist-Gult*(land given to individuals for their services to the state and with the right to be passed on to holders' heirs), *Siso* (a land system where the tenant pays up to one-third of the yearly produce to the landlord), and *Simon* lands (which are given to individuals in the

[51]*Rist* is a group right emanated from family relations and inherited among descendants. On the other hand, *gult* is not the right to hold land but the right to administer and collect tribute from landowners. Hence, *rist* was relatively secure in that there was less eviction and state interference. But taxes were payable in both cases. See generally, Temesgen Gebeyehu, Land Tenure, Land Reform and the Qalad System in Ethiopia, 1941–1974, Journal of Asian and African Studies Vo. 46 No 6, 2011, PP. 567–577

service to the church).[52]According to Dechasa Abebe, the government exacted about five types of taxes and tributes from individuals, groups, or institutions who had access to land.[53] These were *feré Geber* (main tax), *asrat* (tithe) mostly of two types, one for the state and the other for the church, labor services, military services, hospitality, religious services (praying for peace, security, prosperity, plenty, a long and comfortable life for the king and his vassals and armies as well as other related services).

It can be emphasized that land played a significant role in the development of the Ethiopian state and taxation in general. The very notion of tax was largely associated with land and agriculture. There was a general claim that land belonged to the king, all land rights emanated from the benevolent gift of the king to his subjects and the Church, and everyone with the exception of the church had an obligation of tribute from all land. The land was the basis of the economy, social status, and political power, the agriculture sector's contribution to the national economy was so large, the industrial or service sector was largely underdeveloped, and urban development was sluggish throughout the history of the country. The tax was mainly levied in the traditional sector in rural areas as opposed to the service and industrial sector in urban areas. This made land and agriculture taxation have a long and complex history in Ethiopia in different localities and at different periods. The diversity and complexity of the different land systems developed in the country due to differences in administrations and the existence of measured and unmeasured land in the country. The system of taxation was important to upkeep not only the central government but also other vast hierarchal organized classes of people. Provincial governors, lords and nobles, soldiers, the clergy, and other privileged persons lived directly or indirectly on the proceeds of the taxes which were levied on the productive class i.e. the peasants, handicraft workers, and traders.[54]The conquest or incorporation of new regions into the Ethiopian state was usually motivated and accompanied by the introduction of the land tenure system and collection of tax and tributes. Land served as a system of political consolidation and integration of newly occupied regions as well as a source of

[52] Ibid

[53] Dechasa Abebe, A Socio-Economic History of North Shäwa, Ethiopia (1880s-1935), PhD Thesis University Of South Africa, 2015

[54] Richard Pankhurst, Tribute, Taxation and Government Revenues in Nineteenth and early Twentieth Century Ethiopia, Journal of Ethiopian Studies , July 1967, Vol. 5, No. 2 (JULY 1967), pp. 37-87

revenue to run the government. The central or provincial governments instill public administration and pay the army and officials by giving land in lieu of salary. For example, according to *Taddesse Tamrat*, Aše/Emperor *Amdä-Šeyon's* conquest of most of the Northern provinces such as *Gojjam* and integration into the Christian kingdom introduced the new system of land tenure cultured from the old Aksumite tradition.**[55]** In this way, *gult* land was granted to members of the clergy, and *ašé-qollo-geber (yä-negus-qollo)* was collected as a fifth of crop harvest during the fourteenth century. The emperor also granted land rights to the church that collect a third of the land production. With this evidence, according to Daniel the peasants' status as subject tenants and the clergies' tributary right on the same plots of lands evidences the earliest instance of a feudal system of 'productive relationship' in Ethiopia analogous to medieval Europe.[56]One can note a number of deficiencies in this system of property taxation. First, because of the subsistence nature of the economy and the absence of a well-developed monetary system, most of the taxes until relatively modern times were paid in kind or the form of labor dues. Shreds of evidence also indicate that taxes were imposed based on various factors including the number of housing units or the number of families on the land, the area of the land, the land classification system (for example, soil fertility estimates), and in some nomadic areas the stock of herds.[57] Second, the principal burden of taxation fell on the peasantry who were expected to make all sorts of contributions to their local lords and rulers. The land was cultivated by poor tenants or farmers with a substantial part of their produce taken by the landlords, often leaving them not only below the subsistence level but also with a perennial risk of eviction. In this way, the feudal system is believed to have generally deprived the broad peasantry of the means of earning a livelihood. Yet, the system had continued in the modern ages. When Emperor Haile Selassie initiated land reform in the Pre-Italian period, it was aimed to create a homogenous tenure system, maximize the government’s revenue from the lands of local and regional 'ruling classes' and reduce the power of local and regional rulers towards absolute centralization.

[55]Daniel Dejene,Land Tenure Reform And Socioeconomic Structures In Däbrä Marqos (Gojjam), Ethiopia: C.1901-1974 , PhD Thesis University of South Africa**, 2020** P. 65
[56]Ibid, P. 68
[57] Teshome Mulat, Agricultural Taxation in Ethiopia, A Report Prepared for thePolicy Analysis DivisionFAO Economic and Social Policy Department, 1992

Modern taxation in Ethiopia is generally associated with the economic transformation and modernization programs in the late nineteenth and early twentieth century. This relates to land measurement (*qalad system)* and the classification of the measured land into three categories (infertile, semi-fertile, and fertile) that had continued until 1974 in various forms.[58] Although there were attempts since the Gondarine period (seventeenth and eighteenth centuries), Emperor Minilik took the measures vigorously to identify extra land for sale and taxation necessary to fund the thriving government expenditure. Yet, there was no efficient and effective taxation system because of the problems in the measurement and registration, keeping up-to-date land records, lack of commitment among tax collectors, and ambiguities in the land tenure. In 1907, the landmark legislation that recognizes private ownership of urban land was declared. The law provided tax as one of its objectives and that government shall assess the amount of money to be paid depending on its value. In the 1920s, the government (to which Haile Sellasie was a regent) made early attempts to simplify and standardize the agricultural tax system. For example, some measures were taken in 1929 such as new regulations for the survey and measurement of lands, abolition of unpaid services, greater equity in taxation, and making the *Asrat* or Tithe(a tax levy paid yearly to the Government and equal to one-tenth of the produce of the land) payable in cash. In 1935, a law establishing a single land tax was introduced, which among others provided that all landholders were henceforth required to pay 30 *Thalers* per *Gasha* per annum and were to be liberated from all other taxes and obligations of service.

During the Italian Occupation (1935-1941), the colonial administration canceled all land taxes, collecting only the *Asrat* and imposing *corvees* i.e. forced labor exacted in lieu of taxes. . Soon after liberation in 1941, some administrative and temporary reforms were made to centralize taxation and reintroduce the land tax. For this purpose, several reform measures were taken to address major limitations of the property tax system in ancient and medieval Ethiopia, and as a foundation for the series of subsequent legislative enactments on property taxes and also other types of taxes. First, the Emperor abolished the serfdom landholding system of feudalism. Second, the Emperor centralized political and fiscal powers by eliminating regional ruling along with the taxation powers, and thus uniform tax legislations were enacted. Third, in-kind taxation was totally abolished with the earlier introduction of currency.

[58]Temesgen Gebeyehu Supra Note 51

In 1942, a special regulation was issued for the payment and collection of the *Asrat*. This was followed by the introduction of the first land tax after the War i.e. Land Tax Proclamation No. 8/1942. According to the Proclamation an annual land tax is collected at the rates of 15, 10, and 5 Birr respectively on a *Gasha* (equal to about 40hectares) of fertile, semi-fertile, and poor land.[59] In the provinces, where land had not been measured, land taxes were paid on the basis of the 1935 law, the rate being half the rate on measured lands. In most places, lands were not measured and no prior three-way land classifications (into fertile, semi-fertile, and poor) were ever made, although under Article 7 the Law provides for the measurement and classification of land by local administrators as an interim measure. In 1944, the Land Tax Proclamation No. 70/1944 was enacted to repeal Proclamation No. 8/1942 and continued in service for more than two decades. This law introduced two land-based taxes: the *Asrat* and the Land Tax. The tax provides for the classification of lands into fertile, semi-fertile, and poor lands and authorizes the Minister of Finance, subject to the approval of the Council of Ministers, to change or amend the rates for the payment of the Asrat.[60]

The *Asrat* was criticized for being discriminatory and unfair for various reasons. First, the law introduced a system of flat-rate taxation and the rate of tax is invariant with the amount of land under individual holding. Second, the tax discriminated against individuals based on location as the rate of land taxation in Gojam, Tigre and Begemdir were lower than in the provinces of Shoa, Arusi, and Wello. Third, there was discrimination based on the type of landholding as *Rist-Gult*, *SisoGult***,** and *Samon*landowners pay only theAsratbut not land taxes, and owners of *Gebbar* unmeasured lands and in Shoa-Amara Rist holders pay fewer taxes than owners of "measured" land. Over theyears various aspects of Proclamation No 70of 1944, which was considered as the basic land tax law, were subjected to revisions or amendments. For example, under article 5 of the basic law, holders of *rist-gult*, *siso-gult* and *samon* were relieved of the Land Tax and had to pay only the *Asrat* until land registrations were made, but when the Land Tax (Amendment) Proclamation No. 230/1966 was enacted taxes on the three land systems were put into law.

[59] Ibid
[60] Land Tax Proclamation No. 70/1944, Article 5

The Land Tax (Amendment) Proclamation No. 84/1947 also introduced some minor changes concerning penalties with regard to default in the payment of the tax. Subsequently, the Land Tax Amendment Proclamation No. 106/1949 was enacted. It was concerned with the measurement and classification of lands for purposes of tax application**.** Later, Land Tax Regulation Legal Notice No. 257/1962 came to require and provide for a reclassification of all measured semi-fertile and poor lands into three groups (fertile, semi-fertile, and poor) and a five-way reclassification of all unmeasured Gebbar lands. It also amended the scope and coverage of the law and established a new land classification commission and provided appeal rules and procedures.

The other major amendments to the 1944 tax law included the introduction of "Education" and "Health" taxation. The Education Tax Proclamation No.94/1947 levied taxes on all lands. The Education Tax is basically a proportional tax since the relative tax burden remains constant with increases in the size of private landholding. Later, Additional Education Taxes Proclamation No. 279/1970 imposed a 30 percent education tax on urban property and on personal emoluments at the rate of 0.50 Birr on monthly earnings of 50.00 - 100.00 Birr and at the rate of 2 percent on all monthly earnings in excess of 100.00 Birr. When it comes to the health tax, Health Tax Decree No. 36/1959 provided for the payment of tax on measured and unmeasured land in various provinces. For example, 15, 12, and 4.50 Birr are paid respectively, per *Gasha* of measured fertile, semi-fertile, and poor land in the provinces of Shoa, Harar, Arusi, Wello, Wellega,Sidamo, lllubabor, Gemu-Gofa, and Keffa**.** On "unmeasured *Gebbar*" lands the tax rate ranges between 1.50 Birr per *Gasha* of the 5th category of land to 6.00 Birr per *Gasha* of first category land.

In 1954, the Cattle Tax Proclamation No. 142/1954 was enacted, and according to this tax law all cattle breeders had to pay an annual tax on each head of cattle, except those suckling, at the following rate: Camels, 0.50 Birr; Horned cattle, 0.25 Birr; Horses, 0.25 Birr; Mules, 0.25 Birr; Donkeys, 0.10 Birr; Goats, 0.05 Birr; Sheep, 0.05 Birr; Pigs, 1.00 Birr. This law was amended once in relation to the administration of the tax through Cattle Tax Assessment Legal Notice No. 187/1954. In 1961, the law which taxes incomes from the exploitation of woods and forests for lumber purposes was enacted as Income Tax Proclamation No. 173/1961 (Schedule C). It should be recalled also that Income Tax Amendment Proclamation No. 255/1967 makes certain agricultural

activities liable for taxation under Schedules B, C, and D of the amended proclamation.

With regard to municipal governance, the mayorship system which includes municipal council and municipal management under a 'Kentiba' (Mayor) or Town Officer was introduced in 1945.[61] The law assigned specific competencies and functions to municipalities. Accordingly, municipalities were entitled to fix local rates on fares for taxis, carts, and saddles; and on all immovable properties; to assess and collect charge fees for water supply, and for municipal public services such as licenses on trade and professions, use of market places, vehicles and driving license, slaughtering and meat delivery fees, sanitary charges, land survey and registration fees advertising, cattle registration, and to collect rental income tax, as well as health tax.[62]Property taxes on land and buildings were assessed by area or calculated as a percentage of the rental value of the Property. With the introduction of fuel tax, all municipalities were entitled to share revenues from the excise tax on petroleum and lubrication products on an origin basis.

After the revolution that broke out in 1974 ended the imperial regime, the Derg or the Military Regime (1974-1991) restructured the political and economic systems of the country in line with the socialist ideology. The adoption of the socialist politico-economic ideology entailed several prominent changes in the governance structure, the land and property system, and the tax system. The revolution started whipping through what is known as the 1975 comprehensive land reform, which abolished private ownership of land and then land taxation. It was headed by enacting two prominent pieces of land reform legislation both in the rural and urban areas: nationalization of rural land by Public Ownership of Rural Lands Proclamation No. 31/1975) and Government Ownership of Urban Lands and Extra Houses Proclamation No. 47/1975. Collective ownership, control of major means of production and distribution, widespread nationalization of rural and urban land, as well as extra houses were immediately carried out in marking a commitment to the socialist ideology. Business organizations and industries were nationalized. In the rural areas, all land becomes the collective property of the Ethiopian people and is

[61]Municipality Proclamation Legal Notice No. 86/1945
[62]Proclamation to Provide for the Control of Municipalities and Township Proclamation No.74/1945

redistributed to the peasants through comprehensive land reform and nationalization.

In the rural area, the new Rural Land Use Fee and Agricultural Activities Income Tax Proclamation No. 77/1976, and in the urban area, Urban Land Rent and House Tax Proclamation No. 80/1976 were promulgated consistent with the new political economy. These laws made some tax laws obsolete and replaced them with new ones, others were amended, and new ones were introduced. In particular, the Land Tax Proclamation No. 70/1944 (as amended), Legal Notice No. 257/1962 (as amended), the Education Tax Proclamation No. 94/1947, the Health Tax Decree No.37/1959, and the relevant provisions of the Income Tax (Amendment) Proclamation No. 255/1967 were expressly repealed. As it can be read from the heading, Proclamation No. 77/1976 introduced two types of levies in the rural area (land use fee and an agricultural income tax) and Proclamation No. 80/1976 levied two kinds of payments in the urban area (urban land rent and house tax). Proclamation No. 80/1976 was amended by Proclamation No. 161/1979 and reinforced by the 1979 Provincial Urban Land Rent and Urban Houses Tax Regulation Legal Notice No. 64/1979. Proclamation No. 77/1976 was also amended by Proclamation No. 152/1978, which increases the fees and the rates in the rural area. Peasants Associations (PAs) and Kebele Urban Dwellers Associations (KUDAs) were established as local administrative units through Peasant Associations Organization and Consolidation Proclamation No. 71/1975 and the Urban Dwellers Association Consolidation and Municipalities Proclamation No. 104/1976. These local administrative units were purely policy implementers of the central government and were in charge of implementing land reform, coordinating the land redistribution, and collecting taxes.

Following the fall of the Derg regime, the FDRE Constitution of 1995, as also hinted at the 1991 transitional charter and establishment of national regional self-governments proclamation No 7/1992, had explicitly declared Ethiopia to be a federal polity with nine states (now eleven) that constitute the federation. It established federal and regional governments with their respective expenditure responsibilities[63] and taxation powers[64] while it pledged the need to decentralize both expenditure and revenue to the local

[63] FDRE Constitution, Article 51-52
[64] FDRE Constitution, Article 96-99

level[65]. Accordingly regional states established rural districts (Woredas) through their respective constitutions and urban Administrations through separate establishment and organization Proclamations. Expenditure responsibilities and revenue powers of these urban and rural local governments are defined accordingly. The constitution decentralized the administration of land to the regional governments while it kept the formulation of land policy at the center.[66]Looking to the division of taxation power under articles 96-99, most land and property-related taxes, fees, and charges were assigned to regional states. However, the constitution had no clear provision about the power of property taxation. This being the case, in the early days of EPRDF, the Derg laws on agricultural taxation and land use fee and urban land rent and house tax remained in force and was used by regional states. Later, regional states enacted Rural Land Use Fee and Agricultural Income Taxes Laws.

In urban areas, the urban rent and urban houses tax law of 1976 as well as the regulations issued by City administrations remained in force long after Derg was toppled. While Addis Ababa continues to rely upon municipality tax laws issued during the Derg and Imperial times, some of the regional states have issued their own legislation on fees and taxes following the decentralization of power in the post-1991 period. As lease holding becomes the cardinal system of urban land tenure, lease revenue has become an important urban revenue source. With regard to other municipal revenues, the practice in some of the regional states is that the minimum and maximum tariff rates as well as the division and rank of cities within a regional state are determined by the Regional Council while the cities and towns determine the actual tariff amounts based on the 'objective situation of the locality. Therefore, taxation powers of the urban local government are limited to municipal revenues such as charges, tariffs, land rental fees, and lease revenues. These are defined by regional regulations.

In short, there is no property taxation in the strict sense of the term, and the existing property-like payments are faced with legal, technical and institutional problems. The only referable national legislation for property taxation is the Urban Land Rent and Urban Houses tax Proclamation No. 80/1976. However, this proclamation has no force of law and needs to be significantly revised to

[65] FDRE Constitution, Article 50 (4)
[66] FDRE Constitution, Article 55 (2) (a) cum 52 (2) (d)

reflect the legal, political, economic, and social changes that have occurred in Ethiopia. The Lincoln Institute of Land Policy has identified four major problems with the property tax system in Ethiopia in studying Property Tax in Africa. These are: (1) the application of the outdated taxation law continued for more than four decades, (2) the land tenure system of the country (the legal and practical problem of fictitious separation of ownership to land and building), (3) the sheer magnitude of informal property ownership and informal property market or transfer in urban centres (tortoise regularization), and (4) urban local governments in Ethiopia are not sufficiently assertive in identifying taxpayers and serving tax notices.

In an attempt to change this situation, Ethiopia has started property tax reform in 2011. Recently the Ministry of Urban Development, Housing, and Construction has shown an interest in modernized urban property valuation and taxation system across the urban centres of the country. The Ministry's interest is demonstrated by the findings of research conducted in three pilot cities namely Dire Dawa, Mekelle, and Bahir Dar on issues regarding real property identification and valuation, capacity design, and building and public engagement. Draft and prototype legislations are also prepared for federal and regional governments.

10.4 Power of Taxation

Property tax is well-suited to be local taxes for it falls upon assets that clearly fall within a jurisdiction and identify as taxpayers those who have a stake in the community. There is no however clear consensus on the ideal distribution of responsibilities in property tax administration between central, regional, and local levels of government. In some countries, the property tax lawmaking or even parts of property tax administration responsibilities lies with a central authority. In many African countries, the administration of property taxes is a shared responsibility between central and local governments. In this case, the central government is mainly concerned with rate-setting or tasks of identification and evaluation while local governments are responsible for collecting the tax and ensuring enforcement. Some countries that decentralize the power to tax property impose restrictions that limit the ability of local governments to levy, collect or spend revenues. For example, António Afonso and Ana Venâncio identify three types of property tax limits: levy, assessment,

and tax rate limits. [67] It can be concluded that a gradual shift of administrative responsibilities to local governments is recommended but every transfer of responsibilities to local governments must be accompanied by efforts to strengthen their administrative capacity. Experiences also show that collaboration and consultation among tiers of governments are keys to property tax reform efforts.

The power of taxation will be one of the central questions in the property tax reform of Ethiopia. Ethiopia's government system is organized into at least three tiers: federal, regional, and local governments. Despite the absence of constitutional recognitions and their revenue autonomy is rather limited, local governments provide a plethora of services. As already mentioned in chapter two, the FDRE Constitution established a federal form of government and the division of power between the federal government and constituent units is one of the hallmarks of federations.[68] Accordingly, the Constitution bestows the power to enact laws for the "utilization of land and natural resources" to the federal government and the power to "administer land and natural resources" to the regional governments.[69] The Constitution also divides the fiscal power of taxation into four headings: federal power of taxation, state power of taxation, concurrent power of taxation, and undesignated power of taxation.[70] The constitution is silent about the expenditure responsibilities and revenue powers of local governments except that it states that "adequate power should be allocated to the lowest unit of government".[71] Local governments are the neglected part of government entities while they have access to so many resources such as land and other properties. There is no specific mention of property tax under articles 96, 97, and 98, and itis not clear why the Constitution elides property taxation, which is one of the oldest types of taxes in Ethiopia. The only thing mentioned in the constitution is the power of regional states to determine and collect fees for land usufruct rights, taxes on income derived from private houses and other properties within the state, and rent on houses and other properties they own.[72] The constitutional assignment

[67]António Afonso and Ana Venâncio, Local Property Tax Reform and Municipality Spending Efficiency, REM Working Paper 0210-2022, January 2022
[68] FDRE Constitution, Articles 1, 50, 51. 52
[69] FDRE Constitution, Article 51 (5), 55 (2, a), and Article 52 (2) (d)
[70] FDRE Constitution, Art.96-99
[71] FDRE Constitution, Article 50 (4)
[72] FDRE Constitution, Article 97 (2), (3), (4) and (6)

of real property-related revenues to the regional government seems justifiable in that, at least legally speaking, the federal government has no land administered under its own jurisdiction. Some associate the silence with regard to property taxation with the constitutional clutch of land under the ownership of the public and state ownership. Yet, this argument seems to hold no water for what is taxable is the property right rather than the physical assets and there are countries with the same land tenure (such as Vietnam, China, South Korea, and Singapore) that impose and collect even land tax. Even the Derg regime, with more restricted property rights, had collected Urban Houses Tax through Proclamation No. 80/1976. So, why the Constitution is silent at least for house tax or personal property tax? It should be noted that both urban and rural lands in Ethiopia are owned by the state and the public, and an individual has a full property right for the real property he/she built and for the permanent improvements he/she brings about on the land by his labor or capital.[73] Whatever the reason is it is clear that the power of taxation on real property is an open question. The most important question that must be addressed is whether it is really silent that can be entertained as an undesignated tax in the language of article 99 or it can still be interpreted for example by reading other constitutional provisions such as Article 52 (2) (d) and Article 97 (6) of the constitution. This is because it can be argued that property tax is simply one type of revenue collected from land and landed property and tax collection is purely an administrative activity. On the other hand, it can be argued that there is no term like property tax in the Constitution and it is an undesignated tax that must be determined by the two-third majority vote joint in the joint session of the House of Federation and the House of People's Representatives. What about local governments? In many jurisdictions, property tax is a local tax. Is the Constitutional amendment mandatory to assign the power to tax property to local governments?

The Ministry of Urban Development and Housing in its proposed real property tax prototype proclamation stated that the constitutional basis of real property tax is article 99 of the constitution.[74] The Ministry considered this tax as a new source of revenue so that the House of Federation and the House of Peoples Representatives are expected to jointly decide by the two-third majority vote and assign the power to the federal, regional, or even local governments, or it

[73] FDRE Constitution, Article 40 (3) & (7)
[74] FDRE Modernized Property Tax System Prototype Proclamation, Preamble, Paragraph 6

might find options to allocate the tax levying, collecting, and use power to different tiers. According to Tadesse Lencho, the difference between 'related' taxes and 'undesignated' taxes is not well defined under the Constitution. Both the federal and regional governments have continued to levy and collect taxes that are not expressly stated in the Constitution as theirs. That is to say, regional governments have been levying and collecting real property taxes through their municipalities although these taxes are nowhere mentioned clearly in the Constitution. For example, the Addis Ababa city administration fixes and collects urban land rent and levies urban houses tax in the city without any constitutional basis. The Amhara Region City Proclamations provide revenue powers for city administrations and other urban centers.[75] Therefore, with the constitutional silence with respect to property tax (by name), regions have continued levying and collecting the property tax saving all the limitations. For its part, the federal government has not confronted the levying and collecting of taxes and other charges on real property by regional governments. This practice continues with the spirit of Urban Land Rent and Urban Houses Tax Proclamation No. 80/1976. Meaning as the federal government doesn't have access to the there is no land under its jurisdiction.

As the country is under property tax reform, the power of taxation on real property tax in Ethiopia can be contested by both the state and the federal governments. In other words, all the powers of levying, collecting, and utilizing the revenue can be the subject of arguments. To start, levying power is a legislative power to make laws on the issue of property tax. As the country is awakening the sleeping giant, one can argue that this power can be given to the federal government. If the federal government is to participate and show its power in the property tax reform it should be levying the tax. This can be justified by the Constitutional provision which entrusts the Federal Parliament with the power to enact specific laws on the utilization of land and other natural resources; property taxes can be considered one tool of real property management.[76] However, this type of law will be the framework for legislation under which the state governments will act accordingly. This helps to set national standards on the use of innovative scientific tools for property

[75] The Revised Proclamation Issued to Provide for the Re-establishment, Organization, and Determination of their Powers and Duties Urban in Amhara Regional State Proclamation No 245/2017

[76] FDRE Constitution, Article 55(2) (a)

identification, registration, and cadastral systems as well as for valuation and billing. The need to harmonize the new system can still be another justification to support the argument for the federal government to legislate framework law for real property tax. Exaggerated differences among regional property tax legislation would distort investment distribution, broaden horizontal fiscal imbalance, and finally defeat the constitutional endeavor to establish and sustain one political-economic community in the country as a whole. Obviously, States have the power to administer land and other natural resources and taxation is one element of land administration.[77]

It is very difficult to assume the power of the federal government to collect and use the tax because of the very nature of the tax and the exercise of the constitutional division of tax power so far. In the existing system of fiscal federalism, the revenue allocations between the federal and the state governments as well as between the regional and local governments do seem not fair and there is a wide vertical and horizontal fiscal gap at all levels. In particular, the fiscal capacity of local governments is weak to the point it cannot be improved by the existing fees and charges. This doesn't mean that the federal government will not have a claim to the revenue generated, especially in light of the huge amount of construction and real property development it possesses throughout the country.

In absence of clear indication under the federal or regional constitutions, the dispute will continue between regional and local governments? Identifying the possible role of these two tiers is equally important. The power Regional and local governments shall also enact necessary property tax legislation in light of federal laws. The power of collection and use would be exclusively given to the urban local government. This tax has brought fresh support to empower Urban Local Governments according to the constitution.[78] However, what will be the role of regional governments?

10.5 Main Design Features of Property Taxation

While property tax remains the most important local revenue source across the world, there is no uniform structural design and administrative procedure. Both the law and the practice feature substantial differences across countries. There

[77] FDRE Constitution, Art. 52(2) (d)
[78] FDRE Constitution, Article 50(4)

is also a bulk of literature justifying such different approaches by policymakers. Understanding such alternatives in designing the structural and administrative components of the property tax is crucial in countries like Ethiopia that undergoing the reform. According to Sjoquist and Sweat, operationalizing property tax requires a mix of choices regarding design issues and questions such as: what property will be taxed (land, improvements, personal property); what is the basis of assessing the tax (market value, rental value, area or something else; who will the taxpayer (owner or user); what will the tax rate structure be (a flat rate or rates that differ by value, type or location of property); what options will be available to enforce collection (foreclosures, police force), etc.[79] This is to refer the some of the key components of a property tax system such as determining the tax base, assessing that base, setting the tax rate, and running the system through levels of government.[80]This section aims at highlighting some notable legal and practical issues in designing and administration of property tax law. For this purpose, an attempt is made to survey how the various structural and administrative questions are answered in various countries and the literature with a special focus on arguments for and against alternative approaches. In addition, reference is made to the provisions of Proclamation No. 80/1976 and the Draft Federal Prototype Proclamation in discussing major design issues.

c. Tax Bases: What shall be taxed?

Property tax is supposed to be levied on the different types of property: real or personal, movable or immovable, private and public, corporeal or incorporeal, tangible or intangible, etc. as recognized by legal systems. Thus, the first important question with respect to the tax base is what shall be taxed or what types of property are subject to tax.[81]This issue has attracted different views and countries have no uniform approaches in the determination of property tax base. The general property tax that taxes all types of property (movable, immovable, tangible, or intangible) is common in countries such as the USA but became untenable in other countries as movables, financial assets and other intangibles

[79] David L. Sjoquist and Dan E. Sweat, Foreword, in William J. McCluskey et als (ed), A Primer on Property Tax Administration and Policy, Blackwell Publishing Ltd, 2013 p. xvii; Enid Slack and Richard M. Bird, P. 7

[80] Ibid

[81] Enid Slack and Richard M. Bird, P. 7; Richard M. Bird and Enid Slack, Land and Property Taxation Around the World: A Review, March 2002 p. 12

are inherently difficult to identify and assess.[82] This is particularly true for developing countries such as Ethiopia. Even within the category of immovable property, an important choice exists between a tax on land and a tax on buildings or both.[83]In some countries, like Kenya, only the land portion of the property is taxed; while in countries, like Tanzania, only buildings are taxed. Many support taxing land because its value increment is largely contributed by the state and the public, it's most concentrated in the hands of the rich and speculators, it shares the greatest value as a portion of real estate value, and it has a fixed supply and tax encourages good use. It's also argued that taxing buildings might be counterproductive for it stifles or retards urban renewal and capital formation, it tends to be progressive, and shifting the tax burden to the poor and public/citizens involvement is minimal on building compared to land. Studies indicated that most countries in the world prefer to tax both land and buildings (improvements). There is no uniformity even among those countries that levy tax on both the land and the improvements as one can see in Table I under the next section of this chapter. Some of these countries value land and buildings together and others value the two separately. In countries where both land and improvements are taxed, the land portion is sometimes taxed more heavily than improvements.[84] This is to discourage speculations and encourage property developments, especially in the urban areas. However, not all land and buildings are the subjects of the same tax. In almost every country, owner-occupied residences and farm or agricultural land and property receive favorable tax treatment, while non-residential properties are is subjected to higher taxes. There are also exemptions that we will see down the lines. Although few in number, some countries such as South Africa also levy what is known as 'site value taxation'[18]. These countries prefer to impose a tax on location or site value regardless of other attributes. The literature recommends such a tax should be more progressive than a tax on land and improvements.

[82] Ibid

[83] Harry Kitchen Property Tax: A Situation Analysis and Overview, in William J. McCluskey et als (ed), A Primer on Property Tax Administration and Policy, Blackwell Publishing Ltd, 2013 P. 3 Harry Kitchen describes the experience of countries in Choice of tax base as some countries tax land only, few countries tax buildings only, and most countries tax both land and buildings.

[84] Ibid

The Ethiopian legal system classifies all goods (the *subject matter* of property rights) as either movable or immovable.[85] Furthermore, it considers land and buildings as two separate types of immovable and provides for the private ownership of both. [86] Accordingly, the imperial government introduced land tax through the first Land Tax Proclamation No.8/1942[87], which remained in force, in different forms, until 1974. The separate treatment of land and improvements under the civil code was further reinforced in the 1975 land reform, which nationalized all land by two different proclamations (Proclamation No. 31/1975 and Proclamation No. 47/ 1975) and restricted private ownership to improvements over land. The regime further abolished land taxation and introduced urban land rent and house tax through Proclamation 80/1976 and rural land use fee and agricultural activities income tax through Proclamation No. 77/1976. Under Proclamation No. 80/1976 it was only buildings that were the subjects of property taxation. After the downfall of the Derg regime, the FDRE Constitution envisages that ownership of land is vested in the state and the people, while ownership of the building is given to the individual.[88] The Constitution assigns the power to levy and collect the various tax and non-tax revenues from land and buildings to the regional states that attempts to decentralize the power to urban and rural local governments. Thus, land and buildings are separate things and are owned by two separate bodies under the Ethiopian legal system. The determination of tax bases in the ongoing property tax in the country will be guided by these historical and constitutional dictates.

[85] Ethiopian Civil Code, 1960, Article 1126. The reading into the subsequent articles of the civil code and other legislations also reveals the recognition of incorporeal (intangible) things as subject matter of property. Separate legislations are currently developed for the four types of intellectual property rights (IPRs): patents, trademarks, copyrights, and trade secrets. See The Copyright and Neighboring Rights Protection Proclamation No. 410/2004; A Proclamation Concerning Inventions, Minor Inventions and Industrial Designs Proclamation No. 123/1995; Trademark Registration and Protection Proclamation No. 501/2006. Ethiopia doesn't yet develop a separate tax regime to IPRs. The various taxes applicable to IPRs are found scattered in the income tax laws.

[86] Ethiopian Civil Code, 1960, Articles 1130 and 1204. This is an unusual position different from other legal systems such as the French Civil Code, which declares that ownership of surface of land means ownership of all things above and below the land.

[87] The Proclamation to Provide for a Tax on Land, Proclamation No. 8/1942, NEGARIT GAZETTA, 1st Year No. 1, 1942,

[88]FDRE Constitution, Article 40(3), (7)

The Draft Federal Prototype Proclamation, which delimits the scope of application of the law and provides the general categories of property tax, seems to favor tax levying on both land and buildings although there can be a separate assessment. In particular, Article 3 of the same draft law provides that property tax shall be levied on all urban land and buildings located in Ethiopia unless otherwise expressly specified by this Proclamation. According to Article 6, land use tax should apply to urban leasehold land and land improvements other than buildings and building tax should apply to buildings on urban leaseholds. Permit fees shall be charged and collected from all land uses and buildings constructed or to be constructed on all urban land and landed properties outside the lease-hold land tenure. The possibility of separate and joint rating of land use tax and building tax is also indicated under article 7. How do you see developments under the draft law concerning the property tax base?

d. Property Tax Assessment and Valuation

Once the tax base is decided, a second key question in designing property tax law is how to determine the value to which the tax rate will be applied. This is commonly known as assessment or valuation. A measure of the tax base requires several crucial choices concerning the determination of the property attributes that will be valued for taxation and the form that valuation will take. In the literature, there are four recognized assessment methodologies commonly used by countries independently or in combination. These are area-based assessment (area-based taxation), market value assessment (market value as a tax base), rental value assessment (income-based valuation), and land (or site) value systems.[89] Enid Slack and Richard M. Bird broadly classify assessment methodologies into two: area-based (specific systems) and value-based (*ad valorem* systems) assessments, with the latter again divided into capital, rental, and site value approaches.[90] As the following table depicts, there is no uniform property tax base or method of assessment that applies in every country.[91]

[89] Roy Bahl, Property Tax Reform in Developing and Transition Countries, USAID, 2009 P. 6 See also Enid Slack, Why Value-Based Property Taxation? Institute on Municipal Finance and Governance, University of Toronto, 2013; Harry Kitchen Supra Note 83, P. 3; Richard M. Bird and Enid Slack Supra Note 81 pp. 15-21

[90] Enid Slack and Richard M. Bird, P. 8

[91] The conventional consensus is that value based systems are best for benefits from services are more closely reflected (in property values than in its size) and it enable to capture the value

Table 1: Experience of Selected Countries on Tax Base and Assessment[92]

Country	Tax Base	Basis of Assessment
Australia	Land or land and improvements	Market value or rental value or combination
United Kingdom	Land and improvements; some plant and machinery	Market value for residential; rental value for non-residential
Hungary	Unimproved value (plot tax); buildings (building tax)	Area or adjusted market value
Ukraine	Land	Area
China	Occupied land; land and improvements	Area; market value or rental value
Kenya	Land (but can use land and improvements)	Area; market value; or a combination
South Africa	Land and/or improvements	Market value
Tanzania	Buildings, structures, or limited development	Market value (or replacement cost, if the market value is not available)

Under the area-based assessment method, each unit of property is taxed at a specific rate per area unit of land and improvements or structures.[93] This assessment method is widely used in over 44 developing countries. It brings both advantages and disadvantages. The advantage of the area-based system is that it's simple, transparent, and fairly easily administrable. Unlike value-based systems, area-based systems don't require a parcel-based valuation. This makes the system affordable to even countries with no or only a fledgling property market. However, it's not free from defects. In the first place, it hardly seems fair for the tax to be imposed based on the size or physical characteristics of a property without considering the quality of any improvements or value increments. There is also a fear that an area-based system cannot generate adequate revenue growth. It can only generate increased revenue through growth in the number of buildings, or by periodic and unpopular tax rate increases. In other words, there is no automatic growth in the tax base and its

added by government or public expenditures. On the other hand, countries use area-based systems of taxation because they lack the necessary information, expertise, and resources to determine market values or perhaps because the market-value approach is considered politically unacceptable. Some countries also give the choice to taxpayers.

[92] Harry Kitchen Supra Note 83, PP. 5-6

[93] Roy Bahl, Supra Note 89, P. 10-11

buoyancy is limited for it cannot enable tracking market price developments. Scholars such as Roy Bahl argue that developing and some transition countries should focus on administrative considerations and the area-based approach is the one they have a chance to effectively administer.[94] This system is a good first step toward a transition to a value-based system.

The market value assessment method starts with defining the base as the market value[95] of the property in an open market.[96] This is known as the capital value of land and improvements or structures. The comparable sales approach, which relies upon valid sales of similar properties, is the most commonly used method to estimate market value. Comparisons are often accompanied by adjustments based on the physical characteristics of the site, construction materials used, size, availability of infrastructure services, and homogeneity of zones. This approach is recommended when the market is active and similar properties are being sold frequently. The "depreciated cost approach" and the "income approach" are also used to arrive at market values. The first approach values the property by estimating the land value as if it were vacant and adding the cost of replacing the buildings and other improvements to that value. Such an approach is recommended when the property is relatively new, there are no comparable sales, and the improvements are relatively unique. In the second approach, valuations are made by estimating the potential gross rental income the property could produce and deducting operating expenditures. This approach is recommended if properties have actual rental income.

The market value assessment method is the most equitable method for it helps to identify the extent that which a property value benefits from public or neighborhood investment i.e. unearned increment. The advocators of the method also claim that it's more easily understandable and makes taxpayers feel a low tax burden with nominal tax rates. This is not to say that the capital value approach is easily implemented. The key problems with this assessment method are the scarcity of accurate data reflecting market transactions or sales values of properties and under-declaration of prices. In part, the under-declaration is attributable to property transfer taxes that often are levied at high rates. There is likely great variation across as well as within countries in the quality of the

[94] Roy Bahl, Supra Note 89, P. 12
[95] Market value is the price that would be struck between a willing buyer and a willing seller in an arm's length transaction.
[96] Roy Bahl, Supra Note 89, P. 7-9

data on the sales value of properties and oftentimes these data are supplemented by the "expert judgment" of assessors and real estate professionals. The administrative cost of the system can also be high for valuations are often provided by expert assessors. Recently countries are applying computer models to undertake valuation more accurately and at a better speed. The market value assessment method is used in most developed countries although there is a global trend to shift towards this method in other countries.

In the rental value assessment method, tax authorities define the tax base as the rent that can reasonably be expected in a fair market transaction.[97] The justification is that it is appropriate to tax income (a flow) rather than from wealth or the property itself (a stock). In general, the rental value assessment method is simple in concept and simple to enforce. However, the method can be challenging to use in practice. In the first place, there is usually a scarcity of data rents actually paid. Without such direct evidence, it's problematic to put the method into practice and countries often look for estimated, not actual, rental value as a tax base. In some countries, rental values are determined by estimating the market rental values that can be imputed to all properties in a neighborhood-based on available rent data from surveys or expert judgment. This method is used mainly for flats and some houses. The other problem is that some properties may not be found in the rental market. This is particularly true for properties such as owner-occupied housing, larger commercial establishments, factories and industrial properties, and vacant land. The same problem can also happen with respect to properties covered under the rent control regime. For such kinds of properties, countries tend to use capital value and cost of acquisition to determine rental value.

In the land (or site) value systems, countries assess and tax the market value of the land alone.[98] Although the system is introduced very recently, it has been in several countries such as Australia, New Zealand, Denmark, Estonia, Jamaica, and Kenya. Many support the system for good revenue-raising potential, incentivizing efficient use of land and requiring low administrative costs. However, assessing land value is complex, especially in highly urbanized areas. The system also suffers from the same type of administrative shortcomings as the capital value tax. Finally, limiting the tax base to land may result in some

[97] Roy Bahl, Supra Note 89, P. 6-7
[98] Roy Bahl, Supra Note 89, P. 9-10

arbitrary rules in assigning tax liability within multi-unit structures in cases where there is not a private or single owner of the land.

What do you learn from the discussion over the fourth method of valuation and Table 1? There is no easy answer to the question of which is the best approach. The discussion leads us to the conclusion that the best system for a given country probably depends on the administrative capacity of the state, the present state of property markets, the availability of transaction data, land and housing tenure, and policy objectives i.e. what that country most wants to accomplish with the property tax. One can notice various options here as an example. Obviously, valued-based assessment systems are adopted in countries where there are fully functional property markets, and in countries where property or real estate markets are not fully developed, area-based assessment is preferred. However, it's common for developing and transitional economies to eventually move to a value-based system as their economies develop and real estate markets emerge. If the overriding policy goal in the country is to treat taxpayers equitably, it's the value-based systems that can work well. In some developing countries, property tax reforms are designed to treat the property tax as an extension of the individual income tax. The idea is that as rental income is often under-declared for income tax purposes, the property tax can be seen as a backup.In this regard, a rental value system is considered appropriate. However, property tax revenue is affected by underreports in rental income tax. On the other hand, in developed countries, property taxes are seen as wealth taxes. In these countries, a capital value or a land value property tax is a reasonable approach. On the other hand, if most of the properties are held in rental tenure, the focus might be on annual rental value, and if tenure is dominated by owner-occupancy, there is a stronger argument for an (improved) capital value base. The area-based system works best in rural areas while *advalorem* system is good for urban places, especially for large cities. In urban areas where land is subject to speculation or is not being developed intensively, a land value tax might be considered preferable for its ability to encourage efficient land use and internalize social costs. The identification and valuation of the property tax base are difficult, if not impossible, where land ownership is not in the private sector, where there is a slow or no real property market, and land registries and cadastres are weak, and not regularly updated.

The valuation and assessment of annual property tax under Proclamation No. 80/1976 begin with the assumption that land is a property of the state and cannot be sold in the market. Moreover, land rent values were nominal amounts for it was not considered as an investment return but rather as exploitation. In other words, the annual assessed rental value of properties for tax purposes was far below the market rate. Thus, the method of assessment and valuation under proclamation No. 80/1976 was largely area-based. However, article 12 (2) (a) of the Draft Federal Prototype Proclamation provides that the annual tax rating schedule shall take into account the annual value or rental or market value of landed properties assessed in the valuation roll applicable to the concerned urban area.[99] It should be noted that the fair market value principle is also recognized under the Tax Administration Proclamation No. 983/2016 although its applicability to the coming property tax law remains questionable.[100]

e. Property Tax Rates

In property taxation, like the case in other taxes, liability is determined by multiplying the assessed value of the tax base with the tax rate. The determination of property tax rates or rates is one of the basic design elements and it attracts a number of legal issues.[101] The first question is who determines the tax rate. This is to say should the tax rate be set centrally or locally. The authority to set the tax rate is debatable for countries in a majority of cases that have two or more two tiers of government such as central or federal, provincial or regional, and local governments. There is a considerable difference among the countries regarding the responsibility for determining tax rates. In some countries such as Japan, Ukraine, Chile, Thailand, and Tunisia, property tax rates are essentially set by the central government; in other countries such as Hungary, Colombia, Philippines, local governments are empowered to fix the tax rate with the range of rates set by the central government; and in other countries like Canada, Argentina, and Kenya, the local government has full right to determine the tax rate. [102] In some countries with more than two tiers of

[99] FDRE Draft Federal Prototype Proclamation, Article 12 (2) (a)
[100] Federal Tax Administration Proclamation No. 983/2016, Article 3
[101] Richard M. Bird and Enid Slack Supra Note 81, pp. 21-24
[102] Richard M., Bird and Enid, Slack, Land and Property Taxation*:* A Review, 2002, p.21. Richard Almy, A Survey Of Property Tax System In Europe, Department of Taxes and customs, Ministry of Finance, Republic of Slovania, 2001, P. 13; Enid Slack and Richard M. Bird, p. 9-10

government, regional or provincial governments are made to assume the role of central or federal governments. The choice among these alternative approaches is usually determined by the commitment of the higher government to fiscal decentralization. Scholars such as Zorn argue that for fiscal decentralization to be successful, local governments need to have control over the property tax rate.[103] Roy Bahl also agrees that the accountability of elected local officials can be enhanced if the responsibility for rate setting is placed at the local government level.[104] The assumption is that setting local tax rates places accountability for tax decisions at the local level and increased accountability may lead to better local services. However, there is a fear that local governments (with large tax base) may choose to lower tax rates (for example, to attract business)[105] or may levy higher tax rates (for example, on industries and business establishments) in the belief that the ultimate tax burden will be borne by non-residents.[106]Enid Slack and Richard M. Bird call such practices of local governments as problems of tax competition and tax exporting respectively. According to them, a maximum rate must be set by higher governments in order to overcome these problems. The second and related question is how often tax rates should be determined. In some countries tax rate is statutorily provided or fixed and in other countries, it is left for local authorities to be adjusted regularly (increasing or decreasing tax rates) based on the budgetary needs and other considerations. Obviously, static property tax rates would adversely affect revenue buoyancy, especially in an inflationary environment and where there is no regular revaluation of properties. In other words, a change in property development or value increment of existing properties cannot easily bring changes to the revenue collected. This would expose local governments to budget constraints. The problem is critical in countries like Ethiopia where there is a high inflation rate but properties are not properly and regularly valued.[107] Moreover, fixing property tax rates could take away the flexibility of property taxation, and defeat the purpose of frequent determination. Hence, for the wants of the canon of flexibility in taxation, there

[103]*Kurt Zorn*, Establishing a Tax Rate, in William J. McCluskey et als (ed), A Primer on Property Tax Administration and Policy, Blackwell Publishing Ltd, 2013 PP. 125-140

[104] Roy Bahl, Supra Note 89, P. 13

[105] Obviously such local governments can continue providing public services equivalent to other local governments with poor tax base.

[106]Enid Slack and Richard M. Bird, p. 10

[107] There are a number of reasons for this fear. First, there is no comprehensive property valuation rule governing property valuation in the country. Secondly, there are no experts trained or institutions established for that purpose.

is a preference to accommodate varying circumstances. Such rooms for flexibility however should not invite administrative complexity, arbitrariness, and abuse of power.

The third and the most important question is should there be one rate, or should the rate be allowed to differ between types, uses, ownership, location, or value of a property. This is about the choice between uniform and differential rates, which is crucial in the study of property tax rates. In some countries, a uniform tax rate/single statutory tax rate is applied on all taxable properties irrespective of variations. However, many other countries apply differential or classified tax rates based on ownership (owned by individuals or by legal entities or state-owned), location (center or periphery), tenure status (vacant/undeveloped or developed), land use (residential commercial, or agricultural use), type of real property (land or buildings), or a combination of two or more of these features.[108] In many countries, differential rates are normally applied for land and buildings. Differential or variable tax rates among property classes are justified on a number of grounds. The first and the most obvious reason is that benefits from local public services are different for different property classes. For example, although the reality is the opposite presumably for political reasons, scholars recommend that non-residential properties must be taxed at lower rates than residential properties for business capital tends to be more mobile than residential capital.[109] Farmland and properties are favored in many countries compared to the urban counterparts. However, there is a fear that differentially higher taxation would distort land-use decisions (residential, commercial, and industrial uses) and efficient use of the factor of production (land and capital).[110]

The last issue is about the amount and nature of the tax rate. There is a consensus that the rate must be kept generally low, especially in developing countries.[111] This may emanate from the nature of the tax itself or the economics of property. In the study of economics, in a given period, individuals and businesses earn income for providing goods or services using the different

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[109]Enid Slack and Richard M. Bird, p. 10

[110]Enid Slack and Richard M. Bird, p. 10

[111] Richard M. Bird and Enid, Slack, Land and Property Taxation in 25 Countries*:* A Comparative
Review,Cesifo Dice Report 3/2005, 2005 p.35.

factors of production (labor, entrepreneurship, and capital) as input. Then, a person spends parts of his after-tax income (disposable income) for consumption and saves the rest. People commonly use (invest) the saved amount to acquire or develop the property and create wealth (an assemblage of multiple properties), which can again serve as a source of income. In other words, the marginal propensity to save and the resultant size of property or wealth are determined by changes in income and consumption. This relationship between income, consumption, and saving is abbreviated in mathematical formulas as "income - consumption= saving".[112] Thus, income, consumption, and property taxes are imposed one after another. With a view to encouraging property formation and wealth creation, property tax rates are emboldened to be low for governments have already collected income and consumption taxes at relatively higher rates.[113]

When it comes to the question of design, property tax can be designed with proportional or progressive rates. Like the case in other taxes, progressive rates are good in terms of equity (those who own more expensive properties have a greater ability to pay) but it has its own limitations (it is difficult to administer and induces tax avoidance). The literature recommends a simple rate structure in order to minimize complexity in administration and encourage compliance. For example, Zorn comes down on the side of a one-rate system pointing out how simplicity and transparency are compromised with classification systems.[114] Others also consider rate differentiation as a poor substitute for good valuation. Some vied in support of discriminatory tax rates from the perspective of equity, especially in cases of vacant lands.

Roy Bahl summarized the different rate structures appropriate to developing countries and their respective rationales as follows[115]

Alternative Property Tax Rate Structures and Their Rationale

[112] Daniel Abraham, The Impact of Fiscal Policy on Poverty in Ethiopia: A Computable General Equilibrium Microsimulation Analysis, Ethiopian Journal of Economics Vol. XXII No 1, April 2013

[113] Richard Goode, Income, Consumption, and Property as Bases of Taxation, The American Economic Review , May, 1962, Vol. 52, No. 2, pp. 327-334; William Dougan and Lei Zhang, Consumption Taxes, Income Taxes, and Saving: Evidence from OECD Countries, Clemson University September 2009

[114]*Kurt Zorn*, Establishing a Tax Rate, in William J. McCluskey et als (ed), A Primer on Property Tax Administration and Policy, Blackwell Publishing Ltd, 2013 PP. 125-140

[115]Roy Bahl, Supra Note 89, P. 14

Alternative Tax Rate Structures	Rationale
Flat *ad valorem* rates	The simplest way to tax property value
Flat *specific* rates	The simplest way to tax an area base
Progressive *ad valorem* rates	Build more equity into the system by taxing higher valued property at highly nominal rates
Differential rates are applied to different types of property, with non-residential property tending to be taxed at the higher rates and agricultural property tending to be taxed at lower rates.	Usually to protect agricultural property from higher taxes, and to capture the greater tax-paying capacity of commercial and industrial firms.
Different rates are applied to land and structures. Sur rates are applied as a penalty for keeping "priority lands" out of development or for unutilized land.	To encourage the development of vacant land and underutilized land
The tax rate is applied to the *total value* of an individual's land holdings (Peru).	To penalize concentration in the holding of property wealth.
The annual increase in tax rates to compensate for the failure to revalue (indexing	To protect revenues when the revaluation is postponed

In Ethiopia, Article 6 of Proclamation 80/1976 stipulates that land rate shall be based on the grade or quality of the land. In the same way, Article 11 (1) of the Draft Federal Prototype Proclamation provides that property tax rating at the local level shall take into account estimated annual expenditures divided by the total assessed value of all taxable leasehold rights and buildings. Sub-article (2) further states that subject to sub-article (1) and taking into account reasons of macroeconomic stabilization and balanced development based on the categorization of cities, the initial property tax rate to be imposed by any local government shall not be less than 0.4 % and more than 2.5% of the real property value and the annual increment, excluding inflation, shall not exceed 1% and 2.5% of the value of the property at most. Revenues generated from different sources of urban areas other than taxable leasehold rights and buildings as well as federal and regional government subsidies shall not be

considered in the rating of property tax. Property tax rating shall, therefore, be conducted based on the following procedure of calculation:

$$\text{Property Tax Rate} = \frac{\text{Estimated Annual Expenditures} - (\text{Intergovernmental Transfers} + \text{Other Revenues})}{\text{Total Assessed Value of All Taxable Leasehold Rights and Buildings}}$$

Do you think that the property tax structure in Ethiopia needs amendment? How? Discuss the implications of each alternative.

f. Exemptions

In tax law, exemptions are particularly important for there is a general assumption that what is not exempted expressly under the law is taxable.[116] Like the case in other taxes, property tax laws provide exemptions to certain owners or users of property for social, economic, political, or administrative accounts.[117] However, exemptions should not be confused with exclusions, preferences, or preferential treatments and deductions. In the first place, property tax laws or other relevant laws might exclude some properties through definitional provisions or in determining the scope of the law. This is permanent exclusion from the tax base. Under the Draft Federal Prototype Proclamation, definitions given to terms like "real property", "property tax" "taxpayer" and "urban area" under article 2 and the scope of application delimited under article 3 have this purpose.

Preferential treatments are other forms of tax relief and are granted (mainly to owner-occupiers, senior citizens, disabilities, members of the armed forces and veterans, pensioners and retirees, large family size, and government properties) through rebates, value reductions, or tax incentives such as rate reductions, special tax forgiveness programs, and property tax holidays.[118] For example, in Serbia, owner-occupiers receive a 40 percent reduction in taxes. Some countries

[116] David L. Sjoquist, A Brief History of the Property Tax in Georgia, Fiscal Research Center, Andrew
Young School of Policy Studies, No. 182, 2008, P.18;Richard M. Bird and Enid Slack Supra Note 81, Pp. 13 & 14
[117]Richard M. Bird and Enid Slack Supra Note 81, P. 13
[118] Roy Bahl, Supra Note 89, P. 15

also give executives discretionary powers to give further property tax exemptions but this is dangerous as it can be used for personal political gain, and corruption - all to the detriment of (local) government budgets. Some countries set the public benefit requirements in order not to leave relief in the blanket. For example, not all retirees or large size families are poor without a proper income test. It's worth noting however that both exclusions and preferences have different natures and goals than exemptions. There is of course a difference across legal systems. Properties that are excluded or preferentially treated in one country can be provided as exempted properties in other countries.

Exemptions are also significantly different from tax deductions available to property owners or holders. An exemption can help to avoid a property tax bill completely while a deduction can only help to lower tax liabilities at tax time.

In many countries, the common exemptions include residential houses, principal residences, public service infrastructure or public utilities, property owned and used for public worship, cemeteries, public educational institutions (schools, colleges, and universities), charitable institutions, public museums and libraries, foreign embassies and property owned by international organizations, public roads, parks, sports facilities, and public hospitals and medical facilities and agricultural land.[119] The perceived social benefits, consideration of economic neutrality, administrative efficiency, and political implication are the most common reasons used to justify exemptions. Yet, exemptions are criticized on several grounds.[120] The most common challenge is that most of the exemptions tend to be politically driven, substantially erode the tax base, introduce unfairness to the system, and are prone to abuse. There is a related concern that lost revenue and fiscal inadequacy would in turn increase the tax burden on other taxpayers or reduce the level of local services. Obviously, exemptions are differential tax treatment that would negatively affect free competition among property owners and holders and distort location and other economic decisions. There is also a fear that if local governments themselves provide tax exemptions and incentives, they could engage in tax competition to attract and keep taxpayers. This would create the problem of race to the bottom.

[119] Roy Bahl, Supra Note 89, P. 14;Enid Slack and Richard M. Bird, P. 7

[120] Richard M. Bird and Enid Slack Supra Note 81, P. 24; Harry Kitchen Supra Note 83 PP. 10-11; Enid Slack and Richard M. Bird, P. 7-8

On the other hand, if higher levels of governments grant exemptions, the measure can result in somber legal and constitutional issues for one (state or national) government shouldn't be able to give away the tax base of another (local) government. In Poland, for example, centrally granted exemptions are a hot political issue. Local governments claim that the central government should compensate them for the loss of revenues and the introduction of new exemptions should require local government consent.[121]

Countries devise some tools to address this concern. Some strictly restrict exemptions to those properties that meet certain criteria such as properties with merit uses (such as schools and churches), properties of low value[122], or properties that are protected from domestic taxation by international treaties (such as foreign embassies). They also place a "sunset clause" on exemptions so that exemptions in the coming tax period are dependent upon a successful evaluation. In these countries, there is a periodic review of property tax exemption policy with the goal of determining whether exemptions continue to serve their intended purpose. The taxpayer claiming the exemption is also required to file appropriate documents establishing the exempt status of the property annually and sometimes only on a change in status. Governments also adopt the practice of valuing all property, whether taxable or exempt and publish an annual tax expenditure note for the property tax quantifying the revenues foregone from exemptions and other reliefs. Such approaches are followed in many countries such as India and Kenya in order to limit or avoid the danger of blanket exemptions.[123] In addition, the administration of exemption also engenders a question of intergovernmental relations. This happens when exemptions granted by central or provincial governments deprive local governments of the right to charge property and land uses within their boundaries. In such cases, the considerable services provided to those properties will not be compensated by the users.

Article 14 of the Proclamation No. 80/1976 provided some lists of exemptions from land rent and property tax. These included public roads, squares, recreation, and sports centers, cemeteries, places of worship and their

[121] Ibid

[122] Such exemptions are primarily granted to protect low-income families who live in areas that are not well serviced. In the same and related note, properties have low assessed values so that the cost of collection could be as much as the revenue takes, if not more.

[123] Roy Bahl, Supra Note 89, P. 15

compound, non-profit making private schools, hospitals, charitable institutions, government institutions drawing their budgets from the central treasury, and properties with an annual rental value of less than 300 Birr. A similar list is recognized under Article 14 of the Draft Federal Prototype Proclamation. There are no however qualifications and requirements in order to limit or avoid the negative impacts of exemptions on revenue, fairness of the system, or economic decisions. Thus, exemptions are one of the essential elements in the development of the Ethiopian property tax system.

How best shall Ethiopia employ best practices concerning property tax exemption policy?

10.6 Property Tax Administration

As important as an appropriate tax design is, the structure and quality of the administration of the tax system are crucial to the equitable and efficient operation of property tax. Conversely, Empirical shreds of evidence confirmed that poor tax administration is an impediment to the implementation of the property tax.[124] It should be noted here that the success of property tax administration is measured not only by improvements in national revenue performance or yield but also by other equally important considerations such as equity and fairness, improvements in land and property governance, local government enablement, and autonomy, rates of compliance by property owners and holders, and coverage of the tax base.[125] The achievement of these colossal objectives requires practical operation on top of germane designs in the black letters of the law. There has been a remarkable uniformity in the literature that poor administration is the main reason why property tax reforms fail to achieve the expected result in developing and transition countries. Local governments are often reluctant to make investments in property tax administration for they wrongly see the cost needed as very high relative to the revenue increase.

According to scholars in the field, there are some key components of property tax administration such as identification of properties being taxed, preparing records and keep updating, valuation, and collection, enforcement, and

[124] Roy Bahl, Supra Note 89, P. 16; Richard M. Bird and Enid Slack Supra Note 81, pp. 29-31
[125] Ibid

appeals.[126] These elements form parts of conventional recommendations and many agreed that property tax reforms are not likely to be successful without recognizing them. In building a viable property tax administration, the first to do is to identify properties taxable in the jurisdiction and determine the owner (or the person responsible for tax liability), and ensure that such information is periodically updated and consistent. Many countries have no provision for regular re-evaluations of the tax base or have postponed revaluations. As a result, assessed values bear little relationship to market value or annual rental value.

The problem in most developing countries is that most land and other properties such as new constructions and those found in slums are not titled and reported in the real estate cadastre.[127] It is also important to record property information such as unique parcel identification number physical descriptions, tenure and ownership forms, (such as owner-occupied and non-residential), uses (such as residential, commercial, or mixed), assessment, and tax payment history, and constantly update the record. This helps to track changes and apply timely and accurate data for tax purposes. In many developing countries, only partial information is available, the system is not automated and records are not regularly updated.[128] Valuation and assessment of properties is the most important component of tax administration particularly when the property tax law is designed as *ad valerom*. A major constraint in developing countries is that there are usually no reliable transaction values, no adequate qualified valuers, and inefficiency in the assessment process**.** The final key component of property tax administration concerns collection, enforcement, and appeal. The findings of various studies have shown dismal property tax collection rates in many developing and transition countries. The most obvious reason for so low performance is that the tax is apparently unpopular and people often try to avoid payment. Weaknesses in the administration bear much of the blame, however. Obviously, people resist paying taxes or voluntary compliance declines when enforcement is weak, penalties are low, compliance costs are high, the tax is inequitable or local services are not adequately delivered, etc. Frequent use of draconian measures such as penalties and property seizure and foreclosure, and lack of an independent and efficient appeal system also frustrate compliance.

[126] Roy Bahl, Supra Note 89, p. 16; Enid Slack and Richard M. Bird, PP. 11-12
[127] Roy Bahl, Supra Note 89, P. 17
[128] Roy Bahl, Supra Note 89, P. 18

On the other hand, the tax authority should enforce the tax by using the powers granted by the law. Sometimes it shall also look for soft measures such as "name and shame" approaches.

One of the debatable points in the design of property tax is whether a tax on land and buildings is to be designed as "*in rem*" or "*in personam*".[129] Some argue that property is taxed *in rem (*against a thing) not *in personam (*against a particular person). In line with this view, the tax liability goes to the property (not the person) and thus consideration must be made to the property characteristics rather than the personal attributes of the owner in the assessment process. This suggests that assessments must name the property and remedy for nonpayment being limited to seizure and sale of the property itself. Of course, it goes without saying that real property taxes are secured by the real property upon which they are assessed by a tax lien. When property owners do not pay the tax, the law permits counties to enforce the tax lien to collect the delinquent taxes. In order to collect property tax due, local governments rely on tax sales or in rem tax foreclosure proceedings. Because these proceedings result in the loss of constitutionally protected property rights, they must satisfy the due process requirements of notice and an opportunity to be heard. The other view is that property tax is *in personam that* goes with the right holder (ownership, possession, holding, or other interests). In fact, all proceedings are against persons no need to rush to cumbersome seizure or foreclosure procedures and draconian means of securing payment. The latter view is supported on the basis that rights and liabilities are two sides of one coin. In a technical sense, "property" consists of a set of legal rights pertaining to a specific object, and a property tax is not imposed on the physical land and buildings, but rather on intangible rights to them.

Another important question in property tax administration is the role of various tiers of governments and the cooperation between and among government departments.[130] The major activities in property tax administration can be the responsibilities of one or more institutions and can operate at various levels of government.[131] For example, projects such as cadastre and computerized property registration systems are naturally expensive national projects that

[129] Joan M. Youngman, Supra Note 2
[130] Roy Bahl, Supra Note 89, P. 17
[131] Joan M. Youngman Supra Note 2, pp.23-67

require commitment by the central rather than local governments. The central government is additionally responsible to prepare valuation manuals, deliver training, and provide other forms of technical assistance. This is because central authorities arguably can have better human, material, and budgetary resources. Yet, the full reliance on central authorities is not feasible for local governments shall play their role and eventually assume full responsibility for property tax administration. In many jurisdictions, central and state governments can be responsible for enacting legislation and setting up the administrative bodies and their functions. It is generally recognized that the day-to-day or more specific functions are best undertaken at the local level. This underscores the need to empower local governments through human and material resources in order to improve the administration and service delivery. Some studies associate low collection performance with governance and political factors. Lack of attention is common when the responsibility for collections is at one level by revenues are shared with the other level of government. Governments also hesitate to aggressively enforce property tax collections to keep the political flavor. On the other hand, unlike other taxes, property tax needs the existence and the synergetic cooperation of different organs (revenue department, land management, and registration department, valuation authorities, urban governance, and judicial organs) and levels of the government (federal, regional, or local). These institutions should be adequately staffed with material, human and technological resources.

In Ethiopia, the role of all these organs and levels of government is well appreciated as a foundation for property tax reform.[132] It is, in particular, suggested that MoFEC and MoUDH should have specific responsibilities. The synergy of the Federal, Regional and Local Urban Governments is also well noted under the draft legislation. Ethiopia has enacted a separate tax administration proclamation governing the administration of domestic taxes in general intending to render the tax administration system more efficient, effective, and measurable.[133] Once the ongoing property tax reform is completed, property tax administration including the rights and duties of taxpayers will be governed by this law.

[132] MoUDHC, Concept Note to Reform Real Property Tax Legislation, 2013, Pp.13 & 15.
[133] Federal Tax Administration Proclamation No. 983/2016

Summary

Property taxes are taxes imposed on a property (real or personal; immovable or movable; corporeal or incorporeal) that belongs to and appropriated an individual or entity. Although taxes and other forms of exactions on the property have a long history in Ethiopia and the rest of the world, they are neglected areas of tax compared to consumption and income taxes. In this chapter an attempt is made to conceptualize, theorize, rationalize and historicize property taxation. Property taxes, particularly taxes on land and other valuable properties are the most debatable areas of tax in ancient, medieval, and modern times. Property tax is complex for it interacts in many ways with decentralization and local government, and land and property administration. Hence, to increase property taxes and make them better, broader reforms are needed in the public sector. The power to levy, collect and use property tax must be properly assigned to local, regional, and federal governments. The other most important issue that this chapter tries to address is property tax law design and administration. There is no uniform structural design and administrative procedure for property taxation. There are various country experiences and a bulk of literature justifying such different approaches by policymakers. An attempt is also made to share the experiences of Ethiopia as reflected in the proclamation no 80/1976 and the current draft prototype proclamation. The conclusion is that a country must carefully determine the tax bases, assessment and valuation, tax rates, exemptions, and finally the administration.

Review Questions

1. How do you understand the term property tax?
2. Identify the different advantages and disadvantages of property taxation and show strategies to optimize the benefits and reduce the disadvantages.
3. Some argue that the existing Political Economy of Land Governance in Ethiopia is an impediment to Ethiopia’s topical undertaking on Property Tax Reform. Discuss if such concerns have a theoretical and contextual foundation?
4. Ethiopia is undertaking Real Property Tax Reform, which among others involves designing a new property tax law. Assume you are called to advise the framers' panel, provide your learned recommendation taking the

experience of other countries and the reality in Ethiopia on the following issues;

a. Power of taxation
b. Tax base
c. Assessment and valuation
d. Tax rate
e. Exemption

5. One of the important questions in property tax administration is the role of various tiers of governments and the cooperation between and among government departments. Discuss the possible role of federal, regional, and local governments with respect to the ongoing property tax reform in Ethiopia.

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Chapter Eleven

The Law of Tax Administration and Procedure in Ethiopia

Introduction

This chapter provides a brief highlight about how tax administration works in the Ethiopian tax system. Tax administration is considered the nucleus of a tax system. Tax laws are not operative and meaningful without the necessary institutional readiness and administration mechanisms.

The historical context suggests that the role of tax administration in Ethiopia has been fragmented and unstructured. With the advent of the Federal Tax Administration Proclamation in 2016, the hitherto unstructured tax administration regime changed. The first section of the chapter is aimed at introducing readers with the fundamentals of tax administration. As it is essential, the rights and duties of the taxpayers and officers are dealt under the second section of this chapter. The third section of the chapter intends to deal with the institutional aspects of tax administration. The fourth section of this chapter provides a discussion on taxpayer's identification and registration. The discourse on tax representatives and agents; tax declarations; tax assessments; and advance rulings are covered under sections 5 through 8 of this chapter.

It is natural that disputes are inevitable and indispensable part in every dimension. This is so true when it comes to tax. Tax disputes mainly occur between the tax authority and the taxpayers. Certainly, tax administration laws are required to put in place effective tax dispute settlement mechanisms. In view of this, section nine of this chapter provides a discussion on tax dispute settlement in Ethiopia.

11.1 Tax Administration: Definitional Exercise

Tax laws do not stand in and of themselves; they need robust and tailored administration schemes. Tax administration is a mechanism that gives a life to the corpus of tax laws. As Professor Richard has noted, "tax administration is not only about collecting the most revenues, it also encompasses facilitating tax compliance issues, treating tax-payers as clients, efficiency in tax collection costs, and utilization of the tax collected."[1] The effectiveness of a given tax

[1] Richard K. Gordon, The Law of Tax Administration and Procedure in Tax Law Design and Drafting, volume 1 International Monetary Fund: 1996; Victor Thuronyi, ed.)

system relies on a tax administration a country puts in place. It is also relates to the institutional setup that engages in implementing different tax laws.

11.2 The Institutional Aspect of Tax Administration

The history of tax administration in Ethiopia reveals that the role of tax administration had been given to ministries and organs with no specialization on tax matters, i.e., the Ministry of Trade and Industry before 1936 and the Ministry of Finance after 1941.[2]During these times, tax administration was undertaken by departments organized pertaining to taxes on international trade taxes and to domestic (internal) taxes.[3] The establishment the Federal Government Revenue Board in 1995 as a separate and autonomous body took tax administration to a completely new dimension.

The Board was established to administer and coordinate three different revenue agencies: the Inland Revenue Authority, the Ethiopian Customs Authority, and the National Lottery Administration. In 2001, the tax administrator was reorganized in the form of ministry: the Ministry of Revenue. Like its predecessor, the Ministry of Revenue is entrusted with the administration of the three revenue agencies.

In 2008, a further restructuring of tax administration took place, and it brought the Ethiopian Revenue and Customs Authority in to the picture. The Ethiopian Revenue and Customs Authority is the result of the merger of the three revenue agencies. During these times, tax administration laws were scattered in different tax laws. This had been the case until the coming into force of the Federal Tax Administration law in 2016. This law is the first of its kind in the Ethiopian tax law history. Accordingly, the tax administration chiefly belongs to the Ethiopian Ministry of Revenue. In particular, Art 5 of the proclamation states that the implementation and enforcement of the tax laws is the duty of the Authority. However, ERCA is in no way the sole player in tax administration. A case in point is the Ministry of Finance and Cooperation. Art 136 of the tax administration proclamation entrusted the Ministry to issue directives for the implementation of the tax administration proclamation. This harmonizes the tax administration.

[2]Taddese Lencho The Ethiopian Tax System: Excesses and Gaps, Michigan State International Law Review Vol.20:2,p.347.
[3] Ibid.

11.3 The Rights and Duties of Taxpayers and Tax Officers

In any jurisdiction, tax administration requires seamless cooperation of taxpayers and tax administration authorities. The tax authorities' mandate to ensure taxpayers' compliance with the tax laws on the one hand and respect the rights of the taxpayers on the other hand must be balanced. To this end, countries define the rights and duties of both taxpayers and tax officers (authorities) through their tax laws to ensure that the tax officers have enough power to control and demand compliance and that the taxpayers enjoy rights.

Defining the rights and duties of taxpayers as well as tax officers encourages tax compliance from the taxpayers' side in return for fair, transparent, and certain service.[4] It also discourages and penalizes tax avoidance and tax evasion practices of taxpayers.

In Ethiopia, the latest Federal Tax Administration Proclamation No. 983/2016 contains rights and duties of taxpayers and tax officers. While the provisions addressing the rights and duties are not organized and clearly provided, the below discussion navigates through and discusses the most important rights and duties.

11.3.1. Rights of Taxpayers

Enhancing taxpayers' rights is believed to increase voluntary tax compliance as it builds trust and confidence between the taxpayers and tax officials.[5] A taxpayer is defined as a person who has a duty to pay taxes; the term includes persons who do not have taxable income in that year or is on a tax holiday, persons registered or required to be registered for VAT, and persons who are turn over taxpayers.[6] Below are the rights of taxpayers as envisaged in the Ethiopian tax laws.

[4] OECD Committee of Fiscal Affairs Forum on Tax Administration, Taxpayers' Rights and Obligations – Practice Note, p. 3.
[5] See for example John Bevacqua, Taxpayer Compliance Effects of Enhancing Taxpayer Rights–A Primer for Discussion of a Dedicated Research Agenda, Journal of Tax Administration Vol 4:2 2018, p 6.
[6] Federal Tax Administration Proclamation No. 983/2016, Article 2(41).

a. Right of appeal

Taxpayers are entitled to appeal against decisions of the tax authority. The Federal Tax Administration Proclamation envisages taxpayers' right of appeal. Accordingly, any taxpayer that is aggrieved of the tax authority's decision can bring its grievance before the Tax Review Committee (a committee established under the Ministry of Revenue).[7] Further, if the taxpayer is not satisfied with the decision of the Tax Review Committee, the Federal Tax Administration Proclamation provides for the opportunity to appeal to the Federal Tax Appeal Commission.[8] The taxpayer also has the right to take the case to the courts if it is not satisfied with the decision of the Federal Tax Appeal Commission.[9]

However, it should be noted that there are technical barriers that may hinder the taxpayer from exercising its right of appeal. For instance, a taxpayer who wants to appeal to the Federal Tax Appeal Commission must deposit 50% of the actual tax. Without doing so, the taxpayer is not entitled to appeal.[10]

Once the Federal Tax Appeal Commission renders a decision, the aggrieved taxpayer can appeal an adverse decision to the courts only on issues of law and only when the taxpayer pays 75% of the actual tax.[11] It follows that a taxpayer cannot appeal on issues of fact and needs to pay the remaining 25% of the actual tax (as 50% would be deposited during appeal to the Federal Tax Administration Proclamation) even on issues of law.

b. Right to refund of unduly paid amount

The Federal Tax Administration Proclamation guarantees taxpayers the right to request a refund in different situations. For example, taxpayers may request refund of late payment penalties[12] and interest[13] if the tax to which the penalty or interest relates is found not to have been payable. It also allows refund when the tax credits allowed to a taxpayer for a withholding tax or advance tax

[7] Ibid, Article 55
[8] Ibid, Article 56
[9] Ibid, Article 57 and 58
[10] Ibid, Article 56(2)
[11] Ibid, Article 57(3 & 4)
[12] Ibid, Article 105(3)
[13] Ibid, Article 37(3)

payments exceed the income tax liability of the taxpayer.[14] Moreover, the taxpayer is entitled to interest (on banks' lending rate) when the tax authority fails to refund timely.[15] Finally, the taxpayer is entitled to a refund when there is an overpayment of tax.[16]

c. Right to amend assessments

Another right that the Federal Tax Administration Proclamation grants to taxpayers is the right to amend self-assessments. Article 29 of the proclamation states that "[a] taxpayer who has filed a self-assessment declaration may apply to the Authority to make an amendment to the self-assessment". Accordingly, taxpayers can correct their own assessments. However, this right is not an absolute right and may be rejected by the Authority.[17]

d. Right to confidentiality

Taxpayers have the right to have their tax information kept confidential. Specifically, pursuant to article 8 of the Federal Tax Administration Proclamation, tax officers are duty bound to keep tax information confidential except for certain circumstances.

Taxpayers have also the right to obtain tax clearance[18]. While a tax clearance is a letter stating that the tax payer has paid the due taxes it is necessary to renew licenses and take part in bids.

11.3.2. Duties of Taxpayers

Taxpayers also have duties. The following are some of the duties of taxpayers as envisaged in the Federal Tax Administration Proclamation No. 983/2016.

a. Obligation to provide accurate information

The proclamation penalizes failure to provide accurate tax information. One of these provisions is found in article 113(7) of the proclamation. It reads as "[a] person who fails to provide information to the Authority as required under a tax

[14] Ibid, Article 49(1)(c)
[15] Ibid, Article 49(3)
[16] Ibid, Article 50
[17] Ibid, Article 29(3)
[18] Ibid, Article 61

law and for which no specific penalty is provided shall be liable for a penalty of birr 5,000". Taxpayers are also required to insert accurate information in cash register machines[19] and provide accurate information necessary for private rulings.[20]

b. Obligation to keep records

The Federal Tax Administration Proclamation contains an express provision that dictates taxpayers' obligation to keep records. Article 17 reads as follows:

> "1) A taxpayer shall, for the purposes of a tax law, maintain such documents (including in electronic format) as may be required under the tax law and the documents shall be maintained:
>
> a) in Amharic or English;
>
> b) in Ethiopia; and
>
> c) in a manner so as to enable the taxpayer's tax liability under the tax law to be readily ascertained.
>
> 2) Subject to sub-article (3) of this Article or a tax law providing otherwise, a taxpayer shall retain the documents referred to in sub-article (1) of this Article for the longer of:
>
> a) the record-keeping period specified in the Commercial Code; or
>
> b) 5 years from the date that the tax declaration for the tax period to which they relate was filed with the Authority.
>
> 3) When, at the end of the period referred to in sub-article (2) of this Article, a document is necessary for a proceeding under the Proclamation or any other law commenced before the end of the period, the taxpayer shall retain the document until the proceeding and any related proceedings have been completed

[19] Ibid, Article 112(1)
[20] Ibid, Article 72(1)(e)

4) When a document referred to sub-article (1) of this Article is not in Amharic or English, the Authority may, by notice in writing, require the taxpayer to provide, at the taxpayer's expense, a translation into Amharic or English by a translator approved by the Authority by the date specified in the notice."

c. Obligation to pay taxes on time

This is an obvious duty of a taxpayer. Tax is taken as a debt due to the government and must be paid on time.[21] Moreover, a taxpayer who fails to pay tax on time, is liable for any costs incurred by the authority in taking the action to recover the unpaid tax.[22]

d. Duty to inform changes

Taxpayers are obliged to notify the tax authority of changes made to the memorandum of association and articles of association of the company.[23]

Under article 10 of the proclamation, it is stated as follows:

1) "A registered person shall notify the Authority, in writing, of a change in any of the following within 30 days of the change occurring:

   a) the person's name, physical or postal address, constitution, or principal activity, or activities;
   b) the person's banking details used for transactions with the Authority;
   c) the person's electronic address used for communication with the Authority;
   d) such other details as may be specified in a Directive issued by the Authority.

2) The notification of changes under sub-article (1) of this Article by a registered person shall be treated as satisfying any obligation to notify the same changes in relation to a registration of the person for the purposes of a particular tax under another tax law." It is stated that failure to notify of such change entails a penalty of ten thousand birr.[24]

[21] Ibid, Article 30
[22] Ibid
[23] Ibid, Article 62 and 112 (1) (h)
[24] Ibid, Article 112

Aside from these obligations, taxpayers have other obligations including but not limited to the obligation to make documents available for inspection[25] and to register as may be required.[26]

11.3.3. Rights of Tax Officers

From the Ethiopian perspective, a tax officer refers to: "a) the Director-General of the Authority; b) the Deputy Generals of the Authority; c) an officer or employee of the Authority appointed under the Ethiopian Revenue and Customs Authority Establishment Proclamation (now the Ministry of Revenues) with responsibility for the administration and enforcement of the tax laws; d) when performing functions on behalf of the Authority: (1) a member of the Ethiopian Federal police; or (2) an employee or official of the Ethiopian Postal Services".[27] It also includes a member or former member of the Advisory Board of the Authority, a person employed or engaged by the Authority in any capacity including as contractor, and a former officer, employee, or contractor of the Authority.[28]

These tax officers have rights or mandates that allow them to implement the tax laws. These rights or mandates include:

a. Right to issue a departure prohibition order of a taxpayer who does not pay taxes (Article 49).

b. Right not to be sued for allowing or prohibiting departure of a taxpayer from Ethiopia without paying taxes (Article 44(9)).

c. Right to issue a closure order of a business that failed to pay taxes (Article 45).

d. Right to enter and search premises, up on authorization from the Director General (Article 66).

e. Right to be rewarded for his or her outstanding performance (Article 134).

[25] Ibid, Article 18.
[26] Ibid, Article 9
[27] Ibid, Article 2(36)
[28] Ibid, Article 8(4)

11.3.4. Duties of Tax Officers

Article 6 of the Federal Tax Administration Proclamation envisages express obligations of tax officers. Accordingly, tax officers are duty bound to:

a. Perform any duty assigned by laws for the purpose of enforcing the tax laws.

b. Be honest and fair in the exercise of any power, or performance of any duty or function, under a tax law, and shall treat each taxpayer with courtesy and respect.

c. Not act as a tax accountant or consultant, or accept employment from any person preparing tax declarations or giving tax advice.

d. Not exercise a power, or perform a duty or function, under a tax law that: a) relates to a person in respect of which the tax officer has or had a personal, family, social, business, professional, employment, or financial relationship; b) otherwise involves a conflict of interest.

Furthermore, the proclamation provides the following additional obligations:

e. Duty to maintain the secrecy of all documents and information received in their official capacity (Article 8).

f. Duty to perform his mandate without delay (Article 130(7)).

11.4 Taxpayers Identification and Registration

11.4.1 Registration of Taxpayers

Article 9 of the tax administration proclamation provides for the registration of taxpayers. The registration under this Article is the primary registration for the purposes of tax laws. This registration is for the purposes of all the tax laws under which the person is liable for tax. In addition to this basic registration, a taxpayer may be required to go through a process of registration under specific tax law such as VAT registration. As mentioned under Article 9(10), once a person applies for registration, the Authority will use the information for any subsequent and specific registration required by a tax law for that taxpayer. Thus, the person is relieved from reapplying and refilling any registration form.

It goes without saying that a person who is liable for tax must apply for registration unless the person is already registered.

According to Article 9(2) the following persons do not have to apply for registration:

(1) A non-resident whose only Ethiopian source income is subject to non-resident tax under Article 51 and 53 of the Income Tax Proclamation. Article 51 of the ITP applies to dividends, interest, royalties, management fees, technical fees, and insurance premiums derived by a non-resident from sources in Ethiopia. Article 53 of the ITP applies to the income of a non-resident entertainer or group of entertainers derived from participation in a performance in Ethiopia.

(2) An individual whose only income is subject to Article 64(2) of the ITP. This applies to an individual whose only income is subject to tax under Schedule D of the ITP.

Sub-article (1) is also subject to sub-article (3). Sub-article (1) obliges the person liable for tax to apply for registration. Sub-article (3) modifies this in the case of an employee by providing that an employer must apply for the registration of an employee entering into employment with the employer unless the employee is already registered. This is a rule of administrative convenience intended to facilitate the registration of employees as taxpayers. Sub-article (4) makes it clear that an employee is still required to apply for registration if the employer fails to comply with sub-article (3).

Sub-article (5) specifies the requirements for making a registration application:

(1) The application must be in the approved form, i.e. the form approved by the Authority for registration applications (see Article 79).

(2) The application must be accompanied by documentary evidence of the person's identity (including biometric identifiers) as may be specified in the Regulations.

(3) The application must be made within twenty-one days of the person first becoming liable for tax under a tax law or within such further time as the Authority allows.

Sub-article (7) makes it clear that the obligation to apply for registration under sub-article (1) is in addition to an obligation or option to apply for registration for the purposes of a particular tax as required under the tax law imposing the tax (such as compulsory or voluntary registration for VAT under Article16 and 17 of the Value Added Tax Proclamation). However, this is subject to sub-article (10), which obliges the Authority to use the information provided in a registration application under sub-article (1) for the purposes of any other registration of that person as required or permitted under a tax law without the person being required to lodge any additional registration forms.

Sub-article (8) obliges the Authority to register a person who has applied for registration under sub-article (1) if the Authority is satisfied that the person is liable for tax under a tax law. The Authority must issue a registered person with a registration certificate in the approved form, i.e. the form approved by the Authority for such certificates (Article 79). If the Authority refuses to register a person who has applied for registration under sub-article (1), sub-article (9) obliges the Authority to serve that person with written notice of the refusal within fourteen days of making the decision.

11.4.2 Notification of Changes

Article 10 obliges a registered person to notify the Authority of any change in personal details.

Sub-article (1) obliges a registered person to notify the Authority of any change in relation to the following:

(1) The registered person's physical or postal address.
(2) The registered person's activities.
(3) If the registered person is a body, a change in the constitution of the body.
(4) The registered person's banking details used for transactions with the Authority.
(5) The registered person's electronic address used for communication with the Authority.
(6) Any other details that may be specified by the Authority in a Directive.

A registered person is obliged to notify the changes within thirty days of the change occurring

11.4.3 Cancellation of Registration

Article 11 provides for the cancellation of the registration of a person. This Article applies only when a person ceases to be required to be registered for the purposes of all the tax laws.

Sub-article (1) obliges a person to apply to the Authority for cancellation of registration if the person ceases to be required to be registered for all tax laws.

Sub-article (2) specifies the requirements for making a cancellation of registration application:

(1) The application must be in the approved form. This is the form approved by the Authority for cancellation of registration applications (see Article 79).

(2) The application must be lodged with the Authority within thirty days of the person first ceasing to be required to be registered under all the tax laws or within such further time as the Authority may allow. Sub-article (4) obliges the Authority, by notice in writing, to cancel the registration of a person who has applied for cancellation under sub-article (1) if the Authority is satisfied that the person has ceased all operations and is no longer required to be registered for the purposes of all tax laws.

Sub-article (6) empowers the Authority on its own motion to cancel the registration of a person if satisfied that the person is no longer required to be registered for the purposes of all the tax laws. It is expressly provided that the Authority can cancel the registration of a person who has died or otherwise ceased to exist (such as a liquidated company).

11.4.4 Taxpayer Identification Number

Article 13 provides for the issuing and use of Taxpayer Identification Numbers ("TINs"). A TIN is a personal identification number issued to taxpayers. The Article obliges the Authority to issue a person registered for the purposes of the tax laws with a TIN in accordance with Chapter Two of Part Three of TAP. Importantly, the issuing of a TIN is an automatic incident of registration under Article 9 (i.e. the issuing of a TIN is something that follows automatically from registration rather than being a separate process).

Sub-article (1) provides that the Authority must issue a TIN to a person registered in accordance with Article 9.

Sub-article (2) provides that a TIN is issued for the purposes of all the tax laws and a taxpayer can have only one TIN at any time.

Sub-article (3) provides that a TIN is issued to a person when the Authority serves the person with written notice of the TIN.

11.4.5 Cancellation of a TIN

Article 15 provides for the cancellation of a TIN.

Sub-article (1) specifies three circumstances when the Authority must cancel the TIN of a taxpayer:

(1) The person's registration for the purposes of all the tax laws is cancelled under Article11.
(2) A TIN has been issued to the taxpayer under an identity that is not the taxpayer's true identity.
(3) The taxpayer has been previously issued with a TIN that is still in force.

A TIN is cancelled under sub-article (1) when the Authority serves the taxpayer with written notice of cancellation of the TIN.

11.5 Tax Representatives and Agents

Tax representatives and tax agents describe two different persons and functions. Tax representatives refer to individuals that receive and pay money on behalf of the taxpayer. Tax representatives do not have any special license. The Federal Tax Administration Proclamation defines tax representatives as follows:

> "Tax representative, in relation to a taxpayer, means an individual responsible for accounting for the receipt or payment of moneys or funds in Ethiopia on behalf of the taxpayer and includes the following:
>
> a) for a partnership, a partner in the partnership or a manager of the partnership,
>
> b) for a company, a director of the company;

c) for an incapable individual, the legal representative of the individual responsible for receiving income on behalf or, or for the benefit of, the individual;

d) for a taxpayer referred to in Article 40 of this Proclamation, the receiver in relation to the taxpayer under that Article;

e) for any taxpayer, an individual that the Authority has, by notice in writing to the individual, declared to be a tax representative of the taxpayer for the purposes of the tax laws."[29]

In sum, a tax representative is a person who is responsible for receiving income and making payments including declaring income to the tax authority and effecting tax liabilities.

Tax agents, on the other hand, refers to licensed persons who participate in the: a) preparation of tax declarations on behalf of taxpayers; b) the preparation of notices of objection on behalf of taxpayers; c) the provision of advice to taxpayers on the application of the tax laws; d) representation of taxpayers in their dealings with the Authority; or e) the transaction of any other business on behalf of taxpayers with the Authority.[30]

Unlike the tax representatives, tax agents are generally external persons and are licensed to engage in activities of helping the taxpayer to prepare declarations, notices, complaints and so on.

Tax representatives are duty bound to make the necessary declaration of income and payments to the tax authority. The following are some of the duties as stated in the proclamation.

- Perform any obligation imposed by a tax law on the taxpayer, including the filing of tax declarations and payment of tax; when there are two or more tax representatives of a taxpayer, each tax representative shall be jointly and severally liable for any obligations referred to in this Article but the obligations may be discharged by any of them. (Article 16 of the proclamation);

[29] Ibid, Article 2(39)
[30] Ibid, Article 2(17), 95 and 96

- Any tax that is payable by the tax representative of a taxpayer shall be recoverable from the tax representative only to the extent of the monies or assets of the taxpayer that are in the possession or under the control of the tax representative (Article 16 of the proclamation);

- a tax representative shall be personally liable for the payment of any tax due by the tax representative in that capacity when, while the amount remains unpaid, the tax representative: a) alienates, charges, or disposes of any moneys received or accrued in respect of which the tax is payable; or b) disposes of or parts with any moneys or funds belonging to the taxpayer that are in the possession of the tax representative or which come to the tax representative after the tax is payable, when such tax could legally have been paid from or out of such moneys or funds (Article 16 of the proclamation);

- Sign on taxpayers' declaration when the taxpayer is not an individual or incapable (Article 21(6) of the proclamation).

As stated above, for an agent to engage in the provision of services, s/he must be licensed.[31] According to the Tax Agents Licensing Directive No. 4/2019 (the Directive), there are two types of licenses. The first one is a grade 1 license which allows the tax agent to provide services to any taxpayer. The second one is a grade 2 license that allows the tax agent to provide services to all except grade 1 taxpayers.

According to the directive, a person who fulfills the following criteria may obtain a grade 1 license[32]:

a. Degree or equivalent in tax administration, accounting, economics, management, law or other relevant area;
b. Took courses from the tax authority or any other authorized organ and scored 50% and above on pertinent exams;
c. Has good conduct and is approved by the authority (if the applicant is a partnership, all partners must have good conduct; if the applicant is a company the directors and executives must show that they are of good character);

[31] Ibid, Article 98
[32] Tax Agents Licensing Directive No. 4/2019, Article 5.

d. Has 5 years of experience on domestic tax issues;
e. Must be an Ethiopian citizen above 25 years old;
f. Has not be convicted for tax related crimes;
g. Has the capacity to produce insurance for professional liability; and
h. Can produce an affidavit in writing.

The criteria for grade 2 are similar except for the lenient requirement in the work experience. The applicant may be a person who has been working under the supervision of a tax agent.[33]

Tax agents have certain duties. The following are some of the duties prescribed in the Directive and the Federal Tax Administration Proclamation.

- Duty to have and produce upon request names of the clients, service contract, address of the clients, clients' area of business (Article 16 of the Directive);
- Information regarding the date of the last tax refund or notice given to the client, receipts of paid or payable taxes, and others (Article 16 of the Directive);
- Sign taxpayers' declaration when the taxpayer is not an individual or incapable (Article 21(6) of the proclamation);
- Provide the taxpayer with a certificate, in the approved form, certifying that the tax agent has examined the documents of the taxpayer and that, to the best of his knowledge, the declaration together with any accompanying documentation, correctly reflects the data and transactions to which it relates (Article 22 of the proclamation).

11.6 Tax Declarations

A tax declaration, as the name indicates, refers to the notification of payable tax or income to the tax authority. A tax declaration must be made in the approved form. Except for self-assessment declarations, the tax authority may require the taxpayer, by notice in writing, to file a tax declaration by the due date indicated in the notice.[34] Moreover, the notice may contain a request for a fuller declaration in relation to a tax declaration already filed; or such other tax declaration as the Authority specifies in the notice. However, the tax authority

[33] Ibid, Article 6.
[34] Supra note 6, Article 21

is not bound by the declarations made by the taxpayer and may determine a taxpayer's tax liability based on any reliable and verifiable sources of information available to the Authority.

Tax declarations must be signed either by the taxpayer himself or by a tax representative or an agent if it is not an individual or incapable person. It should also state the TIN.[35] Further, a tax declaration that was prepared by a tax agent must be certified by him that he has examined the documents of the taxpayer and that, to the best of his knowledge, the declaration together with any accompanying documentation, correctly reflects the data and transactions to which it relates.[36]

Tax declarations may be made in advance. Pursuant to Article 23 of the proclamation, the tax authority may require a person, who ceases to carry on an activity or who is about to leave Ethiopia or who the authority has reason to believe that the taxpayer will not declare during the due date, to file an advance tax declaration for the tax period in which the taxpayer ceased to carry on the activity and for any prior tax period for which the due date for filing has not arisen; and b) pay the tax due under the advance tax declaration at the time of filing the declaration. Hence, advance declaration.

11.7 Tax Assessment

Tax assessment refers to a self-assessment (Article 25), estimated assessment (Article 26), jeopardy assessment (Article 27), and amended assessment (Article 28), or penalty assessment (Article 115(1)).[37]

11.1. **Self-assessment**: Self-assessments are those made by the taxpayer.[38] Despite the fact that the approved form included pre-filled information provided by the Authority and that the payable tax is computed electronically, the assessment will be considered as self-assessment.[39] This assessment made by the taxpayer is considered as a payable tax.[40]

[35] Ibid, Article 14
[36] Ibid, Article 22
[37] Ibid, Article 2(31)
[38] Ibid, Article 2(27)
[39] Ibid, Article 25(4)
[40] Ibid, Article 25(1)

11.2. **Estimated assessment**: Estimated assessments are those made by the tax authority when a taxpayer fails to file a tax declaration for a tax period as required by the law.[41] The tax authority, based on the available information, makes assessments on the amount of loss when there is a loss under schedule B and C of the income tax proclamation; the amount of excess input for the tax period in case there is excess amount of input under the VAT proclamation; and the amount of taxes payable in other cases.[42]

As indicated in Article 26(2) of the proclamation, the tax authority shall serve the taxpayer a notice containing the following information: the amount of tax assessed, or loss or excess input tax carried forward, as the case may be; b) the amount assessed as penalty (if any) payable in respect of the tax assessed; c) the amount of late payment of interest (if any) payable in respect of the tax assessed; d) the tax period to which the assessment relates; e) the due date for payment of the tax, penalty, and interest being a date that is within 30 days from the date of service of the notice; and f) the manner of objecting to the assessment, including the time limit for lodging an objection to the assessment.

11.3. Jeopardy assessment: Jeopardy tax assessments are assessments made by the tax authority when it believes that the tax collection may be jeopardized by delay. For example, a jeopardy assessment may be made when a taxpayer is taking steps to conceal property in order to avoid paying taxes. In such cases, the tax authority may assess the tax even before the due date in order to tackle any jeopardy.

Jeopardy assessment is made when the taxpayer has not filed a tax declaration for the tax period and the tax is collected by assessment.[43] Once a jeopardy assessment is made, the tax authority shall serve the notice to the taxpayer; the notice will contain: a) the amount of tax assessed; b) the amount assessed as penalty (if any) payable in respect of the tax assessed; c) the tax period to which the assessment relates; d) the due date for payment of the tax and

[41] Ibid, Article 26
[42] Ibid, Article 26(1)
[43] Ibid, Article 27(2)

penalty, which may be a date before the tax would otherwise be due for the tax period; e) the manner of objecting to the assessment, including the time limit for lodging an objection to the assessment.[44]

11.4. **Amended assessment**: An amended assessment is one that is modified by the tax authority by making alterations, reductions, or additions, based on such evidence as may be available, to the original assessment of a taxpayer for a tax period.[45] As stated in Article 28(1) of the Federal Tax Administration Proclamation, the purpose of the amendment is to ensure that; the assessment is made in respect of correct amount of loss, correct amount of excess input and correct amount of payable tax.

Such amendments may be made within five years and may also be re-amended by the Authority. In any case, the notice of amendment must include: a) the original assessment to which the amended assessment relates and a statement of reasons for making the amended assessment; b) the amount of tax assessed, or loss or excess input tax carried forward, as the case may be; c) the amount of penalty assessed (if any) under the amended assessment; d) the amount of late payment interest (if any) payable in respect of the tax assessed; e) the tax period to which the amended assessment relates; f) the due date for payment of any additional tax, and penalty and interest, payable under the amended assessment, being a date that is not less than 30 days from the date of service of the notice; and g) the manner of objecting to the amended assessment, including the time limit for lodging an objection to the assessment.

11.8 Collection and Recovery of Tax and Other Amounts

As is stated in article 30 of the Federal Tax Administration Proclamation, a tax is a debt due and payable to the government and the tax authority shall collect it from the taxpayer.

[44] Ibid, Article 27(4)
[45] Ibid, Article 28

Recovery of taxes involves other costs that the tax authority incurs in recovering the unpaid tax. As a result, the taxpayer is liable for any costs that the tax authority incurs to recover the unpaid tax.

Tax may be collected either on a one-time payment basis or on an installment basis. However, installment payment is an exception. When a person fails to pay tax on time, he may request for extension of time according to article 32 of the Federal Tax Administration Proclamation. Following this request, the tax authority may either grant extension or allow the taxpayer to pay in installments, if it finds the reasons for delaying payment convincing. When the tax authority allows payment in an installment, the tax may be collected as such.

In tax collection and recovery proceedings, the tax authority may request the taxpayer provide security to assure payment when it has reason to believe that it is necessary.[46] This security may serve as either as a security for the payment of that is due or may become due by the taxpayer, or as a condition for a taxpayer claiming refund. When the authority sends a notice to this effect stating, the amount of the security required, the manner in which the security is to be provided, and the due date for providing the security, the taxpayer may furnish cash or bank guarantee as a security. However, the amount of security that the taxpayer fails to produce will be considered as unpaid tax.

11.8.1. Priority of tax and order of payment

While collecting and/or recovering taxes, not all taxes have the same priority. During liquidation, the amount of withholding tax is not considered as a part of the estate of the taxpayer and shall be paid to the authority before the distribution is made.[47] Also, it shall not be subject to any attachment for the payment of any debt or liability.

With regard to the order of payment of the tax, interest and penalties, Article 34 of the Tax Administration Proclamation states that the tax liability must be paid first, then the late payment interest, and finally the late payment penalty.

[46] Ibid, Article 35
[47] Ibid, Article 33

11.8.2. Recovery of unpaid taxes

Final tax assessments must be paid and failure to do so puts the taxpayer in default. A final tax assessment is the assessment made by the tax authority or the next levels of appeal if the taxpayer appeals within the time limit provided by the law. When the taxpayer is in default, the tax authority may send a notice informing its intention to apply to register a security interest in any of the taxpayer's assets to cover the unpaid tax together with the costs incurred in recovery proceedings.

Subject to secured claims and employee salaries and wages, the tax authority has a preferential claim upon the assets of the taxpayer until the unpaid tax is paid. However, withholding taxes are not part of the taxpayer's assets and secured claims do not have priority over the withholding taxes.[48]

When a property is under the control of a receiver[49], the receiver must notify the tax authority within 14 days following his appointment and the authority shall notify the receiver of the amount of unpaid tax within 30 days. The receiver cannot dispose of assets before this 30-day period of time lapses. In case of noncompliance with this obligation, the receiver shall be personally liable to the extent of the amount required to be set aside for the tax payable by the taxpayer who owned the asset. However, the receiver may pay the debt that has a legal priority over the tax referred to in the notice (such as the employee salary and wage and secured claims) and the expenses properly incurred by the receiver in his capacity as such.

A property of the taxpayer may be seized if the unpaid tax is not paid within 30 days of service of notice. It may also issue a seizure if the collection of tax is in jeopardy. This seizure of property may be executed on the property except for property that is subject to a prior secured claim of creditors; that is, subject to attachment or execution under any judicial process; or property that cannot be subject to attachment under the law of Ethiopia.

[48] Ibid, Article 39

[49] A receiver, as defined in article 40(6), is a person who, with respect to an asset in Ethiopia of a taxpayer or deceased taxpayer and includes: a) a liquidator of a company; b) a receiver appointed by a court or out of court; c) a trustee for a bankrupt person; d) a mortgagee-in-possession; e) an executor of a deceased estate.

Aside from the seizure of properties of the taxpayer, the tax authority may issue an order to block the accounts of the taxpayer, freeze access to any cash, valuables, precious metals, or other assets of the taxpayer in a safe deposit box held by a financial institution, and provide information relating to the accounts or contents of the safe deposit box.

The tax authority may recover taxes not only from the taxpayer but also from third parties who are payers[50] or in possession of the taxpayers' properties. The authority may also issue a departure prohibition order to prohibit a taxpayer who has failed to pay taxes from leaving Ethiopia.[51] Temporary closure of business is also another measure that the tax authority may take in recovery proceedings of unpaid taxes.

When the taxpayer transfers its assets to a related person, the transferee is liable to the unpaid tax liabilities.[52]

11.9 Credit, Refund and Release from Tax Liability

Tax credit refers to the amount of money that is deductible from the tax that is payable to the government. These are incentives that the government provides to taxpayers to encourage them to pay the tax. Tax credits can be refundable or non-refundable. Refundable credits are those that can be refunded even after the tax liability becomes zero. Non-refundable credits, on the other hand, are those that can be refunded and can only be subtracted until the tax liability becomes zero.

Article 49 of the Federal Tax Administration Proclamation states that when tax credits allowed to a taxpayer for withholding tax or advance payment exceeds the total amount of tax liability of the taxpayer, the excess should be applied in the following order: a) first, in payment of any tax (other than withholding tax) owing by the taxpayer under the Income Tax Proclamation; b) then in payment of tax owing by the taxpayer under any other tax law; c) subject to sub-article (2) of this Article and on application by the taxpayer by notice in writing, then

[50] A payer is a person who: owes or may subsequently owe money to the taxpayer; holds or may subsequently hold money, for or on account of, the taxpayer; holds money on account of some other person for payment to the taxpayer; or has authority from some other person to pay money to the taxpayer. See Supra note 6, Article 43(12)
[51] Ibid, Article 44
[52] Ibid, Article 46

refund the remainder, if any, to the taxpayer within 90 days of the date that the taxpayer filed the tax declaration for the year to which the tax credits relate.

Be that as it may, the excess may be carried forward to pay future tax liabilities. But if the taxpayer wants the credit to be refunded and the tax authority fails to refund in accordance with the law, the taxpayer is entitled to interest for the period commencing from the end of the ninety period until the refund is paid.

Different from the credit, a tax refund, for the purpose of this topic, is the refund of an overpaid tax. A taxpayer who overpaid a tax may claim a refund within three years after the date in which the tax was paid.

Following such application by the taxpayer, the tax authority shall render decision regarding the request. If the authority finds that there was an overpaid tax, it shall apply the amount of overpaid tax in the following manner: a) first, in payment of any other tax (other than withholding tax) owing by the taxpayer under the tax law; b) then in payment of tax owing by the taxpayer under any other tax law; c) subject to sub-article (5) of this Article, then refund the remainder, if any, to the taxpayer within 45 days of making the determination that the taxpayer is entitled to the refund. Alternatively, upon the written agreement of the taxpayer, the overpaid tax may be carried forward to pay future tax liabilities.

A tax authority, in addition to providing tax credits, may release a taxpayer from tax liabilities (wholly or in part) when it believes that tax collection will cause a serious hardship for the taxpayer or his successors. According to article 51 of the proclamation, a taxpayer may be released from tax liability when the Minister is satisfied that the payment of the full amount of tax owing by a taxpayer will cause serious hardship to the taxpayer due to natural cause, or supervening calamity or disaster, or in cases of personal hardship not attributable to the negligence or any failure on the part of the taxpayer; or owing to the death of a taxpayer, the payment of the full amount of tax owing by the deceased taxpayer will cause serious hardship to the dependents of the deceased taxpayer.

11.10 Advance Rulings

Advance rulings are interpretations made by the tax authority for clarification purposes. Advance rulings are a newly introduced concept in the Federal tax Administration Proclamation. As indicated in the preamble of the proclamation, one reason for amending the proclamation is that "it is believed that introducing the system of advance tax ruling helps to address the problem of prolonged pendency of taxpayers' cases resulting from divergent interpretation of tax laws within the tax administration".

They are of two types of advance rulings: public advance rulings and private advance rulings. According to Article 68 and 69 of the Federal Tax Administration Proclamation, public advance rulings are interpretation of the application of tax laws that are designated as public rulings and are published on the Ministry's website. It "sets out the Ministry's opinion on the application of a tax law in the circumstances specified in the ruling and is not a decision of the Ministry for the purposes of this Proclamation or any other law".[53] Thus, it is not binding on the taxpayers.

A public ruling may be withdrawn by either publishing a notice to this effect on the website or when another public ruling which is inconsistent with the previous one is made.[54] A public ruling that has been withdrawn, in whole or part: a) shall continue to apply to a transaction commenced before the public ruling was withdrawn; and b) shall not apply to a transaction commenced after the public ruling was withdrawn to the extent that the ruling is withdrawn.[55]

A private ruling, on the other hand, is made upon request by a taxpayer. It sets out the "Ministry's position regarding the application of a tax law to a transaction entered into, or proposed to be entered into, by the taxpayer".[56] As per article 71 of the proclamation, a taxpayer who requests a private ruling should fulfill the following:

a) include full details of the transaction to which the application relates together with all documents relevant to the transaction;

[53] Ibid, Article 69(4)
[54] Ibid, Article 70
[55] Ibid, Article 70
[56] Ibid,

b) specify precisely the question on which the ruling is required; and
c) give a full statement setting out the opinion of the taxpayer as to the application of the relevant tax law to the transaction.

Once the request is made, the tax authority is duty bound to issue private rulings within 60 days, and this ruling is binding on the ministry. This private ruling remains in force for the period specified in the ruling and contains the taxpayer, the relevant law, the tax period, the transaction to which the ruling relates, and any assumptions on which the ruling is made.[57]

Like the public ruling, private rulings may be withdrawn by a written notice served to the taxpayer or by issuing an inconsistent ruling. Private rulings and their withdrawal must be published in the official website of the Ministry.[58]

When inconsistency exists between the private ruling and a previously issued public ruling, the private ruling shall prevail.[59]

11.11 Tax Disputes Settlement

So long as the tax authority levies and collects tax, tax disputes remain unavoidable. Tax disputes are portrayed as disputes between the tax authority and the taxpayer, which largely relate to tax declaration, assessment, audit, and collection. As Victor Thoranyi has noted, the existence of tax dispute to a certain level in a country is a normal part in the taxation system.[60] This is why it is said that tax dispute helps to identify problems that need solution and clarification.[61] The following are the tax dispute settlement mechanisms in Ethiopia.

[57] Ibid, Article 73(3)
[58] Ibid, Article 75
[59] Ibid, Article 71(6)
[60] Victor Thoranyi and Isabel Espajo, How can an excessive volume of tax disputes be dealt with? (2013)International Monetary Fund at p. 1
[61] Misganaw Gashaw, 'The Room for Alternative Dispute Resolution (ADR) Process in Tax Disputes: A Message to the Ethiopian Tax Administrations', in Yazachew Belew (eds), The Resolution of Commercial/Business Disputes in Ethiopia: towards Alternatives to Adjudication? Ethiopian Business Law Series 5 25

a. Review Department

The tax Authority resolves tax disputes using its internal review organ called the Review Department. In many countries, giving the taxpayer an opportunity to get his grievance resolved by an internal review organ has become a common practice since there has been a firm belief that such approach strengthens the integrity of the tax administration, expedites the process of redressing the grievance of taxpayers, and lightens the caseloads encountered by tax tribunals and ultimately by the regular courts.[62] An effective internal tax dispute resolution mechanism is not only less expensive than formal tax litigation before quasi-judicial organs and the regular courts, it also gives the taxpayer a real chance to be heard as speedily as possible.[63]

In several countries, taking a case to an internal review organ of the tax authority is mandatory while in several other countries resorting to this kind of dispute resolution mechanism is left to the free choice of the taxpayer.

As per Article 55 of the Federal Tax Administration Proclamation, the tax authority is obliged to establish a review department within the authority. In view of this, the Ministry of Revenue issued establishment directive. The relevant provisions from the Tax Administration proclamation depicted that taking a case to the internal review department is mandatory.

b. Tax Appeal Commission

Tribunals, the Tax Appeal Commission in our case are considered more advantageous than courts owing to speed, cost, informality, and expertise.[64] In addition, it is argued that the establishment of administrative tribunals is justified to avoid the courts, which could not be sympathetic to policy objectives of a given state as the courts cannot be appropriate forums to entertain disputes arising between an administrative agency and individuals.[65]Therefore, tax appeal tribunals are also thought to be useful in modern tax systems since they can resolve tax disputes arising between the tax

[62] World Bank Group, The Administrative Review Process for Tax Disputes: Tax Objections and Appeals in Latin America and the Caribbean: A Toolkit, documents.worldbank.org › curated › pdf › The- Admi..,
[63] Ibid
[64] Ibid.
[65]Ibid.

authority and taxpayers with the above advantages both to the tax authority and the taxpayers.[66]

The Tax Appeal Commission is the second dispute settlement mechanism in the ladder, although it also appellate jurisdiction. The Commission is ultimately accountable to the Prime Minister. Per Article 56 of the Federal Tax Administration Proclamation, a taxpayer dissatisfied with an appealable decision may file a notice of appeal with the Tax Appeal Commission.

Here, it is worthwhile to understand what constitutes an appealable decision.. In this regard, art 2(2) of FTAP is relevant.[67] It states:

"Appealable decision" means:

a) an objection decision;

b) any other decision of the Authority made under a tax law other than:

(1) a tax decision;

(2) a decision made by the Authority in the course of making a tax decision . . . .

In addition to the notice of appeal, the amount of tax in dispute, depending on the nature of the appeal, must be paid. Accordingly,

(1) For an appeal made under Article 55(7) (i.e. the 180-day period for considering an objection has expired without the Authority making an objection decision), the taxpayer must pay 25% of the tax in dispute for a notice of appeal to be validly filed.

(2) For an appeal to an objection decision actually made under Article 54, the taxpayer must pay 50% of the tax in dispute for a notice of appeal to be validly filed.

[66]See Ellen R. Jordan, 'Specialized Courts: A Choice' (1981-1982) 76(5) Northwestern University Law Review 750-751.
[67] Supra note 6, Art.2

c. Court

Although the role of internal review organs and tax appeal tribunals in resolving tax disputes is a common practice across many jurisdictions, regular courts, whether administrative courts or ordinary civil courts, also have their own roles in resolving tax disputes in many jurisdictions. However, it has to be noted that their roles and powers vary across different jurisdictions. Courts are involved in tax dispute resolution by way of judicial review or judicial appeal, although in some jurisdictions courts exercise first instance jurisdiction as is the case in civil or commercial disputes.[68]

In Ethiopia, the Federal High Court and Supreme Court have appellate jurisdiction over the decisions of the Commission and of the Federal High Court, respectively.

Accordingly, Article 57(1) of the FTAP provides that that a party to a proceeding before the Tax Appeal Commission who is dissatisfied with the decision of the Commission may appeal the decision to the Federal High Court. The notice of appeal, however, must be filled within thirty days after being served with notice of the Commission's decision. The article also empowers the court to extend the notice period by thirty days.

A notice of appeal is not considered as validly filed unless the taxpayer has paid to the Authority 75% of the tax in dispute.[69] Sub-article (6) makes clear what constitutes a tax in dispute. A tax in dispute refers the primary tax liability in dispute and does not include any penalty and late payment interest payable in respect of the primary tax in dispute.

Another point worth noting is the nature of the appeal brought to the attention of the Federal High Court. Sub-article (4) provides that an appeal to the Federal High Court may be made on a question of law only and the notice of appeal must clearly state the question of law to be raised by the appeal. It is clear that a question of fact, about what has actually happened, cannot be a subject of a notice of appeal.

[68]Bewket Abateneh, The Tax Appeal System under the New Tax Administration Proclamation: Improvements and Potential Shortfalls, LL. M, Bahir Dar University, (2017), p.33.
[69] Supra note 6, Art. 57(3)

The final discussion part pertains to the power of the Federal Supreme Court. Sub-article (1) of Article 58 of the FTA provides that a party to a proceeding before the Federal High Court who is dissatisfied with the decision of the Federal High Court may appeal the decision to the Federal Supreme Court. The party appealing must file the notice of appeal with the Federal Supreme Court within thirty days of being served with notice of the decision of the Federal High Court. Sub-article (2) empowers the Federal Supreme Court to grant an extension of time to lodge a notice of appeal.

11.12 Liabilities and Rewards

The goal of tax authorities is to ensure taxpayers' compliance with tax laws. This is not always an easy task as it depends on different factors. One such factor is taxpayers' willingness to pay taxes. In order to enhance taxpayers' willingness to pay taxes, countries provide different incentives and try to make the system easier for the taxpayers. In despite these efforts, taxpayers may not be willing to comply. As a result, tax authorities provide penalties for those who fail to comply with the tax laws.

Liabilities and rewards are like the stick and the carrot. Those who comply with the tax laws will be rewarded and those who do not will be liable. In this way it is believed that tax authorities will be able to achieve their goals.

11.12.1 Liabilities

Part 15 of the Federal Tax Administration Proclamation contains provisions pertaining to liabilities. There are two types of liabilities: the administrative liability and criminal liability. As a general proposition, a person cannot be liable for both administrative and criminal liabilities for the same act (Article 100).

A. Administrative Liabilities

The following are some of the administrative liabilities and their penalties.

- In addition to the tax due and interest, a taxpayer who fails to apply for registration without a reasonable excuse is liable for a penalty of 25% of the tax payable by the person for the period from the date of registration (as required by the law) up to the date of actual application for

registration either by himself or by the motion of the tax authority. If there was no payable tax, he shall be liable for 1,000 Birr for each month of non-registration. (Article 101).

- A taxpayer who fails to apply for cancellation of registration shall be liable 1,000 Birr for each month (Article 101(3)).
- A person who fails to maintain required documents is liable for 20% of the payable tax. If there was no payable tax, he shall be liable for 20,000 Birr for each with regard to income tax, and 2,000 Birr concerning other taxes (Article 102). If the failure to maintain documents continues for two years, the tax authority shall cancel the business license (Article 102(3)).
- A person who fails to state a TIN on the tax invoice, debit, credit note, tax declaration is liable for a penalty of 3,000 Birr (Article 103).
- Using another persons' TIN or allowing others to use one's TIN is punishable with a 10,000 Birr penalty (Article 103(2)).
- Late filing is punishable for 50,000 Birr for income tax and 10,000 Birr for other taxes (Article 104).
- Late payment is punishable under Article 105 of the Federal Tax Administration Proclamation. The penalty is 5% of the unpaid tax for the first month and an additional 2% for the remaining months to the extent the tax remains unpaid.
- Failure to withhold taxes or failure to pay the withheld taxes is subject to a penalty of 10% of the tax (Article 106).
- Failure to register for Value Added Tax is punishable for 2,000 Birr for each month of non-registration. There are additional penalties for the failure to register for VAT (Article 107). For instance, a person who was registered for VAT lately shall be punished 2000 Birr for each month of failure to register.
- Tax understatement (declaring a tax which is less than the taxpayer's correct tax liability) is punishable for a penalty of 10% of the tax shortfall (Article 108).
- Tax avoidance is also subject to a penalty of double to the amount of tax that was avoided (Article 109).
- Failure to file electronically without good cause is punishable with a 100,000 Birr penalty (Article 110).

- Additionally, there are cash register machine related administrative liabilities. These include using a cash register machine or POS machine that is not registered or accredited by the tax authority (Article 112(1)(a)), carrying out transactions without receipts or invoices or using receipts not generated by the machine unless the machine is under repair (Article 112(1)(b)), causing or attempting to cause damage or changing the fiscal memory of the machine (Article 112(1)(c)), failure to have an annual machine inspection (Article 112(1)(d)).

B. Criminal Liabilities

Like the administrative liabilities, the Federal Tax Administration Proclamation provides for tax-related acts or omissions which are regarded as criminal offenses. Below are some of them.

- Obtaining or attempting to obtain more than one TIN (Article 116);
- Allowing by others to use their TIN (Article 116);
- Using others' TIN (Article 116);
- Making a false or misleading statement or using fraudulent documents with the intent to defraud the authority (Article 117);
- Preparation, production, sell, distribution and use of illegal invoices (Article 118);
- Understatement of sales price (Article 119);
- Claiming unlawful refunds and excess tax credits (Article 120);
- Provision of tax invoices without registering for VAT or failure to provide VAT invoices while registered for VAT (Article 121);
- Refusal to provide tax credit notes or tax debit notes or providing tax credit note or debit note other than the one provided in the VAT proclamation (Article 121);
- Executing or signing a document that is subject to stamp duty without paying a stamp duty (Article 122);
- Disguising or hiding the true nature of the document with the intention of not paying stamp duty or paying a lower amount of stamp duty (Article 122);
- Failure to provide security for the payment of tax as required by the proclamation or a person who sells, disposes, hides, breaks, spoils, damages the property that is subject of such a security order or who

deletes, destroys, damages or hides a document relating the property that is subject to the security order (Article 123);

- Failure to file a tax with the intention to evade tax (Article 124);
- Failure to pay the withheld tax by the due date (Article 124);
- Obstruction of administrative tax laws (Article 125);
- Insulting a member of the tax appeal commission, interrupting or disturbing the proceeding, refusing to comply with the orders of the Commission (Article 128);
- And other offences related to the cash register machine (Article 129);

In addition to the liabilities and penalties stated, the proclamation allows the tax authority to publish the names and other details of persons who committed an offence.[70]

11.12.2. Rewards

The purpose of rewards is to encourage taxpayers to comply with the tax laws. Rewards have two facets. One is rewarding the taxpayer and a tax officer for an outstanding performance in complying with the tax laws. According to Article 134 of the proclamation, taxpayers and tax officers may be rewarded for their outstanding performance and exemplary discharge of tax obligations, respectively. For example, a person who provides information on tax evasion may be rewarded up to 20% of the tax.

The second one is rewarding persons who provide information to the tax authority regarding tax fraud or acts of evasion. A person who provides verifiable and objective information of tax evasion, through concealment, under-reporting, fraud, or other improper means, may be granted a reward equal to 20% of the amount of the tax evaded at the time the tax is collected by the Authority. However, such grant may not be given to the person if: a) the person participated in the tax evasion; or b) the reporting of the tax evasion was part of the person's duties of employment.

[70] Ibid, Art. 132

Summary

In Ethiopia, the administration of tax laws was the responsibility of the Ministry of Trade and Industry before 1936 and the Ministry of Finance from 1941 to 1995. The establishment the Federal Government Revenue Board in 1995 brought the administration the tax laws under a separate and autonomous body. Since 1995, the government restructured the top tax administration organ in different forms; The Ministry of Revenues in 2001, the Ethiopian Revenues and Customs Authority in 2008, and then again the Ministry of Revenues in 2016 are the notable cases. The Federal Tax Administration Proclamation No. 983/2016 contains rights and duties of taxpayers and tax officers. The taxpayers have the rights of appeal, to refund of unduly paid amount, to amend assessments, and of confidentiality. On the other hand, the taxpayers shall provide accurate information, keep records, pay taxes on time, and notify the tax authority of changes made to the address, constitution or activity of the taxpayer. The tax administration proclamation requires the registration of taxpayers. The registration under this Article is the primary registration for the purposes of tax laws. In addition to this basic registration, a taxpayer may be required to go through a process of registration under specific tax law such as VAT registration. Tax representatives and tax agents describe two different persons and functions. Tax representatives refer to individuals that receive and pay money on behalf of the taxpayer. Tax agents are licensed persons that engage in activities of helping the taxpayer to prepare declarations, notices, complaints and so on. Tax assessment is needed to calculate the amount tax liability of the taxpayer. The tax administration proclamation recognizes different types of tax assessment. These are self-assessment (Article 25), estimated assessment (Article 26), jeopardy assessment (Article 27), and amended assessment (Article 28), or penalty assessment (Article 115(1)). A tax declaration refers to the notification of payable tax or income to the tax authority. It must be made in the approved form. Tax may be collected either on a one-time payment basis or on an installment basis. However, installment payment is an exception. When a taxpayer fails to pay tax on time, he may request for extension of time according to the Federal Tax Administration Proclamation. The taxpayer is liable for any costs that the tax authority incurs to recover the unpaid tax. Tax credit refers to the amount of money that is deductible from the tax that is payable to the government. Tax credits can be refundable or non-refundable. Refundable credits are those that can be refunded

even after the tax liability becomes zero. Non-refundable credits, on the other hand, are those that can be refunded and can only be subtracted until the tax liability becomes zero. A tax refund is the refund of an overpaid tax. A taxpayer who overpaid a tax may claim a refund within three years after the date in which the tax was paid. A taxpayer may be released from tax liability when the Minister is satisfied that the payment of the full amount of tax owing by a taxpayer will cause serious hardship to the taxpayer due to natural cause, or supervening calamity or disaster etc. Advance rulings are interpretations made by the tax authority for clarification purposes. They are of two types of advance rulings: public advance rulings and private advance rulings. Tax disputes are disputes between the tax authority and the taxpayer. Review department, tax appeal commission and court are the tax dispute settlement mechanisms in Ethiopia. Penalties are provided for those taxpayers, who fail to comply with the tax laws. There are two types of liabilities: the administrative liability and criminal liability. On the other hand, taxpayers and tax officers may be rewarded for their outstanding performance and exemplary discharge of tax obligations, respectively.

Review questions

1. Explain the concept of tax administration.
2. Discuss the historical development of the tax administration institutions in Ethiopia.
3. What are the rights and duties of taxpayers in Ethiopia?
4. Compare and contrast the registrations of taxpayers under the tax administration and VAT proclamations.
5. What are the differences between tax representatives and tax agents?
6. When and by whom are self-assessment, estimated assessment, jeopardy assessment, amended assessment and penalty assessment made?
7. Discuss the recovery of unpaid taxes procedures, including seizure of property.
8. Explain the essential features, pros and cons of review department, tax appeal commission and court, as tax dispute settlement bodies in Ethiopia.
9. What are the objectives of penalties given for administrative and criminal liabilities?

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Chapter Twelve

The Law of International Taxation

Introduction

Despite the fact that tax is the subject of national jurisdiction, the existence of international tax law becomes undeniable. In simple parlance, international tax law governs cross-border tax issues. This chapter is intended to highlight the essentials of international tax law.

International tax laws are international laws. Thus, according to article 38 of the ICJ statute, treaties, customary international law, general principles of international law, and cases are sources of international law. Countries' right to levy and collect tax is based on a link between the taxing country and the taxpayer. These links mainly are nationality and territoriality. Yet, the employment of these links inevitably leads to a conflict in tax jurisdictions and can lead to double taxation of individual taxpayers.

There are two methods used to solve double taxation. These methods are unilateral actions and double tax avoidance agreements. Numerous other things challenge a tax system of a given country, and of these challenges, tax planning and transfer pricing come in the forefront. It is, thus, the intention of this chapter to discuss tax planning, transfer pricing, and other related concepts. A very important section of this chapter looks at the tax aspects related to the WTO. Finally, this chapter will discuss taxation in the digital age.

12.1 International Taxation Law: Meaning and Development

12.1.1. Meaning

International tax law does not only refer to the international law of taxation. Rather, it refers to domestic and international laws that govern cross-border tax conditions.[1] For instance, the German Foreign Tax Relations Act regulates the taxation of income obtained by taxpayers from international business relations

[1] Peter Hongler, International Law of Taxation: Elements of International Law, OUP 2021, P. 5

with a third party.[2] It also deals with transfer pricing. Therefore, this German act, although a domestic law, governs cross-border tax issues.

Be that as it may, the main focus of this chapter is the international law of taxation and not the domestic laws. However, we will use the international tax law and international law of taxation interchangeably in this chapter to mean international laws.

12.1.2. Historical Development

Peter Hongler classifies the historical development of the international tax regime into four eras.[3] These are: (1) pre-1920, (2) after 1920 and the League of Nations, (3) post-WWII and the rise of OECD in the 1950s and 1960s, (4) and after the 1960s.

Pre-1920

The first groups of tax treaties were signed in 1860. These were free trade agreements signed with the purpose of lowering tariffs.[4] Another notable tax treaty was the treaty addressing double taxation concerning inheritance taxes. It was the treaty between the Swiss Federal Council (on behalf of the canton of Vaud) and Great Britain signed in 1887.[5] The modern tax regime is believed to start in 1899-1900 when the tax treaty between Austria-Hungary and Prussia was signed.[6]

After 1920 and the League of Nations

During the First World War, countries were highly looking for tax as a source of income and because there was a movement of people across borders, double taxation became an issue. The League of Nations, which was established in 1920, was concerned about double taxation and began working on the issue. After discussions on the residence and source basis of jurisdiction to tax, a first

[2] Germany External Tax Relations Act, Federal Law Gazetta I, 1972, Article 1, available at: https://www.bundesfinanzministerium.de/Content/EN/Downloads/Taxation/External-Tax-Relations/External-Tax-Relations-Act.
[3] Supra Note 1
[4] Ibid
[5] Ibid P. 7.
[6] Ibid

model tax convention was developed in 1927. A second convention, known as the Mexico draft, was also developed and published in 1943.[7]

Post-WWII and the rise of OECD in the 1950s and 1960s

The next phase of the development of the international tax regime was led by the Organization for European Economic Cooperation (OEEC).[8] This organization produced four reports on tax and was replaced by the OECD in 1961. Two years later, the first OECD model tax convention was published. While the first final OECD Model Convention was adopted in 1977, it was amended in 1992, 1994, 1995, 1997, 2000, 2003, 2005, 2008, 2010, 2014 and 2017. As the OECD was developed to benefit the developed states, the UN published a draft model convention in 1980. Like the OECD model convention, many amendments were made to the UN model convention and the latest one is the 2017 version.

After the 1990s

The recent phase of development is led by the G20 and the main themes of these developments are the fight against cross-border tax evasion and the fight against aggressive tax planning. One of the tasks done in this stage, which is in 2013, is that the OECD drafted and published a report on the problems of the Base Erosion and Profit Shifting (BEPS) and issued the Action Plan on BEPS[9] following the mandate given by the G20.

To sum up, the international tax regime has passed through different stages. There were fluctuations in the development of the tax regime but now it has become a primary issue for policy makers (the G20).

12.1.3. Sources of International Tax Laws

International tax laws are international laws. In addition, according to article 38 of the ICJ statute, treaties, customary international law, general principles of international law and cases are sources of international law. This is also true for

[7] Kevin Holmes, International Tax Policy and Double Tax Treaties, An Introduction to Principles and Application, 2nd edn, IBFD, 2014, P. 61.
[8] Lijun Zhao et al, The Complementary Role of the WTO in the Enhancement of the Base Erosion and Profit Shifting Project, MDPI World, Vol.2, 2021, PP. 267-294
[9] OECD, Action Plan on Base Erosion and Profit Shifting, OECD Publishing, 2013.

international law of taxation. In addition to these sources, however, soft laws play a pivotal role and are considered as sources of international tax law.

Some scholars argue that customary international law has not been an important source if international tax law. This is because of the legality requirement and technical nature of tax laws. International customary law is composed of two elements: state practice and *Opinion Juris*. While practice indicates the state's overt behavior, *Opinion Juris* is about the state's belief that the practice is required as a matter of international law. In brief, customary international law is a law that results from a general and consistent practice of states followed by them from a sense of legal obligation.

Because of the existence of more than 3,000 double tax treaties, the prohibition of double taxation could be viewed as customary international law. Further, some scholars believe that the non-taxation of consular and diplomatic personnel, the arm's length principle, the principal purpose test, and fiscal transparency (exchange of information) have attained the customary international law status.

Like customary international law, the general principles of international law are disputed. That is to say that some scholars do not accept that there are general principles of international law applicable to the tax regime. Some principles such as the abuse of law principle, estoppel, and collusion rules are considered as general principles of international law that can be applied in the tax regime.

As stated above, the other source of significant importance are soft laws. Soft laws under international law include the general principles of laws accepted by civilized nations, decisions of courts and tribunals and writings of scholars. Although soft laws are not binding, they have the capacity of influencing other countries in their application. The Commentaries of the OECD and UN model conventions, BEPS reports, and related material can be taken as soft laws that have great influence on the international tax regime and hence are sources of international tax law.

12.2 Tax Treaties

Tax treaties are agreements between more than one sovereign state. Treaties can be bilateral or multilateral agreements.

12.2.1. Multilateral Tax Treaties

Multilateral tax treaties are of three types: (1) special purpose multilateral tax conventions, (2) multilateral double tax conventions, and (3) multilateral tax harmonization conventions.[10] Special purpose multilateral tax conventions are conventions that have a specific purpose other than double taxation issues. The Convention on Mutual Administrative Assistance in Tax, which aims to ensure and enhance the administrative assistance among the parties, and the Multilateral Competent Authority Agreement Matters which aims to improve international tax compliance are examples of special purpose multilateral conventions.

The second category of the multilateral tax conventions is some multilateral conventions that are mainly taken from the UN and OECD model conventions. These include the Nordic Tax Convention, the Caribbean Community Multilateral Double Taxation Agreement, and the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS.[11]

The third categories of the multilateral tax conventions are not common. But there are attempts such as the Common Consolidated Corporate Tax Base in the EU.

12.2.2. Bilateral Tax Treaties

Bilateral tax treaties are tax treaties signed between two countries. Depending on the issue they address, some of the bilateral tax treaties are:

- Treaties dealing with withholding tax rates,
- Tax information exchange agreements,
- Tax treaties on income and capital, and
- Double taxation treaties.

12.3 Jurisdiction to tax

Jurisdiction to tax refers to countries' right to levy and collect taxes. Jurisdiction is based on a certain type of link that exists between the country

[10] Peter Hongler, Justice in International Tax Law, IBFD, 2019 PP. 131 et seq.
[11] Kim Brooks, 'The Potential of Multilateral Tax Treaties' in Michael Lang and others (eds), Tax Treaties: Building Bridges between Law and Economics, IBFD, 2010, PP. 227 et seq.

and the person or the income or the property in question. Below is a detailed discussion on this topic.

12.3.1. The Genuine Link

"[A] state has the right to tax a certain income or person as long as such income or person has a genuine link to the state's territory."[12] This genuine link could be nationality, residence, source of the income, or place where the property is situated. A country may have jurisdiction to tax if the person is either a national or a resident of the country, or if the country is the source of the income or the property that is subject to tax is situated in the country.

A. Nationality: Very few countries levy taxes on their nationals in respect of their worldwide income. One of these countries is the United States of America.[13] While the reason advanced is that the US provides protection to its citizens irrespective of where they are, many scholars have found the reason to be weak and criticized this means of having jurisdiction to tax.[14]

B. Source Vs. Residence

Source and residence are the two most accepted links in the world and they often co-exist. In almost every jurisdiction, countries levy taxes based on both residence and source.[15] Taxpayers will pay tax with regard to their worldwide income in their country of residence but they pay (as applicable in most countries) only the income generated from that country when the basis is source. To put it differently, if a taxpayer is a resident, then he will pay based on this residence factor, if he is not a resident, however, he will be required to pay tax for the reason that the source of the income he received is that country.

Source and residence are defined in national laws. As a result, they may overlap sometimes. For instance, a person who entered a country for ten days to deliver service may be considered a resident in some countries, and not in other countries. Due to such differences in definitions, the link with respect to some

[12] Peter Hongler, Supra Note at P. 22
[13] Avi-Yonah, Reuven S. "International Tax as International Law." Tax Law Review, 57, No. 4, 2004, PP. 483-501
[14] Ibid
[15] Subhajit Basu, Global Perspectives on E-Commerce Taxation Law, Ashgate, 2007, P.35

countries could be only the source because the person would not qualify as resident in those countries.

The problem with the source factor is that it is sometimes difficult to identify the source of a certain income.[16] For instance, assume that a US Company (X) has a subsidiary (Company S) in Uganda and a Chinese Company (Y) has a subsidiary (Company T) in Argentina. Also, assume that Company S and T have operations in five countries. If a tax consultancy firm known as Firm T advises Companies S and T on the possible tax implications of a merger of the two companies, which country is the source of the income of Firm T? This service involves many countries and will be difficult to identify the source of the income in the absence of a tax treaty that defines source in such complex cases.

12.3.2. Worldwide or Territorial

While a genuine link is necessary, it is equally important to note the extent to which the genuine link justifies taxation. That is to say, if the residence is a genuine link, which income (the worldwide income or the income generated within the territory of the country) can be subjected to tax in that country is an important issue. The current practice shows that countries levy taxes on residents with regard to their worldwide income. However, those adopting source income, levy taxes on income that has been derived from that country. However, this is not always true and countries adopt both links to levy and collect taxes.

12.4 International Double Taxation and Avoidance Mechanisms

12.4.1. International Double Taxation: Definitional Exercise

International double taxation refers to the tax of a certain taxable event for an identical period and the same or a different taxpayer by more than one country. The OECD glossary defines international double taxation as arising when comparable taxes are imposed by two or more states [mostly] on the same taxpayer in respect of the same taxable income or capital.[17]

[16] Reuven S. Avi-Yonah, International Tax as International Law: An Analysis of the International Tax Regime, Cambridge Tax Law Series, Cambridge, 2007, P. 27.
[17] OECD Glossary of Tax Terms https://www.oecd.org/ctp/glossaryoftaxterms.htm accessed on 14 November 2021.

International double taxation is of two types i.e., juridical double taxation and economic double taxation. Juridical double taxation occurs when two or more countries levy tax on the same taxpayer with regard to the same income (transaction) over the same tax year. Professor Robert Deutsch suggests the following scenarios as situations that may give rise to juridical double taxation.[18]

(a) Country A imposes a tax on its residents on their worldwide income and Country B imposes a tax on non-residents on income sourced in Country B;
(b) Both countries impose tax by reference to the source, but each country considers the income derived as having a "source" within its jurisdiction;
(c) Both countries impose tax by reference to a residence, but A and B both consider the taxpayer to be a "resident" within its jurisdiction for the same period.

From a practical point of view,

(a) The first scenario happens when one country imposes tax based on residence (in relation to its worldwide income) but the other country levies tax based on a source. For example, a Kenyan company may provide service in Ethiopia and generate income. In such cases, the income will be taxed by Kenya as the company is resident in Kenya and is liable for its worldwide income. This taxpayer will also be taxed by Ethiopia because the source of the income is Ethiopia. To put it differently, Ethiopia will require the service receiver to withhold technical service tax according to the Federal Income Tax Proclamation, but at the same time, Kenya will levy a profit tax on the income. Hence, double taxation.
(b) The second scenario occurs when both countries impose tax based on the source but the standard used to determine the source may allow both countries to levy a tax on the same income. For instance, a Kenyan company may generate income from Ethiopia. Kenya and Ethiopia may

[18] Robert Deutsch et al, Principles and Practice of Double Taxation Agreements: A Question-and-Answer Approach, section 1.1.5, BNA International INC, 2008, P. 16

argue that they are the source of the income. In such cases, both countries may levy taxes.

(c) The third scenario arises when both countries impose taxes based on residence. For example, a company established in Kenya may have a permanent establishment in Ethiopia. As a result, the company may be treated as a resident in both countries and taxes may be levied by both.

With regard to taxes on immovable properties, some countries impose a tax on properties situated within the country. Other countries, on the other hand, levy taxes on properties owned by residents irrespective of the place where the immovable property is situated. Consequently, certain property may be subjected to double taxation.

Economic double taxation, on the other hand, refers to the taxation imposed by different countries on more than one person but on the same item.[19] For a better understanding of the concept, let's use an example taken from a book:

> "The parent company of an unlimited company incorporated in the United Kingdom was a US corporation. The income of the UK unlimited company was taxable in the United Kingdom in the hands of the UK unlimited company itself. For US federal income tax purposes, the UK unlimited company was classified as a disregarded entity because it had a single shareholder, unlimited liability and had not made a "check-the-box" election. The income earned by the UK unlimited company was therefore considered to belong to the US parent corporation even if this income had not been distributed by the UK unlimited company. Thus (sic) the income of the UK unlimited company was taxable in the United Kingdom and in the United States in the hands of the US parent corporation (cf. UK, SCITD 19 Nov. 2008, Bayfine UK Products v. Revenue and Customs Commissioners)."[20]

[19] OECD Glossary of Tax Terms https://www.oecd.org/ctp/glossaryoftaxterms.htm accessed on 14 November 2021.

[20] Michael Lang, Introduction to the Law of Double Taxation Conventions, Linde and IBFD, 2010, P. 25.

12.4.2. Mechanisms of Avoiding Double Taxation

Double taxation is unfair and discourages taxpayers. Thus, countries have devised mechanisms in order to eliminate the negative perception of double taxation. Across the globe, the mechanisms of avoiding double taxation are two, unilateral measures and double taxation treaties.

i. Unilateral Measures

Unilateral measures are measures taken by countries, unilaterally, to avoid double taxation. These measures can be: (1) exempting foreign source income, (2) allowing a tax credit for foreign tax paid on foreign source income, and (3) applying deduction from the taxable base of foreign taxes paid on foreign source income.[21]

The first measure is clear – countries exempt the foreign source income from tax. By not imposing a tax on the foreign source income, countries avoid double taxation. The second measure allows a taxpayer to reduce the tax paid abroad from the tax liability he has in the country that he is resident. For example, if a Kenyan company pays 1000 USD to Ethiopia for the income it generated in Ethiopia, and if it has to pay 2000 USD profit tax in Kenya for the same income, the company will pay only 1000 USD to the Kenyan government as the 1000 USD paid to the Ethiopian government will be deducted from the whole liability (2000 USD). According to the third unilateral measure, on the other hand, the tax paid abroad will be deducted from the total income and tax will only be levied on that net income.

ii. Double Taxation Treaties

The other means of avoiding double taxation is entering into double taxation avoidance treaties that are bilateral treaties. The double tax treaties (DTTs) are sometimes called double tax agreements (DTAs) or Double Tax Conventions (DTCs).

[21] ibid

According to the IMF data, more than 3000 double-tax treaties have been signed at a global level up until 2018.[22] Ethiopia, on the other hand, has entered into 30 treaties. Most treaties, at the international level, are adopted from either the OECD Model or the UN Model treaties.

The purpose of these treaties is to avoid double taxation by either abandoning the imposition of taxes on certain circumstances by one country (the exemption method) or by imposing a tax by both countries proportionately (credit method).[23] In other words, tax treaties limit states' rights to tax and allot jurisdiction to tax according to a predetermined and predictable method.

As can be seen from Article 12(1) of the OECD model, for instance, royalties can be levied only by the state of residence. The state of the source of the income may not impose a royalty tax. So, the source state relinquishes the imposition of royalty tax with the intention of avoiding double taxation. The relevant provision of the model convention reads as follows:

> "1. Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State.
>
> 2. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trademark, design or model, plan, secret formula or process, or for information concerning the industrial, commercial or scientific experience."[24]

Another example is Article 10(2) of the OECD model, which allows both states to impose dividend tax proportionately. Below is the relevant provision:

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[22] IMF eLibrary, Development of Worldwide Tax Treaty Network, <https://www.elibrary.imf.org/view/books/071/28329-9781513511771-en/ch008.xml>accessed on 14 November 2021.

[23] Ulrich Schreiber, International Company Taxation, An Introduction to the Legal and Economic Principles, Springer, 2013, P.16

[24] OECD Model Convention with Respect to Taxes On Income and On Capital, 2017, Article 12.

"1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, dividends paid by a company that is a resident of a Contracting State may also be taxed in that state according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company that holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365-day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganization, such as a merger or divisive reorganization, of the company that holds the shares or that pays the dividend);

b) 15 per cent of the gross amount of the dividends in all other cases. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3. The term "dividends" as used in this Article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident."[25]

12.5 Tax Planning

Tax planning is a legal strategy of reducing the taxable income and the tax. Corporations or taxpayers in general plan in advance to reduce their taxable

[25] Ibid, Article 10.

income and tax liabilities. They do so, for instance, by establishing companies in geographic areas that receive tax holidays by the law. Governments provide tax incentives for taxpayers who want to invest in remote areas and by investing there, taxpayers may be able to reduce tax liabilities.

At the international level, tax planning could be of two types: non-aggressive and aggressive tax planning. While non-aggressive tax planning refers to planning which is legal and in conformity with the intent of the law (see the previous paragraph), aggressive tax planning refers to a tax planning which is legal but that might be contrary to the intent of the law.[26]

12.5.1. Aggressive Tax Planning

Aggressive tax planning exploits gaps in the law and the mismatches between the different tax systems. It may result in double-non taxation. The intention is to avoid tax.

The main channels of aggressive tax planning, as identified by the European commission are three.[27] The first channel is debt-shifting. Corporations in a high tax rate country borrow money from a related entity in a low tax rate country. At the end of each year, the corporation pays interest and the debt to the related entity in the low tax rate country. Because the interest is generally deductible from income, the corporation decreases its taxable income in the high tax rate country. This enables the corporation to shift its profits from the corporation in the high tax rate country to a related entity in the low tax rate country. Because the corporation and the related entity are technically the same company, the corporation will be able to pay a lower tax.

The second channel is the strategic location of intellectual properties and intangible assets. For example, a corporation establishes another company (subsidiary) in the country with no or low tax rates and they locate their intellectual property rights and intangible assets in that subsidiary company. Later, the corporation (located in a country with a high tax rate) enters into a licensing agreement with the subsidiary company in order to use the intellectual properties. By doing so, the company will have to pay royalty fees, which are

[26] OECD, Guidelines for Multinational Enterprises; OECD Publishing: Paris, France, 2011.
[27] European Commission, European Semester Fact Sheet, Curbing Aggressive Tax Planning, 2017, PP. 1-9 available at: http://www.europarl.europa.eu

generally deductible against its income, each year to the subsidiary company. As a result, the company reduces its taxable income in the high tax rate country and may escape from paying any tax if this income is not taxable in the state where the subsidiary is located.

The third channel is the misuse of transfer pricing. Transfer pricing, as well as base erosion and profit shifting, are discussed in detail below in this chapter.

Bilateral tax treaties have also been used as channels of aggressive tax avoidance. As one study shows, developing countries lose 770 billion euro each year from withholding taxes on interest and dividends because of the Netherlands' tax treaties.[28]

12.6 Transfer Pricing

12.6.1. Transfer Pricing Explained

Transfer pricing refers to the determination of the price at which transactions between related parties will be carried out.[29] In transfer pricing, the transaction is conducted between associated companies and they determine the price of such transaction. The following comparative example is illustrative:

Company X is a textile manufacturing established and operating in Ethiopia. Assume that the corporate tax in Ethiopia is 30%. Company X establishes a subsidiary company Y in Sudan. Assume that the corporate tax rate in Sudan is 15%.

Scenario one:

Assume that the cost of producing a certain garment in Ethiopia is 2000 Birr and Company X sells that garment for 4000 Birr to its subsidiary in Sudan. The Sudanese Company (Company Y) sells that garment for 6000 Birr to an independent Egyptian company.

In this case, the related companies pay a corporate tax of 30% of the 2000 Birr (4000 -2000 Birr) in Ethiopia and 15% of the 2000 Birr (6000-4000 Birr) in

[28] McGauran, K. Should the Netherlands Sign Tax Treaties with Developing Countries? Centre for Research on Multinational Corporations: Amsterdam, 2013, P.34

[29] UN Practical Manual on Transfer Pricing for Developing Countries, Department of Economic and Social Affairs, 2013, p. 2.

Sudan. The total amount of profit is 4000 Birr and the total corporate tax is 900 Birr.

Scenario two:

Company X sells the garment for 2000 Birr (with no profit) to Company Y. Company Y then sells the garment at the price of 6000 Birr to the Egyptian Company. In this case, Company X does not pay any tax as there was no profit in Ethiopia. Company Y, on the other hand, pays 15% of the taxable income (4000 Birr) in Kenya. Therefore, the related companies collected a total profit of 4000 Birr (the same as scenario one) but paid 600 Birr corporate tax.

As can be seen from both scenarios, the companies made transactions between themselves. In scenario one, they operated genuinely and both countries were able to collect the necessary tax. In scenario two, however, the companies were able to avoid tax in Ethiopia, where corporate tax rates are higher than in Sudan, by determining the price of the goods and reducing profit. So, the companies were able to save 300 Birr in scenario two. In fact, this would be better yet for the related companies if Sudan was a tax haven or the income was non-taxable in Sudan.

12.6.2. Is Transfer Pricing Illegal?

Transfer pricing is a common phenomenon. Simply put, it is nothing more than a transaction between or among associated companies. It was initially introduced to measure the performance of individual entities in a multinational enterprise and it is legal in principle.

What makes it unjust is the extent and manner of price determination. In the transaction described, neither party is motivated to reflect the market price of the garment. The problem lies when the transaction is made with the purpose of tax avoidance or profit shifting.[30] As in the example above, the driving force could be the intention to reduce tax by shifting profits from one country to another country.

[30] Yosef Alemu, Ethiopian Law on Transfer Pricing: A Critical Examination, Jima University Journal of Law, Volume 5, December 2013.

12.6.3. Measures Against Transfer Pricing

When there is a transfer pricing, the important issue is which government taxes which transaction. If a tax administration authority of a certain country believes that there is a misuse of transfer pricing, it may adjust the pricing and levy taxes. In such instances and in the absence of a corresponding adjustment by the other country, there could be double taxation. For example, assume Company X and Company Y are associated companies residing in Ethiopia and Kenya, respectively. Company X manufactures a bicycle at the cost of 10,000 Birr and sells it to Company Y at a price of 50,000 Birr. Company Y then distributes the bicycles in Kenya for 50,000 Birr. In this case, Company X generated a profit of 40,000 Birr in Ethiopia and will pay tax for that amount but Company Y did not generate any income. If the tax authority of Kenya believes that Company X sold the bicycle for 50,000 Birr in order to avoid paying taxes in Kenya and the market value is different, the authority may adjust the price to the correct price (for instance 30,000). This means Company Y should have bought the bicycle at a price of 30,000 Birr and sold it at 50,000 Birr. Hence, it shall pay tax for the 20,000 Birr profit. Consequently, the associated companies will pay twice for the 20,000 Birr (in Ethiopia and in Kenya).

In order to avoid such consequences, the OECD has developed a transfer pricing guideline for multinational enterprises and tax administrations.[31] They have adopted principles that enable member states to control transfer pricing.

a. Arm's length principle

The first principle is the arm's length principle. OECD[32] member states have agreed to adjust the misused transfer pricing in consistency with the arm's length principle. Article 9 of the OECD model Convention states as follows:

> "[Where] conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the

[31] OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 2017. These Guidelines are a revision of the OECD Report Transfer Pricing and Multinational Enterprises (1979). They were approved in their original version by the Committee on Fiscal Affairs on 27 June 1995 and by the OECD Council for publication on 13 July 1995.
[32] Ethiopia is not a member of the OECD.

enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

Therefore, by comparing the transaction by associated companies with transactions that may be conducted between independent enterprises, countries can adjust the profits and taxes accordingly.

In applying the arm's length principle, multinational enterprises and tax authorities may use different transfer pricing methods. These methods may be categorized into two: the traditional transactional methods and transactional profit methods. The traditional transactional methods are used to measure the terms and conditions of actual transactions between independent enterprises and compare with the transactions made between the associated enterprises.

What this means in practice is that associated entities will be treated as separate entities and their transactions will be compared with transactions made with independent entities (both uncontrolled internal and external transactions). Take the common example that Company X and Company Y are associated companies in different countries. If the purchases made by Company Y from Company X are higher in price than purchases made by Company W (an independent company) from Company X or transactions between independent companies (Company W and Company V), then possibly the purchase made by Company Y from Company X is not consistent with the arm's length principle. Hence, the tax authority of the state where Company Y is situated may adjust the transaction between Company X and Company Y to correct the tax distortions. Nevertheless, it should be noted that not all differences in price are inconsistent with the arm's length principle because there could be other factors such as the volume of the transaction that may affect the price of the goods and services.

In order to compare the controlled transaction with the uncontrolled transaction, specific methods may be applied. These include: first, the controlled comparable price method helps to compare the transactional price charged in the transaction between the associated entities with the price charged in a transaction between the entity within the multinational enterprise and another independent entity. The second is the Resale Price Method. The resale price is the price charged while transferring the goods or services to an independent enterprise. This resale price helps to identify the margin price and thereby the

transfer price. The third method is known as the cost-plus method. Under this method, tax authorities identify the costs of production of the product under transactions between the associated companies. Then it takes the normal profit markup to such costs as applied by independent companies. This profit margin and other considerations, if any, will be added to the cost to determine the true price of the product.

The transactional profit method, on the other hand, compares operating profits and not the actual transaction. It compares the operating profits of the associated enterprises with the profit level realized by independent enterprises. Similar to the traditional transaction method, the transactional profit method also employs different methods to determine the true price of the good or service. The first is the transactional net Margin Method. The second one is the transactional profit split method.

The point is that arm's length principle has the flexibility to use different transfer pricing methods to correct tax distortions.

b. Global formulary apportionment approach

The second alternative principle is the global formulary apportionment approach. This is a means of consolidating the global income of a multinational enterprise across different countries and determining the taxes in accordance with a formula of apportionment. This formula is a predetermined formula applicable to all taxpayers to determine the profit.

According to the global formulary apportionment method, the associated entities are taken as one entity, not as separate entities. As a result, the profit of all the companies is consolidated and apportioned to the countries where the companies are situated in accordance with a predetermined global formula. For example, assume Company B, C and D are associated companies established in Uganda, Botswana, and South Africa, respectively. If there is a misuse of transfer pricing, tax administration authorities of the three countries will sum up the profits of the three companies and determine which profit should go to which country in accordance with a predetermined global formula for tax purposes. Accordingly, the countries will be able to take their portion and levy taxes.

The guidelines provide different mechanisms for determining and identifying transactions that are consistent with the arm's length principle or any other applicable method. They also provide tools necessary for tax administration.

12.6.4. Ethiopian Laws on Transfer Pricing

Ethiopia is not an exception to the misuse of transfer pricing and has lost millions of dollars as a result. One research effort, conducted by Christian Aid in 2009, shows Ethiopia lost 2.01 million euros in 2005, 3.11 million euros in 2006, and 5.63 million euros in 2007 because of transfer pricing abuse.[33]

In Ethiopia, Income Tax Proclamation No. 286/2002 required the application of the arm's length principle by empowering the Ethiopian Revenue and Customs Authority to adjust the profit of a company if a transaction made with an associated company was different from those made with unrelated companies.[34] With the purpose of implementing this provision, a directive on transfer pricing was enacted.[35] This directive also supported the implementation of the arm's length principle.

From the customs perspective, imported goods receive customs value for the purpose of imposing customs duty.[36] Moreover, in order to determine the customs value, ERCA uses the transaction value of identical goods as its primary valuation method.[37]

Transfer pricing is also dealt with in the new Federal Income Tax Proclamation No. 979/2016 which replaced Income Tax Proclamation No. 286/2002. Similar to the previous proclamation, the new proclamation preserves the application of the arm's length principle.[38]

[33] Christian Aid Report, False Profits: Robbing the Poor to Keep the Rich Tax Free, 2009, page 22.
[34] Income Tax Proclamation No. 286/2002 Article 78-79
[35] See Ethiopian Transfer Pricing Directive No 43/2015.
[36] Tariku Adugna, The Application of Ethiopian Transfer Pricing Rules on Multinational Enterprise: Consistency of the Practice with the Ethiopian Transfer Pricing Rules,[Unpublished LLM Thesis], 2019, P.17
[37] Customs Proclamation No. 859/2014, Article 90.
[38] See Federal Income Tax Proclamation No. 979/2016, Article 79.

12.7. Base Erosion and Profit Shifting

12.7.1 Understanding BEPS

Base Erosion[39] and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps in the architecture of the international tax system to artificially shift profits to places where there is little or no economic activity or taxation. In the words of the OECD FAQ, BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low resulting in little or no overall corporate tax being paid.

A few examples will illustrate the use of BEPS.

Example one

Corporate X is established in Rwanda where the corporate tax rate is 30%. Corporate X has a parent Company, Company Y, in Djibouti where the corporate tax rate is 10%. In order to avoid the tax at a higher rate (30%), Company X shifts the profit to Djibouti. It does so, for instance, by borrowing finance from Company Y in advance and paying the debt and interest to Company Y. By paying interest from the profit, Company X reduces its taxable income in Rwanda and thereby reduces its tax. Company Y, on the other hand, receives the money from Company X and pays only 10% tax.

Example two

If we take the above example, the related companies locate their intellectual properties with Company Y. Then Company Y licenses its intellectual properties to Company X. Company X, by paying royalties to Company Y, reduces its taxable income and taxes in Rwanda.

BEPS may also result from the application of bilateral tax treaties. This should be explained.

[39]Base erosion is the reduction of taxable income in a high tax rate country with the reduction being transferred to a low tax rate county.

12.7.2. Problems with BEPS

Although BEPS may not be illegal (because the tax avoidance is made based on gaps in the available domestic tax laws), it nonetheless has a real and adverse impact on the economy. In 2013, it is reported by the OECD that 4% to 10% (100 to 240 billion USD) of global corporate income tax revenues are lost due to BEPS because of aggressive tax planning by multinational enterprises, the interaction of domestic rules, lack of transparency and coordination between domestic tax administrations, limited country enforcement resources, and harmful tax practices.[40] The effects of BEPS can be summarized as follows:

A. It distorts competition: BEPS is available only for cross-border corporations as it involves the gap between at least two countries' tax laws. This does not exist at the domestic level and domestic companies cannot benefit from it. Therefore, while companies who operate at the cross-border level will have the opportunity to avoid tax, domestic companies will have to pay the tax. As a result, it creates unfair competition between the companies.
B. It may lead to inefficient allocation of resources: More resources may be allocated to the companies that operate at the cross-border level. Allocating resources to companies that hide income or shift income to other countries to avoid tax is inefficient.
C. It is unfair: It is unfair to levy tax on domestic companies while the multi-national corporations are avoiding the same tax. In fact, it may decrease domestic taxpayers' tax compliance and may result in failure to voluntarily comply with tax laws.

The OECD Action Plan on Base Erosion and Benefit Shifting identifies three main problems:

A. **Governments are harmed**. Many governments have to cope with less revenue and a higher cost to ensure compliance. Moreover, Base Erosion and Profit Shifting (BEPS) undermines the integrity of the tax system, as the public, the media and some taxpayers see reported low corporate taxes as unfair. In developing countries, the lack of tax revenue leads to critical under-funding of public investment that

[40] OECD, BEPS Project Explanatory Statement, 2015 Final Project, page 4.

could help promote economic growth. Overall resource allocation, affected by tax-motivated behavior, is not optimal.

B. **Individual taxpayers are harmed**. When tax rules permit businesses to reduce their tax burden by shifting their income away from jurisdictions where income-producing activities are conducted, other taxpayers in that jurisdiction bear a greater share of the burden.

C. **Businesses are harmed**. Multinational entities may face significant reputational risk if their effective tax rate is viewed as being too low. At the same time, different businesses may assess such risk differently, and failing to take advantage of legal opportunities to reduce an enterprise's tax burden can put it at a competitive disadvantage. Similarly, corporations that operate only in domestic markets, including family-owned businesses or new innovative companies, have difficulty competing with multinational entities that have the ability to shift their profits across borders to avoid or reduce tax. Fair competition is harmed by the distortions induced by BEPS."[41]

12.7.3 Measures Against BEPS

The problem created by BEPS lies in domestic tax laws. It is the gaps in these laws that give rise to BEPS. Therefore, the solution must target the laws.

Understanding the difficulty of tackling BEPS by unilateral action of countries, the OECD countries came up with a BEPS action plan that addresses it in a comprehensive and coordinated means through 15 actions.[42] OECD identified the interaction of the domestic tax laws that entail double non-taxation or less than single taxation and "arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place".[43]

While the central themes of the action plans are three (coherence, substance and transparency), the following are the 15 action plans:[44]

[41] OECD, Action Plan on Base Erosion and Profit Shifting, 2013, preamble.
[42] OECD, Action Plan on Base Erosion and Profit Shifting, 2013.
[43] Ibid, preamble.
[44] Ibid

1. Address the tax challenges of the digital economy: The assumption is that the digital economy poses challenges to the implementation of tax laws. Thus, this action is to examine, among others, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation because of the lack of nexus under current international rules, the attribution of value created from the generation of marketable location-relevant data through the use of digital products and services, the characterization of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services.[45]
2. Neutralize the effects of hybrid mismatch arrangements: The purpose of this action is to neutralize the mismatch between tax rules and avoid possible double non-taxation, double deduction, and long-term deferral.
3. Strengthen CFC rules:
4. Limit base erosion via interest deductions and other financial payments: The action is to "develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments".
5. Counter harmful tax practices more effectively, taking into account transparency and substance: this action is to renovate the work on harmful tax practices with a priority on improving transparency, and requiring substantial activity for any preferential regime.
6. Prevent treaty abuse: This is to design a model treaty that prevents the granting of treaty benefits in inappropriate circumstances.
7. Prevent the artificial avoidance of Permanent Establishment (PE) status: to redefine Permanent Establishment (PE) to prevent the artificial avoidance of PE status in relation to BEPS.
8. Assure that transfer pricing outcome are in line with value creation (Action 8, intangibles, Action 9, risk and capital, Action 10, other high-risk transactions): Develop rules to prevent BEPS by moving intangibles among group members.

[45] Ibid

9. Establish methodologies to collect and analyze data on BEPS and the actions to address it (Action 11): Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis.
10. Require taxpayers to disclose their aggressive tax planning arrangements (Action 12): Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules.
11. Re-examine transfer pricing documentation (Action 13): Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business.
12. Make dispute resolution mechanisms more effective (Action 14): Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under Mutual Agreement Procedure including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases
13. Develop a multilateral instrument (Action 15): provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.

12.8 International Tax Dispute Settlement

12.8.1 International Tax Dispute: Conceptual Underpinning

International tax disputes arise from tax treaties, usually the double tax treaties (DTTs). DTTs are signed by sovereign states, and not by taxpayers. As a result, the parties to a dispute that may arise in relation to the interpretation of the DTTs are the sovereign states.[46] This does not mean, however, that taxpayers

[46] This generalization is not always true. In Bilateral Investment Treaties, a dispute may arise between an investor and the host state although the treaty is signed by sovereign states. Investor-state dispute settlement, for instance, is a dispute settlement mechanism provided in

are not affected by the decisions made by tax authorities based on the tax treaties. Although there may be a dispute between a tax authority of a state and a taxpayer, the dispute cannot be characterized as an international tax dispute. It is international when it is between tax authorities of different countries. It has to be noted again that a dispute between a taxpayer and a tax authority may give rise to international tax as the OECD model convention allows taxpayers to initiate Mutual Agreement Procedure.

Disputes may arise in relation to transfer pricing, allocation of profits, permanent establishment, and determining the residence of a taxpayer and so on.

12.7.4 Dispute Settlement Mechanisms

The DTTs across the globe provide two main dispute settlement mechanisms. These are the Mutual Agreement Procedure and Arbitration. Below is a discussion on what they are and how they work.

A. Mutual Agreement Procedure (MAP)

MAP refers to the mutual agreement of the tax authorities (or authorities that are responsible for implementing DTTs) to resolve difficulties and doubts that result from the application of the treaties. This mechanism is enshrined in Article 25 of both OECD and UN Model Income Tax Conventions.

i) Who can initiate MAP?

According to Article 25 of the Model Conventions, the taxpayer, as well as the organ responsible for implementing the treaty, may initiate a MAP. Taxpayers, who think that they are taxed contrary to the provisions of the tax treaty, may complain before the competent tax authority. For a taxpayer to initiate a MAP according to the model conventions, it must satisfy the following requirements: (1) it must be a resident of one of the contracting states, (2) it must establish that the measure taken by the contracting party violates the provisions of the treaty, (3) payment of the tax liability, depending on the laws of the state, and (4) must be brought within the period of limitation.

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most investment treaties to allow investor sue host states for violation of the commitments they entered in the treaty.

ii) The Procedure

After receiving the application from a taxpayer, the competent authority is duty-bound to decide on whether the request is justified.[47] The unilateral measure taken by the competent may include the provision of foreign tax credit or exemption.

If the unilateral measure is not successful, the requested authority shall contact the tax authority of the other country. For example, if a company in Ethiopia believes that Kenya is imposing a tax, the company may request the Ethiopian tax authority to contact the Kenyan counterpart with its complaints, if there is a bilateral income tax treaty. The Ethiopian tax authority must do so if it finds that the request is justified. After both parties are in contact and if the Kenyan authority agrees with the request, it adjusts the tax accordingly.

In this process, it has to be noted that the taxpayer is not a party to the negotiations. It is conducted between the government authorities and the taxpayers' role is limited to submitting a request. It is also true that the whole negotiation is confidential, the tax authority is not obliged to do the negotiation and there is no time limit for the tax authority to act.

B. Arbitration

If the MAP fails, the next available resort for the taxpayer is arbitration. According to article 25(5) of the OECD Model Income Tax Convention, if the competent authorities fail to reach in an agreement within 2 years after it is submitted to them, the issue shall be submitted for arbitration, upon the complainants' request. Arbitration is the settlement of a dispute through a third party known as an arbitrator. The arbitrator has the power to make a binding decision. Arbitration is believed to be a neutral forum than the MAP.

Concisely, MAP and Arbitration are the two common mechanisms of tax dispute settlement that have gained recognition by the Model Tax Conventions and Bilateral Income Tax Treaties. However, it has to be noted that no dispute settlement mechanisms are free from criticism.

[47] Supra Note at 24, Article 25(2)

One of the few bilateral double taxation agreements that contain arbitration as a dispute settlement mechanism is the Netherlands-Ethiopia Agreement.[48] Article 24(5) of the agreement states as follows:

> "…. any unresolved issue arising from the case shall be submitted to arbitration if the person so requests. The arbitration decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph"

12.9 WTO and Taxation

With the purpose of fostering smooth trading activities, the World Trade Organization (WTO) deals with tariffs and other tax issues. WTO agreements contain tax rules. Some of the most important agreements that deal with tax issues are discussed below.

A. General Agreement on Trade and Tariff (GATT)

The purpose of the GATT is to eliminate discrimination and reduce tariffs with regard to trade in goods. This agreement recognizes the Most Favored Nation and National Treatment Principles to ensure non-discrimination of taxes.[49] According to the Most Favored Nation principle, member states are not allowed to favor goods imported from a certain country.[50] In other words, any tax favor afforded to goods imported from a certain country must be extended to others as well.

According to the National Treatment principle, on the other hand, tax measures must not be applied to imported goods in order to favor domestic products.[51]

[48] Convention Between the Kingdom of The Netherlands and The Federal Democratic Republic of Ethiopia for The Avoidance of Double Taxation and The Prevention of Fiscal Evasion with Respect to Taxes on Income, Agreement of 10th August 2012.
[49]Lijun Zhao et al, The Complementary Role of the WTO in the Enhancement of the Base Erosion and Profit Shifting Project, MDPI 14 May 2021, P. 275.
[50] General Agreement on Trade and Tariffs, WTO, 1947, Article I
[51] Ibid, Article III

The relevant part of Article III (2) of the GATT reads as follows:

> "The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products."

GATT also contains other provisions that are relevant to the tax regime. Article II imposes an obligation not to raise tax tariffs above the agreed rates during the GATT negotiations and incorporated them into the schedule of concessions.[52] The purpose of this obligation is to ensure the predictability of the tax regime. Other provisions include:

- Article X: publication of tax laws, judicial rulings, and administrative decisions in order to make them accessible to traders and governments and to ensure transparency.
- Article VII: valuation for customs purposes;
- Article VIII: fees and formalities connected with importation and exportation;
- Article XI: General Elimination of Quantitative Restrictions;
- Article XVIII: Governmental Assistance to Economic Development; and so on.

B. General Agreement on Trade in Services

Similar to the GATT, the General Agreement on Trade in Services (GATS) recognizes the principles of Most Favored Nation and National Treatment. Unlike GATT, however, the GATS does not contain a tax-specific National Treatment Principle. Part of the Article XVII reads:

> "In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favorable than that it accords to its own like services and service suppliers."

[52] Michael Daly, Is the WTO A World Tax Organization? A Primer on WTO Rules for Tax Policymakers, International Monetary Fund, 2016, P.13.

As can be seen from the provision, it refers to any measure that affects the supply of the services. Thus, tax is taken as one type of measure that may affect the supply of the services.

C. Agreement on Subsidies and Countervailing Measures

The Agreement on Subsidies and Countervailing Measures prohibits every form of subsidy including any tax credit incentives that affects trade in goods.[53] Article 1 of this Agreement lists relief from taxes in relation to exports, relief from taxes conditional upon the use of domestic goods over imported goods, and other forms of tax relief as tax measures that can be considered as subsidies. The purpose of such measures is tax exemption.

12.10 Taxation in the Era of the Digital Economy

Introductory Remarks

Since time immemorial, trade has been one of the major activities of human beings. It was performed in a traditional way-a way that demands the physical presence of the seller and the buyers. Trade takes, time and it is costly, to mention just a few impediments to trade. The advent of the internet, however, brought a new dimension to commerce and took it to a new level.

The introduction of the internet dates to the 1960s.[54] During its early life, the use of the internet was limited to non-commercial purposes. However, the evolution of the internet in the early 1990s enabled a shift in the internet for commercial use marking the beginning of the age of e-commerce.[55] As is the case in many terminologies, the term e-commerce has suffered from the absence of a single definition. In simple terms, e-commerce is trading electronically. In the parlance of e-commerce, the transaction may take place between consumer-to-consumer, consumer-to-business, business-to-consumer, business-to-business, and with the government.

[53]McLure, C. E., and Hellerstein, W, Does Sales-Only Apportionment Violate International Trade Rules? Tax Notes, 2002, PP.1513-1521.
[54]Dr. P Ashokkumar, E-Commerce Law and Its Legal Aspects, International Journal of Law, 4(1), 2018, PP. 72-74.
[55] W. Ray Williams, the Role of Caesar in the Next Millennium - Taxation of E-Commerce: An Overview and Analysis, Wm. Mitchell L. Rev, 27, 2001, PP. 1703,-1732.

E-commerce, among other things, enables consumers to purchase faster and to access both goods and services in a borderless environment.[56] It also provides for selling faster and reaching more customers with less administrative costs.[57] Put differently, e-commerce allows trade to be undertaken virtually, erodes the value of geography and physical presence, which are the defining characteristics of conventional trade.

Concomitant with these benefits, the advent of e-commerce brought a bundle of issues. As Prof. Rahmet concisely put it, the issues in e-commerce pertain to economic, social, technological, and legal aspects.[58]When it comes to the legal issues, e-commerce challenges intellectual property, tax, privacy and data protection, and consumer protection, to list the foremost. Nonetheless, this part focuses on the tax aspect. Needless to mention, E-commerce brought a challenge to the current tax framework.

This challenge lies mainly in the fact that the current laws are crafted in the context of conventional businesses which are in most cases inapplicable to e-commerce.[59] More specifically, the issue starts with the tax or not to tax question. The debate on whether to tax e-commerce, not to mention the desirability and the extent of that taxation, has been a point of contention, especially during its flourishment. Tax jurisdiction is one of the major concerns. Tax jurisdiction, as it is now understood, revolves around the notion of territoriality and physical presence. This is because tax is national.[60] The current understanding and application of the principle of permanent establishment also become obsolete. The fact that e-commerce introduced what, in the realm of e-commerce, is known as digital products is also another challenge. Precisely, who bears the tax burden, which country levies and collects the taxes, and how

[56]Abdurrahman A. An Evaluation of E-Commerce legislation in GCC States: Lessons and Principles from the International Best Practices (EU, UK, UNCITRAL),[un published doctoral dissertation],Lancaster University, 2016, P.14.

[57] Richard, J. and Subhajit, B., Taxation of E-commerce: a Developing Problem, International Review of Law Computers &Technology, Volume 16(1), 2002, PP. 35-52.

[58]Rahmat Mohamad, Secretary-General of AALCO, "International Law on E-Commerce: Legal Issues and Impact on the Developing Countries" at the China University of Political Science and Law, Beijing, China on 27th September 2013.

[59]Subhajit B., Relevance of E-Commerce for Taxation: An Overview, the Berkeley Electronic Pres ,3(3), 2003, PP.1-38

[60]Subhajit B., Global Perspectives on E-commerce Taxation Laws. Ashgate Publication Limted, 2007, P.2.

to collect the taxes are the puzzles of the e-commerce taxation. What follows is a brief discussion of tax issues in e-commerce.

12.10.1. The Debate on tax E-commerce

As pointed out above, e-commerce brought numerous issues in the realm of tax and one of such issues is the to tax or not to tax question. It needs to be noted that the debate to tax e-commerce has merit beyond academic considerations and this is witnessed in the early days of the development of e-commerce where countries took a diverse approach. A case in point is the U.S. Internet Tax Freedom Act of 1998 which imposed a three-year suspension of taxes on the Internet.[61] The primary justification to tax e-commerce pertains to revenue. As the risk of stating the obvious, tax is considered the largest source of government revenue and, coupled with the unprecedented growth of e-commerce, makes taxation of e-commerce a necessary phenomenon.[62]

The second reason is equity or fairness. This justification is all about the need to level the playing field between conventional and e-commerce ventures. Tax is one of the tools used to level the playfield. Accordingly, if e-commerce is not taxed it will put the conventional business venture in a disadvantaged position. In addition, this disadvantage to conventional businesses becomes worse because e-commerce already has the advantage of convenience to customers in terms of time and accessibility.[63]

On the other hand, those who consider taxing e-commerce as not desirable based their argument on the infant industry perspective. That is, as e-commerce is at its infant stage, its taxation of it will impede its development.[64]

The second reason goes to the remote seller justification. A government levies and collects taxes because those who benefit from public services and goods need to pay a price in the form of tax. Because the remote e-commerce seller receives no benefit from the state in which their customers are situated, taxing

[61]Kenneth J. Hamner, 'Taxation of International and Domestic E-Commerce: Inevitability, Structure, Problems and Solutions,' 1 Fla. St. U. Business Review, 2001, P.3.
[62]Subhajit Basu, 'International taxation of E-commerce: Persistent Problems and Possible Developments,' JILT, 2008, PP 1-25.
[63] Ibid.
[64]Goolsbee, A., Zittrain, J., Evaluating the Costs and Benefits of Taxing Internet Commerce, Harvard Law School, Research Publication, 1999, P.24.

e-commerce should not be appropriate.[65] Nevertheless, despite these objections, the current trend seems to resemble towards taxing e-commerce.

12.10.2 Direct Taxation

A. Permanent Establishment

The notion of permanent establishment is very useful to tax business profits of non-resident corporations in the source country.[66] A permanent establishment is understood as a fixed place of business through which the business of an enterprise is wholly or partly carried on. The advent of the internet, however, makes it possible to undertake business in cyberspace without fixed and specific locations.[67] Hence, the very basis of a permanent establishment, which proclaims the need to have a physical presence, is no longer relevant in the context of e-commerce.[68] It is difficult at best to tax businesses with such a traditional understanding of the concept of permanent establishment and this is the challenge posed to the current tax principle.

B. Jurisdictional Issue

Concomitant to the aforementioned challenges, the introduction of e-commerce also poses a challenge to the tax jurisdiction regime. The story so far envisaged is that there are two principles: source and residence, employed to establish the link between the taxpayers or the income and taxing country.[69] Accordingly, the resident principle is applicable to the residents of a country regarding their worldwide incomes notwithstanding where it is earned.[70] As it is vivid, the resident principle is highly tangled with a geographical or physical presence in a given country.[71]

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[65] Ibid.

[66]Kham Tipmart, International Taxation of E-commerce, LLD dissertation, Nigata University, School of Modern science and culture, 2015, P.13

[67]Rifat Azam, E-Commerce Taxation and Cyber Space Law, The Integrative Adaptation model, Virginia Journal of Law and Technology, 12(5), 2007, PP.1-34

[68]Ibid.

[69] W. Ray Williams, the Role of Caesar in the Next Millennium - Taxation of E-Commerce: An Overview and Analysis, Wm. Mitchell L. Rev, 27, 2001, PP. 1703,-1732.

[70]Aschalew Ashagre, Tax Law Teaching Material, Addis Ababa University School of Law, 2013, [Unpublished, on the file with the author], P.50.

[71]Aschalew Ashagre, Supra Note at 70, P.51.

In the absence of geographical or physical presence, the country may still impose tax using the principle of territoriality or source. Consequently, the country from which the income is derived has the right to tax such income. The justification lies in the fact the country has contributed to the generation of the income.[72]

This principle is heavily territorial because countries assume a right to tax incomes derived from their borders or within their territory no matter who earned the income. This is clearly based on the presumed existence of geographical nexus between the income and the country. When it comes to e-commerce, geography may not necessarily be helpful to identify the link between income and the country. This is the challenge posed by e-commerce to the well-established principle of tax jurisdiction.

12.10.3 Indirect Taxation

The challenge e-commerce posed to indirect tax is twofold. The primary problem pertains to the governing principle of jurisdictions. When it comes to indirect tax, tax jurisdiction emanates from the origin or destination principle. Accordingly, a destination principle is employed to impose a tax on goods and services in the place of consumption.[73] On the other spectrum, the origin principle goes with the area of production or origin regardless of where they are consumed.[74]

The problem with both principles is that they heavily rely on the territorial demarcation of the place of production and consumption. When we see this in view of e-commerce, the fact that the principles employ geography or physical territory does not fit in the age of e-commerce.

The second challenge goes to the nature of digital products. E-commerce introduced us to digital products, which are quite different from the products in the conventional business. The digitalization of products enables goods to lose their physical appearance. This inevitably renders the current tax system applicable to physical goods irrelevant in the context of e-commerce.[75] The

[72]Rifat, Supra Note at 67, P.7.
[73]Aschalew Ashagre, Supra Note at 70, P.112.
[74] Ibid.
[75] Hinnekens, Luc, The Challenges of Applying VAT and Income Tax Territoriality Concepts and Rules to International Electronic Commerce, Intertax, 26(2), 1998, PP.52-70

challenges of e-commerce to VAT are significant and are not something to be compromised because VAT generates over a quarter of the world's tax revenue.[76] Therefore, this sort of tax must be maintained at all costs and countries need to restructure their tax system in a way it is aligned with the digital economy.[77]

Summary

Commercial activities can be either domestic or international. Those businesses or individuals who engage in domestic trade activities will be simply governed by domestic tax laws that are enacted by the legislators of each state. However, it is sometimes difficult to govern international commerce using domestic tax laws since there is an involvement of a foreign element that may not want or be satisfied by the domestic tax laws of a given country. This makes the existence of international tax rules mandatory. Nevertheless, unlike the domestic tax rules, international tax rules are not simple to be made since each state is a sovereign entity in its jurisdiction. As a result, international commercial activities might be prone to double taxation by two jurisdictions, which might discourage international investment and trade, or to tax evasion or avoidance (using tax planning and transfer pricing), which may result in huge revenue loss by governments. Both are unnecessary things for the fairness and progress of the world.

In order to curb these problems, a lot of steps have been taken by states including unilateral and multilateral actions though these steps are far from satisfactory yet. Unilaterally, the legislators of almost all states have included legal provisions that are meant to reduce double taxation on international trades and tax evasion and avoidance mechanisms. To reduce double taxation, these provisions try to put conditions that must be fulfilled so as to fall under the jurisdiction of that state absence of which will exclude that individual or firm from the tax liability of that state. Again to avoid tax evasion and avoidance, they incorporate transfer pricing and anti-tax avoidance and anti-tax evasion rules on those international businesses. Despite the efforts, it was clear that domestic legislation wouldn't effectively address all the challenges that arise from cross-border trade.

[76] Ibid.
[77] Ibid.

Hence, States resorted to international tax laws for better regulation of cross border commerce. Just like any international matter, an international tax law that is supposed to govern international commerce might emanate from custom, treaty, and judicial decisions, general principles of law or the writing of scholars. Among the above, only the first two and especially the first one is the best and the most used source of international tax law. So far more than 3,000 bilateral double tax avoidance treaties have been sighed by various countries. Bilateral treaties are prevalent due to the difficulty of having a common multilateral treaty. However, this does not mean that there are no multilateral treaties since there are regional multilateral treaties such as the Nordic Tax Convention, the Caribbean Community Multilateral Double Taxation Agreement, and the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS. However, these treaties have limited applicability to small geographical areas which makes them inapplicable worldwide.

Despite several attempts to reach a consensus on having treaties that will prevent double taxation and base erosion and profit shifting, the international tax system remains highly unfair, full of legal gaps resulting in the loss of huge revenue by many countries. This challenge is becoming exacerbated due to the digitalization of the world economy which made taxing cross-border transactions using the traditional permanent establishment principle ineffective.

Review Questions

1. Explain the mechanisms used by countries to avoid double taxation problems
2. One of the methods used to prevent transfer pricing on cross-border transactions is an arms-length principle. Expound this principle and its effectiveness
3. One of the mechanisms applied currently are the Base Erosion and Profit Shifting Rules as enacted y the OECD. However, it is criticized by many as unfair. Explicate those criticisms
4. Analyze the legal provisions provided by the Ethiopian Income tax proclamation to reduce double taxation and tax avoidance and the strengths and limitations of those provisions in tackling those challenges.
5. Discuss the dispute settlement mechanisms available to solve international tax disputes.

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