

THE ETHIOPIAN INCOME TAX SYSTEM: POLICY, DESIGN AND PRACTICE

by

TADDESE LENCHO GEMECHU

JAMES BRYCE, COMMITTEE CHAIR

ALAN S. SCHENK

KYLE D. LOGUE

EDWARD J. SCHNEE

KENNETH ROSEN

A DISSERTATION

Submitted in partial fulfillment of the requirements
for the degree of Doctor of Philosophy
in the Department of Interdisciplinary Studies
in the Graduate School of
the University of Alabama

TUSCALOOSA, ALABAMA

2014

Copyright Taddese Lencho Gemechu 2014

All RIGHTS RESERVED

ABSTRACT

Ethiopia used income taxes as one of the principal sources of domestic government revenue since the beginning of modern taxation in the 1940s. The Ethiopian income tax system is “schedular” in structure and orientation, the computation, assessment and collection of income taxes based on some identified sources of income, like income from employment, income from rental of property and income from business.

The basic aim of this dissertation is to turn a critical attention to the design and structure of the income tax schedules and test whether the schedules, as they are currently designed, are adequate instruments for achieving the fundamental tax policy goals of Ethiopia. The dissertation uses the four schedules (identified by alphabets “A,” “B,” “C” and “D”) of the “main” income tax system of Ethiopia to test whether the schedular design of the Ethiopian income tax system is adequate for achieving the fundamental aims of equity and administrability.

The main finding of the dissertation is that the existing income tax schedules are riddled with a number of gaps as to make them inadequate instruments of the fundamental goals of tax equity and administrability. The basic principles of both horizontal and vertical equity are often observed in their breach both in the income tax laws of and the practice of income taxation in Ethiopia.

Drawing upon the numerous cases of discrimination among different categories of taxpayers and sources of income, the dissertation calls for a serious rethinking of the schedular income tax system of Ethiopia. In rethinking the schedular income tax structure of the Ethiopian income tax system, the dissertation recommends two pathways of income tax reform for Ethiopia: the

internal reorganization of the income tax system of Ethiopia, which maintains the schedular orientation of the income tax system but requires “internal” changes on a number of levels; and the complete overhaul of the schedular income tax system in light of the alternative models of income taxation developed both in the theoretical literature and the practice of income taxation in both developed and developing income tax systems of the world.

DEDICATION

I dedicate this dissertation to my loving mother, Adde Dadho Kaba, and the memory of my late father, Obbo Lencho Gemechu

LIST OF ABBREVIATIONS

AACCSA – Addis Ababa Chamber of Commerce and Sectoral Associations

AFTZ - African Free Trade Zone

AU – African Union

BBC – British Broadcasting Service

COMESA - Common Market for East and Southern African States

CSA – Charities and Societies Agency

CTB – Comprehensive Tax Base

DHL –Dalsey, Hilblom and Lynn (DHL Worldwide Express)

DSTV – Digital Satellite Television

DTTs – Double Taxation Treaties

EOC – Ethiopian Orthodox Church

EPRDF – Ethiopian Peoples’ Revolutionary Democratic Front

ERCA – Ethiopian Revenues and Customs Authority

ESIC – Ethiopian Standard Industrial Classification

ETB – Ethiopian Birr (Currency)

EU – European Union

FBT – Fringe Benefits Tax

FIRA – Federal Inland Revenue Authority

GDP – Gross Domestic Product

GTP – Growth and Transformation Plan

IBFD – International Bureau of Fiscal Documentation

IGAs – Income Generating Activities

IMF – International Monetary Fund

IRS – Internal Revenue Service

MFA – Ministry of Federal Affairs

MoFED – Ministry of Finance and Economic Development

NLA – National Lottery Administration

OAU – Organization of African Unity

OECD – Organization for Economic Cooperation and Development

OHADA - *Organisation pour l'Harmonisation du Droit des Affaires en Afrique*

PASDEP - Plan for Accelerated and Sustained Development to End Poverty

PAYE – Pay-as-you-Earn

PRSP – Poverty Reduction Strategic Program

SADC – South African Development Community

SARS – South African Revenue Service

SDPRP - Sustainable Development and Poverty Reduction Program

SHS – Schanz-Haig-Simons

SIGTAS - Standard Integrated Government Tax Administration System

SNNPRS – Southern Nations, Nationalities, and Peoples’ Regional State

TGE – Transitional Government of Ethiopia (1991-1994)

TIN – Tax Identification Number

UK – United Kingdom

UN – United Nations

UNECA – United Nations Economic Commission for Africa

U.S. – United States

USA – United States of America

VAT – Value Added Tax

WTO – World Trade Organization

WWWII – World War Two

NOTE ON TERMINOLOGIES

E.C. – Ethiopian Calendar is the official calendar of the Government of Ethiopia based on old Alexandrian or Coptic calendar. It begins the year on August 29 or 30 in the Julian calendar. There is a seven-to-eight years’ gap between the Ethiopian calendar and the Gregorian calendar. The year 2013 is, for example, 2005 E.C. (from January to August) and 2006 E.C. (from September to December).

The Ethiopian calendar has twelve 30-day months and a thirteenth month “Pagume” having six days in the leap year and five days in other years. The months in Amharic are *Meskerem* (roughly September), *Tikimt* (October), *Hidar* (November), *Tahsas* (December), *Tir* (January), *Yekatit* (February), *Megabit* (March), *Miazia* (April), *Ginbot* (May), *Sene* (June), *Hamle* (July), *Nehassie* (August), and *Pagume*.

Negarit Gazeta – is the name of official publications for principal legislations of the Federal Government and some Regional States of the Ethiopian Federation

Megeleta Oromia – is the name of official publications for principal legislations of the Oromia Regional State

Proclamation (*Awaj* in Amharic) – is the name of principal legislation approved and passed by the Ethiopian Parliament (the House of Peoples’ Representatives) or an equivalent legislation approved and passed by the Regional Government Councils.

Regulations (*Denb* in Amharic) – is the name of derivative legislation approved and passed by the Council of Ministers under the authority given in Proclamations

Directives (*Memeriya* in Amharic) – is the name of derivative legislations passed by ministries or other government agencies under the authority given in Proclamations or Regulations

Guidance Letters (or *Mabrariya* in Amharic) – is a loosely used expression for letter rulings issued by Ministries or other Government Bodies (in the case of taxes, mainly Ministry of Finance and Economic Development and Ethiopian Revenues and Customs Authority)

ACKNOWLEDGEMENTS

Writing is at once the most solitary and most social of human activities. One must sit alone to write, but behind every piece of writing, there are hundreds and perhaps thousands of unacknowledged contributors. For every footnote that acknowledges a particular writer, there are perhaps ten others whose presence is felt in every line of writing. While it is futile to fill pages after pages with names, one would be an “ungrateful biped” (to borrow from Dostoevsky) if one did not mention the few whose contribution during the writing of any piece is significant.

I am very grateful to Professor Jim Bryce, my advisor, for encouraging me all the way from the initiation of the project to the last chapter. He was always magnanimous with his time and words. I am also deeply grateful to Professor Norman Singer, who brought the PhD program to our doors and encouraged all of us to pursue in our areas of interest, instead of some pre-packaged PhD that fits the program. I was able to write on a subject that was closest to my professional and academic background largely because of his hands off policy on the writing of the dissertation. For whatever it is worth, the content of this PhD dissertation is what it is because of his policy. His incredibly intimate knowledge of Ethiopia allowed most of us the space we needed to write about the problems of Ethiopia.

This work has been made possible by the support provided by well-wishing friends across the Atlantic and the Pacific. Across the Atlantic, Professor Kyle Logue, my former professor at University of Michigan Law School, Ann Arbor, brought me a number of books on public finance, taxation, and tax policy providing me with much needed theoretical framework for the writing of this work. Across the Pacific, Professor Miranda Stewart, from the University of Melbourne Law School, provided me with a number of her personal books and collections for

me to put to use in the writing of this dissertation and other scholarly publications over the years. It was my friend, Dr. Jennifer Beard, from the same University, with whom I had the good fortune to meet here in Ethiopia, who brought me into contact with Professor Stewart. I am immensely indebted to both of them. I am also grateful to Fer D'Arnaud, from Amsterdam, for providing me with some European income tax materials. The trans-Atlantic-Pacific gestures of goodwill have a lot to do with the shaping of some of the ideas reflected in this dissertation.

Most of the government documents and communications used in this dissertation are not available in public domain. Many a finding and many more a conclusion in this dissertation depended, like a flip of a coin, upon the discovery of a government letter. I am deeply grateful to all officials of the Ethiopian government for providing me with access to documents and giving me their time to sit for interviews. I am particularly grateful to Ato Wasihun Abate (from the Ministry of Finance and Economic Development), Ato Nebiyu Samuel, Ato Mekonnen Ayele, Ato Mamo Abdi, Ato Eshetu Woldeamayrat, Ato Shimelis Abebe, Ato Eshetu Atlaw, W/ro Tsion Admassu, W/ro Tewedaj Sima, Ato Yonas Argaw, Ato Girma Cherinet, Ato Girma Tafesse, Ato Asfawosen Alene, Ato Girma Balcha, Ato Gebrelibanos W/Aregay, Ato Mekonnen Dereje, Ato Yohannes Gizaw, W/ro Roman Menberu (all from ERCA in Addis Ababa), Ato Dawit Teshome (from the Federal Tax Appeal Commission), Obbo Lammessa Likki, Obbo Abdissa Dhufera, Obbo Lalisa Badhasa (from Oromia Revenues' Bureaus), Ato Sewagegn Gedifew and Ato Getachew Mesfin (from Amhara Regional State ERCA and Revenues' Bureaus), Ato Tibebe Mengistu (Tibebe Mengistu & Co Consulting), Ato Solomon Gizaw and Ato Getu Jemaneh (HST Consulting), Ato Woldegebriel Naizghi and Ato Reta Alemayehu (former members of the Tax Authorities).

I am also grateful to the Ethiopian Justice and Legal Research Institute and the DLA Piper Foundation for providing me with funds in order to collect information and write this dissertation. And, in retrospect, I am grateful to the numerous friends of mine who kept reminding me through the years that the dissertation needed to be written. For a while “How is your PhD going?” became a new form of greeting for me. At times, I resented that reminder as it recalled to me about a job undone. But that also provided me with the courage to get it done and put those nagging questions behind me. I missed the simple, uncluttered greetings of good old times.

Finally, I am grateful to a place: the Graduate Library, which provided me with the ambience for writing most of the chapters of this dissertation. That library truly fulfilled the role of linking “ink and page” (in my case, keyboards and computer screens), as Philip Larkin wrote in his immortal ode to a library. It is in this library that I found the company of fellow toiling students comforting enough to get through the drudgery of writing a PhD dissertation. The library was certainly a more auspicious place than the comfort of cigarettes and ashtrays in a claustrophobic room with papers strewn around.

CONTENTS

ABSTRACT	ii
DEDICATION	iv
LIST OF ABBREVIATIONS	v
NOTE ON TERMINOLOGIES	viii
ACKNOWLEDGEMENTS	x
LIST OF TABLES	xx
INTRODUCTION	
I. Background	1
II. Objective of the Study	13
III. Research Questions	14
IV. The Scope of the Study	16
V. Research Methodology	20
VI. Limitations of the Study	27
VII. Synopsis of the Chapters.....	31
CHAPTER ONE	
GENERAL THEORIES AND PRINCIPLES OF TAXATION: REVIEW OF THE LITERATURE	
I. The General Goals of Taxation	35
II. Criteria for Design of Taxes and Tax Structures: General Principles of Taxation	41
a. Equity	46
b. Efficiency	76
c. Administrative Feasibility	80

d.	Neutrality	83
e.	Certainty	85
f.	Simplicity	86
g.	Other Principles	92
III.	Multiple Goals and Principles: Interaction, Conflicts and Implementation	94

CHAPTER TWO

ETHIOPIAN TAX POLICY: SOURCES, FUNDAMENTAL GOALS AND PRINCIPLES

I.	Introduction	98
II.	Principal Sources of Tax Policy in Ethiopia	100
a.	General Policy Documents	101
b.	The Ethiopian Constitution	107
c.	Tax Laws of Ethiopia	109
III.	The Four Fundamental Goals of the Ethiopian Tax System	109
a.	Raising Revenues	110
b.	Economic Development	117
c.	Tax Equity	120
d.	Modernizing the Tax System and Tax Administration	122
IV.	Major Principles of Taxation in the Ethiopian Tax Systems	127
a.	Equity	129
b.	The Recognition of other Principles of Taxation in the Ethiopian Tax System	144
V	Summation: The Challenges of Tax Policies and Principles in Ethiopia	168

CHAPTER THREE

THE INCOME TAX: DESIGN AND STRUCTURES

I.	Design of Alternative Tax Bases	171
a.	Introduction	171
b.	The Comprehensive Income Tax Model	172
c.	The Dual Income Tax Model	172
d.	The Semi-Dual (Unstructured) Income Tax Model	173
e.	The Flat Tax Model	174
f.	The Expenditure (Direct Consumption) Tax Model	178
II.	The Concept of Income	180
a.	The Economic Meaning of Income: The Schanz-Haig-Simons' Comprehensive Tax Base and Its Critics	180
b.	The Concept of Income in Different Legal Traditions	185
c.	The Schanz-Haig-Simons' Comprehensive Income Tax Base and some Departures in actual Tax Systems	191
III.	The Structures of Income Tax Systems: a Comparative Overview	200
a.	Global and Schedular Income Tax Structures in General	200
b.	Global Income Tax Structures: Country Examples	208
c.	Schedular Income Tax Structures: Country Examples	212

CHAPTER FOUR

GENERAL INTRODUCTION TO THE ETHIOPIAN INCOME TAX SYSTEM

I.	Introduction	247
a.	Agricultural Income Tax Systems	252
b.	Petroleum and Mining Income Tax Regimes	254

c.	The Main Income Tax System	255
II.	The Concept of Income in the Ethiopian Income Tax System: The Comprehensiveness of the Notion of “Income” and Its Limitations	259
a.	The Legal Notion of Income	259
b.	Limitations on the “Comprehensiveness” of the Notion of Income	261
III.	General Features of Ethiopian Income Tax Schedules: the Mutual Exclusivity of the Schedules and Sources	268
a.	Separate Income Tax Bases	272
b.	Exclusive Income Brackets and Tax Rate Structures	273
c.	Computation of Taxable Incomes	278
d.	Income Tax Preferences	280
e.	Modes of Assessment	282
f.	Rules of Income Aggregation	283

CHAPTER FIVE

SCHEDULE “A”: EMPLOYMENT INCOME TAX

I.	Introduction	286
II.	Problems of Delimiting the Scope of Schedule “A”	291
a.	The Notion of “Employment” in the Ethiopian Income Tax Laws	291
b.	The Nature and Source of Disputes	293
c.	Delimiting the Scope of “Employment” in Practice: Distinguishing “Employee” from “Contractor”	297
d.	Delimiting the Scope of “Income from Employment” from “Income from Sources other than that of Independent Contract of Services”	312

III.	Application of Employment Income Tax from Multiple Employments and on Employees of Organizations Enjoying Diplomatic Immunity	319
a.	Aggregation by Employers in Practice	321
b.	Employee Self-Assessments in Practice	325
IV.	The Treatment of Employment Fringe Benefits under Ethiopian Income Tax Laws	335

CHAPTER SIX

SCHEDULE “B”: TAXATION OF INCOME FROM RENTAL OF BUILDINGS

I.	Introduction	342
II.	The Scope of Schedule “B”: the Law	343
III.	The Scope of Schedule “B”: Schematic Representation of Taxation of Income from Rentals in Practice	347
IV	Practical Problems and Challenges surrounding Schedule “B” Income Tax	352
a.	Splitting of Income	352
b.	Differences in Deduction Rules	354
c.	Allocation of Expenses	357
d.	Constitutional Jurisdiction Issues arising over Schedule “B” vs. Schedule “C” Income Tax	359
V.	Should Schedule “B” be Separate?	362

CHAPTER SEVEN

SCHEDULE “C”: TAXATION OF INCOME FROM BUSINESS AND PROFESSIONAL ACTIVITIES (BUSINESS INCOME TAX)

I.	Introduction	368
II.	Delimiting the Scope of Schedule “C” vis-à-vis the other schedules of Ethiopian Income Tax Law	371
III.	Defining the Scope of “Trade” or “Business” for Income Tax Purposes	374

a.	The Notion of Trade in the Commercial Code of 1960	375
b.	The Notion of Trade in the New Ethiopian Standard Industrial Classification (ESIC)	378
c.	The Notion of Trade or Business in the Income Tax Law	381
IV.	The Scope of “Income from Business”: the Primacy of other Schedules on Some Sources of Income for Businesses	399
a.	The Enigma of Article 7 Income Tax: “Business Lease” and “Income from Business Lease”	405
V.	Aggregation of Income from Multiple Businesses: Problems of the Law and Challenges in Practice	413
a.	The Legal and/or Practical Exceptions for Category C Businesses	415
b.	The Un-traceability of Businesses by Related Persons	418
c.	The Constitutional Hurdles to Aggregation of Income from Businesses located in several Regional States	419

CHAPTER EIGHT

SCHEDULE “D” – TAXATION OF MISCELLANEOUS INCOME

I.	Introduction	422
II.	Defining the Scope of Schedule “D”	425
III.	Schedule “D” Income – Miscellaneous Income	428
a.	Withholding Tax on Royalties – Article 31	428
b.	Withholding Tax on Income from Technical Services Rendered Abroad – Article 32 ...	445
c.	Withholding Tax on Income from Games of Chance – Article 33	452
d.	Withholding Tax on Dividends – Article 34	459
e.	Taxation of Income from Casual Rental of Property – Article 35	482
f.	Withholding Tax on Interest from Bank Deposits – Article 36	492

g.	Taxation of Capital Gains from Transfer of Investment Property – Article 37	498
h.	Windfall Profits Tax – 2010 Income Tax Amendment Proclamation	507
IV.	Tax Rate Differentials under Schedule “D” Income Tax	510
CHAPTER NINE		
CONCLUSION AND RECOMMENDATIONS		
	Conclusion	514
	Recommendations	520
	BIBLIOGRAPHY	551
	APPENDIX	574
	Questionnaires	574

LIST OF TABLES

Table 2.1 – Real GDP Projection Annual Growth Rate during the GTP Period (2010/11 – 2014/15).....	103
Table 2.2 – Tax-to-GDP Ratio Growth during the GTP Period (2010/11 – 2014/15)	111
Table 2.3 – Projected GTP Revenue Requirements (in Mil ETB)	112
Table 2.4 – Growth of Government Revenue and Tax-to-GDP Ratio from 2005/06 to 2009/2010.....	115
Table 2.5 – Revenue Collection by Major Tax Types (2005/06 – 2009/10)	116
Table 2.6 – Income Tax Brackets and Tax Rates for Schedules A, B, and C	138
Table 3.1 – Dual Income Tax Structures of Four Nordic Countries (2004)	222
Table 3.2 – Income Tax Structures of Seven African Countries.....	238
Table 4.1 – The Constitutional Assignment of Major Income Tax Sources.....	248
Table 4.2 – Income Tax Brackets and Tax Rates for Schedule “A”	276
Table 4.3 – Income Tax Brackets and Tax Rates for Schedules “B” and “C”	277
Table 4.4 – Income Tax Rates for Schedule “D” (Miscellaneous) Income	277
Table 5.1 – Income Tax Withholding under the Schedules of Ethiopian Income Tax.....	296
Table 5.2 – Comparison of Withholding Practices on Sample Payments in Three Higher Education Institutions (HEIs) of Ethiopia.....	299
Table 5.3 – Treatment of Some Employment Fringe Benefits in Three African Countries.....	338
Table 6.1 – Taxation of Rental Income under Different Scenarios	348
Table 6.2 – Tax Burden Differentials between Sole Proprietor Real Estate Businesses	353
Table 6.3 – Constitutional Division of Revenue Powers over Real Estate Income.....	361

Table 7.1 – Schematic Representation of Income Taxation of a Sole Proprietor Business Owner under the Schedular Income Tax System of Ethiopia.....	401
Table 8.1 – Tax Rates and Modes of Assessment for Schedule “D” (Miscellaneous) Income.....	426
Table 8.2 – Withholding Practices on Certain Payments in Two Theatre Halls in Addis Ababa	442
Table 8.3 – Taxation of Various Types of Interest Income.....	495
Table 8.4 – Tax Treatment of Gains from the Transfer of Capital Assets under the Current Income Tax Regime of Ethiopia.....	500

INTRODUCTION

I. Background

The modern income tax system of Ethiopia began in full earnest in 1944 when the first income tax law was issued to levy tax on income of individuals and businesses. The first income tax law was schedular in approach as have successive income tax laws issued over the years. Ethiopia issued its first income tax law at a time when it had special political relationships with Great Britain, and its schedular income tax structure was borrowed from the British tradition of taxing income by schedules or sources. Although the relationship between Ethiopia and Great Britain has changed considerably a decade after the introduction of the income tax in Ethiopia, the legacy of the British income tax structure has remained with Ethiopia to this day.

The contents of the “schedules” of Ethiopian income tax have changed through successive income tax reforms in Ethiopia. Some of the original schedules have either completely disappeared or been replaced by others, while some of the schedules have retained their original contents. In spite of these, Ethiopia’s contract with the “schedular” approach to income taxation has continued unabated. Not even the comprehensive income tax reforms of 2002 could alter this trajectory of Ethiopian income tax system. To the extent the Ethiopian income tax system became the object of criticism over this period, critics have seldom griped about the structure of income taxation in Ethiopia. While critics have questioned the income tax base of Ethiopian income tax system on account, for example, of its narrow income tax bases, they appear to have

accepted the “schedular” approach to income taxation and the contents of the schedules as the best way to levy and administer income taxation in Ethiopia.¹

The Ethiopian income tax system at the moment consists of a collection of income tax laws. The so-called “main” income tax system consists of four schedules, identified by alphabets: A, B, C and D. Schedule “A” of Ethiopian income tax system charges “income from employment”; Schedule “B” “income from rental of buildings”; Schedule “C” “income from business” and Schedule “D” “miscellaneous income”. Apart from the main income tax system, Ethiopia has issued largely autonomous income tax laws for “income from petroleum activities”; “income from mining activities” and “income from agricultural activities”. Of the income sources chargeable with tax in Ethiopia at the moment, only the agricultural income of farmers and cooperatives can be said to be thoroughly decentralized to the Regional Governments. The other income sources are administered by both the Federal and Regional Governments. Both the Federal Government and the Regional States have issued their own income tax laws in respect of income sources reserved to each respectively by the Ethiopian Constitution, although almost all of them are modeled upon the Federal Income Tax Law issued in 2002. The diversity of income tax laws as well as the sources upon which income tax is levied in Ethiopia compels one to conclude that Ethiopia does not really have an “Income Tax” in the strict sense of the expression but a collection of loosely connected “income” taxes most of which are found conveniently in one body of legislation.

¹ In this regard, see, Eshetu Chole, *Towards a History of the Fiscal Policy of the Pre-Revolutionary Ethiopian State*, pp. 71-72; Eshetu Chole, *Income Taxation in Pre- and Post-Revolution Ethiopia*, pp. 50-77; Teshome Mulat, *Some Properties of the Ethiopian Personal Income Tax*, pp. 78-103

The Ethiopian income tax system has gone through a series of tax reforms through the years. Many of these tax reforms were spawned by the changes in government and the resultant changes in public policy in general and tax policy in particular. Although sustained debates about fiscal policy in general and tax policy in particular particularly in academic circles are hard to come by, many of the changes in income taxation in Ethiopia were the product of the need to bring the income tax laws of Ethiopia in line with the public policies of the governments in power. Taxation, along with land tenure, provided a prominent backdrop to some of the major political upheavals Ethiopia experienced in its recent history. The 1974 Ethiopian Revolution, which marked the end of the semi-feudal and semi-capitalist imperial system of Ethiopia and ushered in a socialist-military government, brought about some major changes in land tenure and the taxation system of the country. The end of the military rule in 1991 resulted in major changes in tax policy as a result of the adoption by the country of liberal economic policies.

The Ethiopian income tax system has gone through a number of changes over the years as a result of economic and political changes in the country. The simple, standardized presumptive business income tax of the early years has given way to a more self-assessment based business income tax system of modern times, with the presumptive income tax regime relegated to serve primarily small businesses. The income brackets and tax rates have changed quite a number of times. Income tax bases that were once exempted (e.g., capital gains and interest on bank deposits) are now subject to income tax. The Ethiopian Governments, particularly in recent times, have shown willingness to expand the income tax to bases that were not contemplated before (e.g., the recent income tax on so-called windfall profits).

The administrative aspects of Ethiopian income tax have also improved quite considerably particularly in recent times, aided in part by technological changes and successive income tax administration reforms (e.g., the introduction of the TIN for all taxpayers and the use of sales register machines). In spite of these changes, however, it appears that the more many things change about the Ethiopian income tax system, the more one aspect of it remains the same: its schedular approach. Indeed, the schedular features of Ethiopian income tax can be said to be the one “constant” throughout the modern history of income taxation in Ethiopia.

Not only has its schedular approach remained virtually unchallenged, the contents of the schedules have also changed very little over the years. Like all schedular income tax systems in the world, the Ethiopian income tax system determines income tax liability by the schedules or sources under which a given income falls. The numbers as well as contents of schedules vary from one country to another, as it is to be expected. Some sources of income are commonly targeted for individual schedules (e.g., income from employment is treated differently in many income tax systems, including the so-called global income tax systems). Nonetheless, it remains to be the case that every country has its own “quirky” or “peculiar” way of designing schedules for various sources of income. Ethiopia is no different.

Some of the sources of income have always been charged with income tax from the very beginning of modern income taxation: income from employment and income from business. Some of the sources of income came into and out of the income tax system at various times (e.g., income from rental of buildings was a subject of income taxation before 1975 and after it was removed from the income tax base following the 1974 Ethiopian Revolution, it was reintroduced as subject to tax after 1993). The current Schedule “D” of Ethiopian income tax was introduced

with its current content in 1978 and has since then been used by Ethiopian governments to target various sources of income: hence its name “miscellaneous” or “other” income. It has now become a schedule into which newly discovered sources of “income” are added from time to time. The most recent addition of so-called “windfall profits” in 2010 is an example of this role of Schedule “D”: a receptacle for newly discovered forms of income.

Ethiopian public discourse is dominated by the discussion of various public policies. The current Ethiopian government in particular has shown tremendous gusto for articulating various public policies in all aspects of Ethiopian life. Tax policies are constantly in the news, although the Ethiopian Government (despite its reputation in this regard) has never issued a separate policy document with respect to taxation. The academic debate regarding the role of tax policy is meager in Ethiopia, which presumably accounts for the disconnect between the tax policies that are found in various public documents and actual income tax practice. For example, little has been written about the relationship between tax policies of Ethiopia and its income tax laws, including the current schedules of Ethiopian income tax system. Ethiopia’s tax policies are found in various public policy documents, including the Ethiopian Constitution and its various tax laws, but the extent to which these public policies (tax policies) provide a backdrop to actual income tax practice is a matter of some debate. It can be deduced from the structure of Ethiopia’s income tax structure, for example, that administrative feasibility is the bedrock of Ethiopian income tax policy or at least the principle that informs much of the structural arrangement of Ethiopian income tax system, but how far this principle actually informs and the extent to which it justifies the current arrangement of Ethiopian income tax system is not clear.

It can similarly be argued that “tax equity” is one of the principles of Ethiopian income taxation, but the income tax structure as well as practice of income taxation has never been critically examined in light of this norm of “tax equity.” The main income tax laws of Ethiopia contain a number of provisions that appear to advance the demands of “tax equity” in its literal or conventional sense. The Ethiopian income tax laws appear to incorporate the requirements of both horizontal and vertical tax equity by imposing progressive income tax rates upon the major sources of income of individuals: from employment, rental of buildings and businesses. The income tax brackets for these sources of income are also outwardly uniform, which appears to indicate that “tax equity” is accepted as a norm in the Ethiopian income tax system. There are also provisions that require aggregation of income from several sources falling under the same schedule for purposes of computation of income tax liability. All these features of Ethiopian income tax system appear to corroborate the argument that “tax equity” is recognized as a policy in the Ethiopian income tax system.

In contrast, there are many aspects of the Ethiopian income tax system which appear to contradict the requirements of tax equity. The Ethiopian income tax system has rules for achieving the requirements of tax equity among employees (up to an extent at least) but not necessarily between employees and traders, or between traders and real estate owners, or between employees, traders and real estate owners, or between employees and shareholders, etc. In some instances, the Ethiopian income tax system does not even pretend to maintain the outward pretense of ensuring tax equity. It applies tax rate differentials among different sources of income. This is particularly the case with regard to the sources of income currently chargeable with tax under Schedule “D.” Royalties are subject to 5% final withholding tax rate; income from technical services and dividends are subject to 10% final withholding tax rate; income from

games of chance and income from casual rental of property are subject to 15% final tax rate. Capital gains taxes, which are currently limited to shares and buildings held for business, charge gains at 30% and 15% tax rates respectively.

Furthermore, despite the intention to reach all sorts of “income” “from whatever source derived,” to use the language of the income tax law, many sources of income are currently un-taxable not because they are exempted but because the current schedules of Ethiopian income tax system lack provisions to capture all forms of “income.” One can mention several sources of income that are currently un-taxable under Ethiopian income tax laws. The tax authorities have found their hands tied even on items that are clearly within their reach largely because of lack of rules that capture all sorts of income as the broad definition of “Income” in the Income Tax Proclamation would have us believe. One of these items is the payments the tax authorities occasionally make to “informants” of tax evasion and tax fraud. The absence of all encompassing schedule to capture manifold items of income has significant implications upon the equitability of the Ethiopian income tax system. It can be argued that the design of the Ethiopian income tax is largely responsible for this state of affairs.

Another aspect of design of the Ethiopian income tax system which casts doubt over its capacity to achieve tax equity relates to significant differences that exist among the schedules in terms of tax reliefs and deductions. As in many other income tax systems, deductions of employment related expenses are proscribed for the ease of administration final withholding taxes on income of employees. But there are times when deductions are allowed but for some mysterious reasons, the rules of deductions are different as to create unjustified differences in income tax burdens based purely on the accident of the sources of income. The rules of deductions of

expenses for Schedule “B” taxpayers are different from those of Schedule “C” taxpayers. These differences have led to significant differences in the treatment of income taxpayers under the various schedules of Ethiopian income tax system.

As a result of the regimentation of the schedules of Ethiopian income tax system, some taxpayers are forced to split their income for purposes of income taxation although for all other purposes (business organization and accounting) their activities are one and the same. The businesses that are at the moment forced to split their income are those involved in real estate business. Under the current structure of Ethiopian income tax, a realtor involved in the business of constructing and selling and renting buildings is forced to split income from selling of buildings (which is currently subject to income tax under Schedule “C”) from that of rental of buildings (which is currently subject to income tax under Schedule “B”). Similarly, enterprises engaged in lease of buildings on the side are required to report their income from lease of buildings separately from the income from their main business. This organization of the Ethiopian income tax imposes extra burdens of compliance upon these types of taxpayers besides exposing the income tax to all sorts of tax avoidance manipulations. These features of Ethiopian income tax have serious ramifications upon the equitability and administrability of the income tax system.

Like all schedular income tax systems, Ethiopian income tax practice has given rise to significant differences of opinion about the scope of individual schedules. There are significant overlaps among the schedules of Ethiopian income tax. There are considerable ambiguities regarding the scope of each schedule of the income tax law. These overlaps are the product of ambiguities in the language of the income tax laws and lack of familiarity with how the income tax is

structured. While the income tax structure is often justified by appeals to administrative simplicity, the controversies regarding the scope of individual schedules have given rise to significant administrative complications in the implementation of the income tax system of Ethiopia. The real differences in income tax burdens resulting from the characterization of income have complicated the business of income tax administration. They are also a source of considerable inequity in the administration of the tax system upon various groups of income taxpayers.

Ethiopia, like most developing countries, received its income tax system from other countries. It can be clearly seen, for example, that its income tax structure was heavily influenced by the British tradition of taxation by schedules. While some aspects of Ethiopian income tax system were the product of an organic growth of the income tax system in response to “Ethiopian” realities, much of the income tax system shows signs of a heavy influence of outside forces, whether these forces came from the UK at the beginning or the IMF technical assistance, as was the case in the recent tax reforms of the country.

In spite of these outside influences, there is very little discussion about what (if any) Ethiopia should learn from the income tax structures of other countries, whether these countries belong to one or another camp of income tax systems. This is a little surprising in view of the fact that Ethiopia shopped all over the world for developing its modern legal system over the last seven decades. It is well known that Ethiopia adopted most of its modern legal codes from the continental legal systems. It is also known that Ethiopia took some of its laws from the common law legal systems (e.g., Its Civil Procedure Code was modeled after the Indian Civil Procedure

Code).² Ethiopia's tax laws were received from all over the place: the income tax structure mainly from Great Britain, the VAT was modeled after the EU VAT Directive. In its reception of modern laws, it can be seen that Ethiopia had an eclectic taste. In spite of this, there is very little research on the lessons of comparative law for formulating and shaping the course of legal transplantation in taxation.

In view of the history of legal transplantation in Ethiopia, the role of comparative taxation in understanding, situating and reorganizing the Ethiopian income tax system cannot be underestimated. While it is by no means necessary to imitate other income tax structures in order to carry out meaningful structural reforms in the Ethiopian income tax system, comparative research has a lot to offer in terms of the options that exist out there and in playing down fears for undertaking meaningful income tax reforms.

Given the administrative limitations and constraints of Ethiopian tax administration, it is difficult to take issue with the path Ethiopia took in picking up the schedular income tax over its global counterpart. On the surface, nothing is more plausible than this. Indeed, those who wish to maintain the *status quo* are likely to argue in their defense that this is the structure that Ethiopian tax administration can afford to implement. However, while it may be too early to call for a complete overhaul of the schedular approach in some of its aspects, there is reason to believe that the Ethiopian income tax structure in its current arrangement is no longer justified. A number of developments in the organization of Ethiopian tax administration point to the reform of the income tax structure at least in some respects. These developments include:

² See Vanderlinden, *Civil Law and Common Law Influences on the Developing Law of Ethiopia*, p. 253

- i) The recognition by the income tax system of Ethiopia to take extra administrative measures to ensure tax equity.
- ii) The reorganization and revamping of Ethiopian tax administration; and
- iii) The movement towards the globalization of income taxation in many erstwhile schedular income tax systems, including some of the African countries.

i. *The Recognition of Tax Equity*

Ethiopian income tax laws recognize the need to ensure tax equity in many of their provisions. The only question is whether Ethiopia has carried these equity concerns far enough? Ethiopian income tax rules accept the role of a progressive income tax rate structure for three of the Schedules: A, B, and C, which implies that the principles of both horizontal and vertical equity are recognized in the income tax system, up to an extent. There are also rules in the income tax laws (although there are problems of enforcement in practice) that require aggregation of “income from employments” when employees generate income from multiple employments. There are similar rules for traders. The three schedules out of four (A, B, and C) have uniform income brackets and tax rate structures, which suggests that the income tax reformers took care not to enforce differential income brackets and tax rate structures among the different schedules of Ethiopian income tax. If the Ethiopian income tax laws take pains to enforce progressive income tax rates, legislate the need for aggregation from multiple transactions and apply uniform income brackets and tax rate structures, why is it difficult to extend these concerns further and ensure aggregation of income from sources falling under multiple schedules and achieve uniformity of income tax treatment among the different forms and sources of income?

ii. *The Reorganization and Revamping of Ethiopian Tax Administration*

Ethiopian tax administration is not what it was when the current schedules were established. A number of recent tax reforms within the tax administration suggest that Ethiopian tax administration has the capacity to meet the demands of tax equity in many respects. The advance in information technology has significantly aided the arm of Ethiopian tax administration. The introduction of the TIN system for all categories of taxpayers, the use of sales register machines, the introduction of private social security scheme in addition to the existing public social security scheme and many other recent developments all aid the tax administration in its enforcement powers. It is becoming increasingly clear that Ethiopia probably needs to introduce an individual income tax return filing for all categories of taxpayers to ensure both vertical and horizontal equity for all sources of income without abandoning the administrative importance of maintaining withholding schemes as advance payments to be settled against final income tax liability.

iii. *The Movement towards Globalization of income in other Income Tax Systems*

Many otherwise schedular income tax systems have introduced rules that require the computation of income tax upon the total income of individuals rather than computation of income tax from individual sources. The UK, from which the original income tax format was taken, requires aggregation of the total income of individuals from all sources of income. Perhaps, more interestingly, many African income tax systems require aggregation of income from all sources for purposes of computation of the income tax. This development suggests

developing income tax structures like that of Ethiopia can introduce similar reforms in their income tax systems in spite of their administrative constraints.

II. Objective of the Study

The objective of this dissertation is to study and analyze the current structure (particularly the four income tax schedules) of Ethiopian income tax system in light of the general tax policies of Ethiopia and principles of taxation, with special emphasis upon the equitability of the current structure of income taxation in Ethiopia. The study will draw upon the various policy documents and tax laws of Ethiopia to articulate Ethiopia's tax policy and in particular establish tax equity as a fundamental goal of Ethiopian tax policy. It will also draw upon the comparative study of income tax structures of select countries from both the developed and the developing world to suggest the possible ways forward for the restructuring of Ethiopian income tax system in order to meet the general objectives set out for it in Ethiopia's general tax policy objectives. The study will investigate the practical challenges and problems the Ethiopian income tax system faces and highlight the problems that arise from design problems of the Ethiopian income tax system. The schedular income tax structure of Ethiopia has been accepted from the very beginning of modern income taxation unchallenged, and this study will direct attention to the way the income tax is structured and will force rethinking about how income taxes should be structured in Ethiopia.

It is often glibly accepted within the Ethiopian tax administration that the current income tax structure is the best Ethiopia can afford given its administrative constraints. The fact that the schedular income tax structure of Ethiopia has gone unchallenged for well over six decades indicates that the schedular income tax system is unlikely to become a focus of critical attention

in the near foreseeable future. Since its beginnings in the 1940s, the Ethiopian income tax system has gone through a number of tax reforms, many ephemeral and some radical, but its schedular arrangement has seldom been challenged either by tax reformers or agents of tax reforms in Ethiopia. While tax policy has been a major driver of a series of tax reforms in Ethiopia, there has hardly been a moment when that tax policy became an impetus for rethinking about the structure of Ethiopian income taxation even within the framework of schedularization of income taxation.

Tax policies are often thought of as distant, remote and rhetorical flourishes of political figures used as props to justify new or revised tax measures. This study aims to establish the link between general tax policies of Ethiopia and its incorporation and implementation in the income tax structure of Ethiopia. The study aims to show that that Ethiopia has accepted “tax equity” as one of the objectives of its tax policy and has indeed incorporated rules for meeting that objective but its income tax structure has loopholes and defects of design that stand in the way of achieving the aim of tax equity even within affordable limits of its limited administrative capacity.

III. Research Questions

The study aims to explore one fundamental question from which several individual questions can emerge. The basic question the study aims to explore and hopefully find an answer to is whether the Ethiopian income tax achieves the basic objective of tax equity in view of the capacity of Ethiopian tax administration to achieve this basic aim. While the equitability of

Ethiopian income tax structure is the basic question that this study explores, the study also aims to raise a number of specific questions:

- i) What are the basic goals of taxation in general and what can the Ethiopian income tax system learn from these basic goals?
- ii) What are the basic goals of taxation in Ethiopia as outlined in its tax policies and where are these basic policies to be found?
- iii) Why is the individual income tax important and what do the different definitions and conceptions of “income” say about a particular income tax system?
- iv) How are income tax systems designed and structured in different parts of the world and how do these designs affect the equitability as well as administrability of the income tax system?
- v) How is the current income tax system of Ethiopia structured, and what does that say about the Ethiopian schedular approach?
- vi) What are the scopes of the four income tax schedules of Ethiopia and how are their scopes perceived in the income tax practice of Ethiopia?
- vii) What problems and challenges have the Tax Authorities faced in delimiting the scope of the four income tax schedules and the various sources that are currently chargeable with income tax under the main income tax system of Ethiopia (outside agriculture and mining sector)?

- viii) How do these problems and challenges of delimitation affect the equitability of the Ethiopian income tax system?
- ix) How are the various categories of taxpayers (e.g., employees, traders, lessors, shareholders, authors, property owners, chance winners, etc) treated by the current structure of income taxation in Ethiopia?
- x) How far has the Ethiopian income tax system gone to achieve the basic aim of tax equity and how far could it have gone within its own administrative resources?
- xi) How does the comparative experience in the design of income tax systems help Ethiopia reorganize its income tax system in order to achieve the basic aim of tax equity?
- xii) Is there a need to reorganize the Ethiopian income tax system and what does that reorganization look like?

IV. The Scope of the Study

This study is limited to the study of the four income tax schedules of Ethiopian Income Tax Proclamation (No. 286/2002). Those who are familiar with the Ethiopian tax system will notice that this leaves out many laws that seek to tax income under various Ethiopian tax laws, namely:

- i) The agricultural income tax system of Ethiopia, which is currently thoroughly decentralized and largely administered by respective Regional States of the Ethiopian Federation;³
- ii) The mining and petroleum income tax systems, which are currently regulated by special income tax laws, namely the Petroleum Income Tax law of 1986 (as amended) and the Mining Income Tax Law of 1993 (as amended).

These income tax systems must remain outside the scope of this study because they have formed autonomous income tax regimes for a long time and have acquired characteristics which make it imperative to study them separately until the Ethiopian income tax system comes around to unifying all the income tax regimes in Ethiopia (if ever). It must, however, be maintained that any insights gained in this study regarding the income tax structure of Ethiopia must be extended with equal force to these other income tax systems of Ethiopia.

This study will not also directly address issues of corporate income taxation and partnership taxation although these are part of the Income Tax Proclamation of 2002 (as amended). Ethiopia does not have a separate body of laws regarding the taxation of corporations or companies. Corporations, or “companies” as they are known under the Commercial Code of Ethiopia, are subject to a flat tax rate (of 30% currently) but all rules regulating the taxation of corporate income are found in the main Income Tax Proclamation of 2002 (as amended). It is well known that the taxation of corporations as separate entities raises a number of issues in income taxation, but the study of the corporate income tax system of Ethiopia requires a

³ For more on these, see Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, p. 112-113

separate study of its own and any digression in a study of this kind to that of the corporate income tax will only confuse rather than enlighten anyone trying to understand the Ethiopian income tax system.

The taxation of partnership income in Ethiopia has never been made clear in Ethiopia's income tax laws. The practice, if it is said to exist at all, is patchy and sketchy. All these raise questions about how partnerships should be taxed under Ethiopian income tax laws. Once again, the issue of partnership taxation is left out of this research.

Last but not least, this dissertation will not directly deal with the "presumptive" income tax regime of Ethiopia, although this regime is part and parcel of the main income tax system of Ethiopia. The "presumptive" income tax regime of Ethiopia, which principally targets small businesses or so-called "Category C" taxpayers in the technical classification of Ethiopian income tax system, is treated separately for assessment purposes. While the equity concerns of the "presumptive" income tax system are similar to that of other parts of the income tax system, the issues involved in the estimation of the income of small business taxpayers are *sui generis* to the presumptive income tax system. These issues require a dissertation of their own due to the range and complexity of issues involved in the choice of presumptive income tax regimes for the income tax system like that of Ethiopia.

It must, however, be maintained that these are not grievous omissions in view of the objective of this dissertation, which is to critically examine the schedular income tax system of Ethiopia in light of the tax policies of Ethiopia and the universally accepted principles of taxation, mainly equity. The Ethiopian income tax system will remain schedular even if these additional layers of income taxation are added. In the end, it is not the number of schedules treated or the sub-

schedular aspects under them but the substance of schedules that is the subject of the critical analysis in this dissertation.

In sum, this dissertation focuses upon the four income tax schedules recognized under the Income Tax Proclamation of 2002 (as amended), namely

Schedule “A” – income from employment;

Schedule “B” – income from rental of buildings;

Schedule “C” – income from businesses and professional activities; except category C businesses which are subject to the “presumptive” income tax regime;

Schedule “D” – miscellaneous income from sources like royalties, technical services, chance winnings, dividends and interest

The division of income sources into these four broad categories and the practice of income taxation in respect of these categories are used to turn the critical eye upon the structure of Ethiopian income taxation from the vantage point of the tax policies the country has adopted and in light of the basic principles of income taxation, particularly tax equity.

The study, to the extent it relies upon information from the practice of income taxation, is not intended to provide a complete and exhaustive study of the current practice of income taxation but to shed light on the structural issues that beset the Ethiopian income tax system. As the title of the dissertation suggests, the study examines the intersection of tax policy, design and practice of income taxation with respect to the four income tax schedules of Proclamation No. 286/2002. In particular, the study:

- i) Articulates the tax policy of Ethiopia in general and income tax policy of Ethiopia in particular from the various binding sources of tax policy;
- ii) Identifies the basic principles taxation that are recognized in the various laws of Ethiopia;
- iii) Examines the four income tax schedules from the vantage point of the laws of Ethiopia and the practice of income taxation;
- iv) And analyzes the impact in general of these structural arrangements upon the income tax policy and the principles of taxation in Ethiopia.

V. Research Methodology

The research is based on qualitative methodology in which an attempt to understand the Ethiopian Income Tax System is made through a combination of literature review of income taxation, an assessment of the income tax practice through cases and interviews of relevant correspondents and a comparative study of income tax systems in different parts of the world. The research does not use quantitative methodology of research except to provide some financial statements with respect to income taxation in Ethiopia and to illustrate the equity implications of the income tax design using hypothetical cases. In general, the research has used the following methodologies:

- a. Interviews, Questionnaires and Cases
- b. Review of the Literature, laws, policy documents and various publications
- c. Comparative study of the income tax structures of other countries;

a. ***Interviews, Questionnaires and Cases***

The author has conducted interviews based on structured questionnaires developed for the purpose of eliciting all relevant information for the research (***see attached questionnaires***). Most of the interviews are conducted with the relevant individuals and officials in person. Since the interview questions require explanation of the background and the technical issues involved, the author has made every effort to ensure that the correspondents understood the tenor of the questions.

This research canvasses the practice of income taxation in all the four schedules of main Ethiopian income tax system: A, B, C and D. Since few cases ever make it to courts to study the Ethiopian income tax system in all its variety and richness, it is perilous to reach any conclusions about the Ethiopian income tax system based purely on the available cases that have reached Ethiopian courts and Tax Appeal Commissions. The researcher has prepared questionnaires which are then used to ask questions intended to elicit adequate information about how the tax authorities view the different schedules of income tax. While few tax officers have filled out the questionnaires, most of the correspondents were approached individually and personally to respond to the questions. Some of the questions involve technicalities that are liable to be misunderstood without adequate explanations from the researcher. All attempts have therefore been made to clear up any ambiguities in understanding the questions during the interview sessions. The accuracy of information regarding the practice is verified by contacting as many tax officers as possible along with well known tax auditors.

Geographically, the correspondents hail from the major regions of Ethiopia in terms of income taxation: the capital and the largest economic unit in terms of taxation, the City of Addis Ababa

and two of the largest Regional States in terms of both population and size, Oromia and Amhara Regional State are included in the interviews. Some questionnaires have also been collected from Tigray Regional State. These Regions constitute more than 70% of the total population of Ethiopia.⁴ As a federation, it is necessary to collect adequate information from both the Federal Government and Regional Government Authorities in order to make any statement about the practice of income taxation. This research has reached tax officers from both Federal and Regional Tax Administration in the Regions mentioned above.

In terms of their affiliations, the correspondents can be divided into three:

- a) Officers and officials of the tax administration – federal and regional tax administration offices as well as government bodies associated with tax administration directly or indirectly, such as the Ethiopian Revenues and Customs Authority (ERCA), the Regional Revenues Bureaus, the Ministry of Finance and Economic Development, the Ministry of Trade, the Charities and Societies Agency (CSA), and the Tax Appeal Commissions
- b) Large auditors who have long time experience in tax auditing in Addis Ababa;
- c) Some taxpayers, particularly withholding agents like universities

In terms of their experience, the correspondents have practical experience ranging from two years to up to 30 years of experience working in tax administration. Depending on the nature of the questions, most correspondents with relevant experience in each area of Ethiopian income taxation have been approached for interviews. Since the practical exposures of various

⁴ This is based on the 2007 Census, which assigns 5.8%, 23.3%, 36.7% and 3.7% respectively to Tigray, Amhara, Oromia Regional States and the City of Addis Ababa, see Central Statistical Agency, Statistical Abstract, 2008, p. 23

correspondents vary and are likely to be limited to some aspects of Ethiopian income taxation, the author has made every effort to ensure that the correspondents with the most relevant experience have been approached to elicit relevant and up-to-date information in specific area of income taxation. To give but one example in this regard, not many correspondents have had practical exposure to the problems of taxation of employees of embassies and international organizations, who, as shall be seen in detail in one of the chapters, pose significant threats to the enforcement of the income tax on all taxpayers due to the fact that their employers are not obligated to withhold income tax on behalf of the government. Those with the most direct experience in this regard have been approached and interviewed to understand the practical problems of taxation of employees of so-called exempt organizations. Similarly, not every tax administrator or officer knows the practical challenges regarding the taxation of unrelated (business) income of charitable organizations and religious institutions. It is therefore necessary to collect information from those that work with charitable organizations and religious institutions, such as the Charities and Societies Agency (CSA) and the Ministry of Federal Affairs (MFA).

As alluded to before, there is a limited number of income tax cases which might be used as a source of information regarding income tax practice in Ethiopia. Although court cases regarding income taxation are not to be found in any organized format, all attempts have been made to draw upon income tax cases decided at various levels of tax dispute settlement in Ethiopia. These cases are far and few in between, but when they are available they provide an instructive account of income tax practice in Ethiopia.

b. Review of the Literature, Laws, Policy Documents and other Materials

Like any literature study, this dissertation draws upon the extensive literature on tax policy, principles of taxation, comparative taxation and the study of individual income tax systems of various countries. The review of the literature takes stock of the latest research on comparative income taxation, tax policy and surveys of the income tax structures of individual countries to portray the contemporary structural design of income tax systems in various parts of the world. The proliferation of online resources in this regard, particularly that of the online survey of most countries of the world – IBFD Online services – has been of particular help in making the study as contemporary and up-to-date as possible.

While the literature on Ethiopian taxation is very scanty, the study makes equally an extensive use of the available literature to the best knowledge of the author. Apart from the conventional sources of information for research, it is necessary to expand the meaning of literature review in the Ethiopian income tax context if one is to properly understand how the system works at the grass roots level. The enormous variety of government documents related to Ethiopian taxation means that it is absolutely necessary to consult a diverse body of legal materials to come to grips with the income tax system of Ethiopia, including the current practice of income taxation. The attempt in this regard is doubly made difficult due to the fact that none of these materials are to be found in any organized form.

The research has taken stock of the available materials in this regard, ranging from the Ethiopian Constitution to the various tax laws issued in the form of proclamations, regulations, and directives. In addition, all available sources of authority for income taxation, such as

memorandums, letters and various official and unofficial communications of the Ethiopian Tax Authorities have been consulted in order to understand the tenor of income taxation at the moment.

c. Comparative Study

No study of the design and structure of any income tax system (particularly that seeks to critique it) will be complete without an overview of the comparative design of income tax structures in different parts of the world. While the inherent merits of any given structure must be analyzed on its own terms, it is also true that many income tax structures have influenced and been influenced by others making it imperative to analyze income tax structures in the context of similar and divergent income tax structures elsewhere.

The foundation for the current income tax system in Ethiopia was laid down at a time when Ethiopia had special historical relationships with the UK, which partly explains the schedular features of the Ethiopian income tax system. While the contents of the schedules have changed slightly over the years, the original plan of the schedular format of the Ethiopian income tax system has remained unaffected over the years. The income brackets, the tax rates as well as the contents of the Ethiopian income tax system have of course changed over the years, but the schedular system of taxation has remained the trademark of the Ethiopian income tax system.

Although Ethiopia is generally taken to be a civil law country, its history over the past six decades of legal borrowing and transplantation shows that the country is in reality eclectic in its

approach, taking the “best the rest of the world can offer”.⁵ While Ethiopia’s income tax structure shows strong influences of the UK income tax system, its other tax laws were borrowed over the years from all over the place. The case in point is the Ethiopian VAT, introduced in 2002 using the EU VAT as model. This eclectic approach suggests that the comparative study of various income tax systems must partake from the different formats that are so far available in the world.

The comparative study of various income tax structures is eclectic in approach. The research takes specimens from global income tax structures of the USA, Canada and Australia, the dispersed schedular income tax structures of the UK, Germany and Japan, and the dual-cum-schedular income tax structures of the Scandinavian countries of Finland, Norway and Sweden to provide a wide variety of structural options for the Ethiopian income tax system. The aim of the research is not to preach one type of income tax structure as “ideal” nor to “essentialize” or “sanctify” one structure over others, but to show the possibilities of income tax structures for a country like Ethiopia.

Ethiopia is an African country and provides the seat for the African Union headquarters. The capital of Ethiopia, Addis Ababa, also hosts a number of regional and international organizations. While Africa as a continent is one of the least integrated economic and legal units in the world, full economic and eventually political integration remains one of the highest aspirations of African countries. A comparative study that does not take these aspirations into

⁵ The phrase “the best the world has on offer” is a modification of the famous phrase coined more than a century ago by the English poet and critic, Matthew Arnold, who wrote in his famous essay “Culture and Anarchy” that culture is “the pursuit of ... total perfection by means of getting to know, on all the matters which concern us, the best which has been thought and said in the world.” see Matthew Arnold, Culture and Anarchy preface, p. viii (1869).

account will remain incomplete if it does not incorporate somehow (incomplete as that may be) the income tax structures of selected African countries.

Income tax structures like that of Ethiopia at times suffer from the inertia of history and the determinism of being a poor and developing country. It is often argued for example that Ethiopia is stuck with its schedular approach to income taxation. The comparative study of related countries of Africa provides just the antidote one needs to counter arguments that press for the *status quo* no matter what the economic circumstances. The comparative study of the income tax structures of selected African countries is intended to show the recent developments in income taxation in Africa and suggest that Ethiopia can develop in a similar trajectory, if not more.

VI. Limitations of the Study

a. Absence of Cases and Absence of Practice on Some Sources of Income Tax in Ethiopia

While income taxation is now more than half a century old, many areas of Ethiopian tax system remain outside the court-case system. While there is an abundance of cases in some aspects, like the deductibility of certain expenses for Schedule “C” taxpayers, most issues of income taxation never make it to the courts, making it difficult to understand the scope and nature of income taxation through the prism of court cases. It is generally true that most cases of income taxation are resolved through administrative channels, which makes it absolutely imperative to study the income tax from the perspective of how tax officers have viewed the various schedules of Ethiopian income tax and how some taxpayers have responded to these schedules in practice. To

the extent possible, this dissertation takes account of the practice from the perspective of the tax administration and some taxpayers.

If we count from the very beginning, the income tax system is now in its six decades of practice. To be sure, some sources of income taxation were a recent addition to the Ethiopian income tax system. With the exception of “windfall profits,” most sources of income taxation are at least two to three decades old, from which one must conclude that there must be an abundance of practice regarding all of the sources currently chargeable with income taxation in Ethiopia. Nothing is farther from the truth. Although most sources of income mentioned in the Ethiopian income tax system are the source of revenue for both the Federal and Regional Governments, it is by no means clear if some sources of income mentioned in the income tax laws are being charged with income tax at all. Interviews conducted with a number of tax officers at various levels of Ethiopian tax administration suggest that some sources are seldom used for collection of income tax, and the controversies regarding what these sources actually mean affirm our prior misgivings about the implementation of these sources in practice. The two sources of income, over which there is considerable doubt whether the Tax Administration even collects revenues, are “income from casual rental of property” and “income from business leases,” the tax officers contacted for interviews have expressed widely divergent views about the very existence and tenor of these two sources of income as to inculcate doubts over whether these two sources of income are at all used as sources of revenues by the Tax Administrations. In the absence of widely known practice with regard to these two sources of income in particular, the tax officers have been forced to speculate as to what they might mean for income tax purposes. The uncertainty over the meaning and scope of these sources of income, no doubt exacerbated by the

absence of firm practices in this regard, generates a limitation of its own in conducting this type of research on income tax practice in Ethiopia.

In general, the absence of cases in most instances and the limited number of cases on few fortunate occasions imposes severe limitations upon the reliability of information elicited through interviews with tax administrators involved. There are times when information supplied by particular tax administrators is nothing more than anecdotal and speculative as they themselves have never come across a practice with regard to some sections of the Ethiopian income tax system. Their statements are at times nothing more than their personal opinion on a given provision of Ethiopian income tax laws. Although interviews of as many correspondents can be reasonably reached will go a long way in ensuring that these types of information are not idiosyncratic, it must be acknowledged that the lack of practice in some respects acts as a severe limitation on the study of Ethiopian income taxation.

b. Lack of Adequate Research on Ethiopian Income Taxation

Lack of adequate research in taxation has become sort of a truism in Ethiopia. While many aspects of Ethiopian legal system suffer from the lack of adequate research, the situation is even more pronounced in taxation in general and income taxation in particular.

With the exception of a few scholarly articles written on the Ethiopian income tax system in the 1980s and 1990s and a limited number of student theses written on a variety of subjects involving Ethiopian income tax system, the Ethiopian income tax system has attracted a scant amount of scholarly attention. The absence of critical studies on the Ethiopian income tax system makes this study one of the first sustained studies on the Ethiopian income tax system.

c. Limitations of the Comparative Study

While comparative studies on the income tax systems of the developed or the industrialized world are fairly and widely available, one cannot mention a single exhaustive study of the income tax systems of the developing world, not to mention African income tax systems. The precariousness of undertaking field studies of select African countries has also forced me to limit my comparative studies based on secondary materials that are available to me as well as primary pieces of legislation of African countries collected on the internet. The comparative study of African income tax systems would have been ideally complete had thoroughgoing field researches are done on each of the countries to understand the background and current status of income tax structures in Africa.

Having been a contributor of chapters on “Ethiopian Taxation” to the International Bureau of Fiscal Documentation (IBFD), Amsterdam, the Netherlands, I am fortunate to have access to the IBFD database in order to be able to assess the current status of income tax structures sampled in this dissertation. I have made attempts to supplement my assessment of selected African income tax systems with other materials on those countries, but because of language barrier and inaccessibility of materials on these countries, I must own up to the limitations of this study. The only countries whose legal texts I can read in the original language are the Anglophone countries of Kenya, Uganda and South Africa. Unavailability of legal texts in English from the Francophone countries and the North African Arab countries means that I must rely almost exclusively upon the surveys compiled by the IBFD.

The objective of the comparative study of particularly the income tax structures of some African countries is not to provide a complete and detailed survey of the African income tax systems but to use these samples as an object lesson for future income tax reforms in Ethiopia. As such, this comparative study emphasizes the structural aspects of the selected income tax systems only, leaving many other issues of income taxation aside.

VII. Synopsis of the Chapters

This dissertation is divided into nine chapters.

Chapter One provides a review of the literature on the general theories and principles of taxation, with particular emphasis given to the theories and principles of tax equity. This chapter also summarizes contemporary tax literature on other principles of taxation, such as efficiency, administrative feasibility (administrability) and neutrality.

Chapter Two attempts to articulate the fundamental goals of Ethiopian tax policy from the various authoritative sources of tax policy in Ethiopia (the Ethiopian Constitution, official and unofficial policy documents and various tax laws). It also identifies the major principles of taxation as these are enunciated in the various sources of tax policy and at the end summarizes the major challenges facing the landscape of tax policy in Ethiopia.

Chapter Three provides a review of contemporary literature on the design and structure of income taxation in the world, definition of “income” in various income tax traditions and furnishes a comparative overview of income tax structures from both developed and developing countries (including that of some African income tax structures).

Chapter Four provides a general introduction to the schedular income tax system of Ethiopia, the various income tax laws, the notion of “income” from the Ethiopian income tax perspective and outlines the general features of the major income tax schedules of the Ethiopian income tax system. This chapter also summarizes the major principles that underlie the schedular income tax structure of Ethiopia.

Chapters Five to Eight examine the four income tax schedules of the main income tax system – A, B, C and D and identify the major challenges the Ethiopian income tax administration faces in defining the scope of each schedule vis-à-vis the others and ensuring the overall equitability and administrability of the Ethiopian income tax system.

Chapter Five critically examines both the laws and the practice on the taxation of income from employment from the perspective of both ensuring the intra-cum-inter-schedular equity and administrability of taxation of income from employment. This chapter identifies some of the major obstacles to both equity and administrability of Schedule “A” income taxation – the problems related to defining the scope of Schedule “A” vis-à-vis the other income tax schedules, the challenges faced in connection with the aggregation of income from multiple employments, the enforcement of self-assessment obligations on some employees, and the current legislative as well as administrative inaction in connection with taxation of employment fringe benefits.

Chapter Six turns the same critical examination on taxation of income from rental of buildings (Schedule “B”), identifies the major challenges faced by the Ethiopian income tax administration in defining the scope of Schedule “B” vis-à-vis the other income tax schedules, and, in view of the numerous problems caused by the application of Schedule ‘B,’ asks an existential question of

whether Schedule “B” is worth all the trouble it has so far wreaked in the income tax administration of Ethiopia.

Chapter Seven examines both the law and practice of the taxation of so-called ‘business income’ (Schedule “C”) and raises similar questions about the challenges of delimiting the scope of ‘Schedule “C”’ vis-à-vis the other income tax schedules. This chapter also addresses some of the peculiar problems of Schedule ‘C,’ such as those arising from the dilemmas caused by the incorporation of ‘income from business leases’ in Schedule ‘C,’ and the political and legislative inaction in connection with the application of the income tax upon charitable organizations and religious institutions.

Chapter Eight addresses a diversity of income tax issues, necessitated by the nature of Schedule “D” – which is about the taxation of miscellaneous sources of income- royalties, income from technical services provided outside Ethiopia, income from games of chance, dividends, income from casual rentals of property, interest on bank deposits, capital gains from the transfer of certain investment property, and windfall profits. As the subject-matter of Schedule “D” is diverse, so are the issues and challenges. This chapter therefore identifies some of the major challenges and problems faced in the administration of income taxation of miscellaneous incomes, most notably the challenges and problems arising in connection with the definition and delimitation of the scope of one source of income vis-à-vis the other sources. Schedule “D” presents a diversity of issues not only on the sources of income chargeable with tax under the Schedule but also of tax rate differentials which are the source of problems in the administrability and equitability of Schedule “D” income taxation. The last part of Chapter Eight therefore examines the consequences of tax rate differentials under Schedule “D” upon the

administrability and equitability of Schedule “D” income tax in the Ethiopian income tax system.

Chapter Nine provides a conclusion and recommendations based on the problems identified in Chapters Four to Eight and lessons drawn from general tax policy of Ethiopia and the comparative experience of other income tax structures in the world.

CHAPTER ONE
GENERAL THEORIES AND PRINCIPLES OF TAXATION: REVIEW OF THE LITERATURE

I. The General Goals of Taxation

Few would argue with the observation that taxation helps governments raise revenues for their various activities. Beyond this bare minimum, there is hardly any agreement about why and how governments raise revenues through taxes. The sentiment about “the why and how of taxes” appears to depend on general sentiments about the end of governments.¹ Those who believe that governments can solve the major ills of mankind may be inclined to believe that taxes help governments create employment, fight inflation, stimulate economic growth and even help fight global warming. Those who value greater economic freedom and see the markets as the major drivers of employment, inflation and economic growth would like to restrict the government to the provision of those and only those services which, everyone agrees, could not be provided under free market conditions. And there are those, even when they accept government, who are skeptical of taxation as an instrument of government policy in the area of stimulating employment, fighting inflation and of generating economic growth. These “debates” are the stuff of which the subject-matter of “public finance” is made of.

In spite of the contentious views about the role of governments, taxation remains one of the most prominent powers and instruments of governments to date. Whatever public policies

¹ See, in general, Steinmo, *The Evolution of Tax Policy Ideas*; see also World Bank Report 1997, pp. 1-15; Adolino and Blake, p. 178

governments have deemed appropriate as their roles, taxation has often assumed an integral part of that public policy. Different writers have developed their own versions of roles for governments, and these roles have in many ways shaped their views about the goals of taxation. One of the most famous is that of Richard and Peggy Musgrave who drew up three major objectives for government budgetary policy and by extension tax policy, calling them the “allocation function,” the “distribution function” and the “stabilization function.”²

The “allocation function” determines the proportion of government involvement in the provision of what Richard and Peggy Musgrave called “social goods” or what are more commonly known as “public goods.”³ Taxation, as a major source of government revenue, of course plays a pivotal role in this regard. Without taxation, few governments would be able to meet their responsibilities in providing even basic public services.

The “distribution function” of budgetary policy (of which, once again, taxation is an important instrument), determines the distribution of income and wealth in accordance with “what society considers fair or just,” which is not usually obtained through the operation of market forces alone.⁴ Taxation is one recognized fiscal instrument for redistribution of income and wealth.⁵

The last, perhaps not the least, goal of taxation may be to play its part in the stabilization of the

² See Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, pp. 3-13

³ *Id.*, see pp. 7-9

⁴ *Id.*, see pp. 9-10

⁵ Richard and Peggy Musgrave list the various fiscal devices at the disposal of governments to meet the distribution function: i) tax-transfer scheme involves the combined use of progressive income taxation of high-income groups with subsidies for low-income groups; ii) use of progressive income taxes to finance public services, which are primarily beneficial to low-income groups (e.g., low cost housing and even education); iii) the levying of taxes upon goods commonly consumed by high-income groups (e.g., luxury goods) and providing subsidies for provision of goods largely consumed by low-income groups; see Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, p. 11.

economy.⁶ It has been known for a long time that economies do not stabilize by themselves and need “policy guidance.”⁷ Without the steady hand of “policy guidance,” economies may suffer from frequent fluctuations, with symptoms of high unemployment, inflation and low economic growth afflicting economies from time to time.⁸ Governments have two major instruments at their disposal to ensure economic stability – monetary and fiscal policies.⁹ Monetary policies utilize the supply and regulation of supply of money and credit facilities to stabilize economies while fiscal policies use taxes and government expenditures to regulate the level of employment, prices and the rate of economic growth.¹⁰ In all of the three functions of budgetary policy, taxation plays an important (albeit controversial) role.

Richard M. Bird, writing primarily from the vantage point of developing countries, has outlined three goals for taxation, that of [economic] growth, distribution and stabilization.¹¹ It can be seen that Richard Bird’s roles match or echo that of Richard and Peggy Musgrave at least in the area of distribution and stabilization, although their emphases are predictably different. As economic growth is a primary aspiration of developing countries, economic growth has featured as one of the recurrent policy goals of taxation in many developing countries.¹² Developing countries have looked to taxes as engines not just for generating revenues to carry out major public projects but also for stimulating the rate of capital investment in the private sector.¹³ Over

⁶ Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, see pp. 13

⁷ *Id.*, see p. 12

⁸ *Ibid.*

⁹ *Ibid.*

¹⁰ *Id.*, see pp. 12-13

¹¹ See Bird, *Tax Policy & Economic Development*, pp. 8-13

¹² *Id.*, p. 8

¹³ *Ibid.*, p. 8

the years, many developing countries have drawn upon an enormous variety of “tax gadgetry” to stimulate, as they saw it, economic growth and private capital investment.¹⁴

Not everyone agrees that taxation should be deployed to stimulate economic growth. There is, for example, tremendous skepticism in the tax incentive literature about the efficacy of tax incentives in attracting investment. Doubters view tax incentives as windfalls to the few that would have invested in the country anyway without contributing much to the attraction of capital investment to poor countries.¹⁵ The literature is awash with policy advisors arguing against tax incentives as instruments of public policy and for other measures that are more likely to lure investors into a poor country’s economy.¹⁶ Whether they work or not, tax incentives have undeniably formed a pillar of public policy measures in many developing countries.

Richard Bird sees “distribution” as one major objective of tax policy just like Richard and Peggy Musgrave, but he relegates it to a second-order objective as far as the tax policies of developing countries are concerned.¹⁷ Unlike the goal of “economic growth,” he views the goal of redistribution of income and wealth through taxation as “a luxury poor countries can ill afford.”¹⁸ Much of the energy in the tax policy area in many developing countries has been drawn to the goal of “economic growth” not just because these countries have realized that

¹⁴ Lentz, 1967; Shah and Toye (1978), cited in Bird, *Tax Policy & Economic Development*, p. 8

¹⁵ For typical arguments against the use of tax incentives, see Margalioth, *Tax Competition, Foreign Direct Investments and Growth*, pp. 177-182

¹⁶ See *The Determinants of Foreign Direct Investment: A Survey of the Evidence*, U.N. Doc. (1992); *Tax Incentives and Foreign Direct Investment: A Global Survey*, U.N. Doc. (2000); *Taxation and Foreign Direct Investment: The Experience of the Economies of Transition*, OECD (1995), all cited in Margalioth, *Tax Competition, Foreign Direct Investments and Growth*, p. 177, foot note 72; Holland and Vann, “Incentives for Investment,” pp. 988-990; United Nations Conference on Trade and Development, *Tax Incentives and Foreign Direct Investment*, available at http://unctad.org/en/Docs/iteipcmisc3_en.pdf, last accessed on August 20, 2012.

¹⁷ Bird, *Tax Policy & Economic Development*, p. 9

¹⁸ *Id.*, p. 10

taxation is an ineffective instrument of “redistribution” of income and wealth but also because the economies of many developing countries need to attract enough economic growth before they start to worry about redistribution of the growth.¹⁹ Many developing countries are content to pay lip service to the policy goal of “redistribution” through personal income taxes, which are superficially progressive, but in actual fact far from being so.²⁰ There is a huge divergence between statutory rates and effective tax rates in most tax systems of the developing world, leading some skeptics to advise the complete abandonment of the pretense of maintaining redistributive personal income taxes.²¹

The third goal of taxation for Richard Bird is not really different from that of Richard and Peggy Musgrave. Richard Bird sees some role for taxation in the area of stabilization in which taxation may be used to regulate price levels and balance of payments.²² Taxation alone cannot do this, of course, and needs to be coordinated with expenditures to have any traction in the stabilization of the economy. Richard Bird is quick to point out that the efficacy of taxation in the area of stabilization depends to a large degree upon the elasticity of taxes to respond to movements in prices and growth in the economy.²³ Even if one were convinced that taxes have enough elasticity to respond to changes in the economy, one must also pass the initial hurdle of whether governments should be involved in these kinds of activities. That, as Richard Bird quickly

¹⁹ Ibid

²⁰ Id, p. 11

²¹ Ibid, p. 11

²² Id, p. 12

²³ Id, see pp. 12-13

admits, “depends not only on economic considerations but also basic questions of political philosophy and practice.”²⁴

The latest example about the goals of taxation in the literature is that of Reuven Avi-Yonah, who, like the Musgraves and Richard Bird above, settled with three major goals of taxation, that of raising revenues for necessary government functions, redistribution and regulation.²⁵ With respect to the two functions, Avi-Yonah essentially agrees with Richard and Peggy Musgrave, who would have called these “allocation” and “distribution” functions respectively. In the third goal, he emphasizes the regulatory function of taxation, which may be subsumed with some justice in the stabilization function of Richard and Peggy Musgrave. As a “regulatory” instrument, writes Avi-Yonah, taxation may be “used to steer private sector activity in the directions desired by government.”²⁶ Avi-Yonah regards the two functions – that of redistribution and regulation – as controversial goals of taxation, but observes many governments (especially of the developed world) have used taxes for both of these goals anyway.²⁷

All writers that have written on this subject have proposed their own goals of taxation after their own fashion. From the sampling of three different authors above, we can conclude a number of things. First, taxation does not and need not have fixed goals. The goals of taxation have varied from one period to another, and indeed among different tax systems. Secondly, the goals of taxation are inextricably linked with our views and sentiments about the roles of governments,

²⁴ Id, p. 13

²⁵ See Avi-Yonah, *The Three Goals of Taxation*, p. 3

²⁶ Ibid

²⁷ Id, pp. 3-4

which have shifted throughout history. Thirdly, the role of taxation as instrument of public policy remains controversial in the literature although governments continue to use taxes as their major instruments in the attainment of various public policies. Some goals of taxation may tend to recur in the literature under various guises, and indeed at least one goal of taxation appears to be beyond the pale of controversy (that of taxation as instrument of raising revenues to provide public goods), but that is no reason to conclude that the goals of taxation are now settled.

II. Criteria for Design of Taxes and Tax Structures: General Principles of Taxation

Taxes determine the fate of many things in life. They determine what is taxable and what is un-taxable, at least by omission, if not by intent. They determine, in the technical language of taxation, what constitutes a tax base, the rate or rates under which the tax base should be taxed and who should pay the tax and who ultimately bears the economic burden of taxation.²⁸ All these questions require the legitimacy of the “criteria” by which taxes need to determine all these things in life.

Richard M. Bird has divided these criteria into “external” and “internal.”²⁹ The “external” criteria are the policy objectives or goals set for taxation, which are for him, as already pointed above, economic growth, distribution and stability.³⁰ The “internal” criteria are what he calls the

²⁸ Bird, *Tax Policy & Economic Development*, p. 13

²⁹ *Ibid*

³⁰ *Ibid*

“attributes... which people would like to see in their tax systems.”³¹ Various writers have used different names referring to “internal criteria.” Some call them simply “criteria,” while others have called them by turns “principles,” “canons” or “maxims.”³²

It may be necessary to distinguish the “goals” or “objectives” of taxation from the “criteria” used to evaluate the good, bad and ugly features of taxation, although in the literature, the “goals” of taxation are sometimes treated along with the criteria of taxation.³³ “Equity” may be a good feature of taxation, but it may not be the goal of taxation. The goal may be “distribution” of income and wealth or simply satisfaction of the society’s desire to ensure fairness in the tax system. Efficiency may be an attribute of a good tax system, but it is not the goal of taxation. The goal may be economic growth. It must, however, be admitted that the goals of taxation are sometimes used interchangeably with the principles of taxation. While we distinguish for the purposes of this section the goals of taxation from the principles of taxation for heuristic purposes, it must be stated that these are often interchangeably employed in the literature.

A common encounter with the literature on “principles” or “maxims” or “canons” of taxation is that every writer has had her special list of principles, which while overlapping with others, in some respects reflect the idiosyncrasies of each author. Just as Adam Smith thought it appropriate to limit the principles [of taxation] to four, others have deemed it appropriate to

³¹ Ibid

³² Adam Smith called them “maxims” of taxation; while John Stuart Mill, who fully endorsed Adam Smith’s “maxims,” liked to call them “principles.” Richard M. Bird simply 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 “canons,” see Bhatia, *Public Finance*, pp. 41-43

³³ See, for example, Cooper, Krever, & Vann’s *Income Taxation*, p. 7; where the three national objectives of taxation [in Australia] were stated as “optimizing economic growth, ensuring equity and facilitating simplification”

extend the principles to a dozen or even more. The German economist, Adolph Wagner, thought taxation needed nine principles, which were sufficiency, flexibility, choice of sources upon which tax is applied, choice of kind of tax, generality, fairness, certainty, comfort and cost efficiency.³⁴ Another German economist, Neumark, was even more elaborate and extended the principles of taxation into eighteen, which he then grouped into four major categories:

1. Budgetary and Fiscal Principles: sufficiency; adaptability;
2. Socio-political and ethical principles: generality, horizontal equity; ability-to-pay; redistribution;
3. Political and economic principles: avoidance of fiscal interventionism; minimum impact on the decisions of agents; minimum impact on market efficiency; active flexibility, passive flexibility; promotion of economic growth; and
4. Legal and technical principles: congruence and systematization; transparency; feasibility; continuity; cost efficiency; comfort.

Although not as detailed as that of Neumark, the American tax analyst Daniel J. Pilla developed ten (perhaps to coincide with the ten commandments?) principles of taxation which he called “simplicity,” “non-invasiveness,” “efficiency,” “stability,” “visibility,” “neutrality,” “economic growth,” “broad-based,” “equality” and “constitutionality.”³⁵ A recent study commissioned by the Addis Ababa Chamber of Commerce and Sectoral Associations (AACCSA) mentioned twelve principles of taxation: ability-to-pay, equality, adequacy, neutrality, broad-basing, non-

³⁴ Cited in Perdices de Blas and Revuelta Lopez, *Markets and Taxation: Modern Taxation Principles and School of Salamanca*, Esic Market, vol. 138, 2011, p. 99

³⁵ See Pilla, *Ten Principles of Federal Tax Policy*

retroactivity, compatibility, predictability, earmarking, restricted exemption, efficiency and simplicity.³⁶ The list can go on.

It will be seen that many of the principles overlap in meanings, although the emphasis in each particular instance is different. Many writers have preferred to speak and write about “equity” and “efficiency” in part because these principles subsume many of the other goals of taxation. Some of the writers who have chosen to deal with a more extensive list of principles are obviously of the opinion that the details which they want to emphasize will be lost in the generality of the two principles of equity and efficiency.

The principles of “simplicity,” “neutrality,” “certainty” and “administrative feasibility” (all discussed below) can be subsumed under the principle of “efficiency” but the emphasis which specific treatment of these principles will obtain will be lost in the generality of the principle of “efficiency.” One of the principles treated below is that of “administrative feasibility,” which in the words of Joseph Sneed, is taken to mean a number of things, that of “simplicity of the tax,” “convenience and ease in assessment and collection from the standpoint of both government and taxpayer” as well as “certainty of obligations imposed on both taxgatherer and taxpayer.”³⁷ It may thus justly be assumed that the concerns of “administrative feasibility” will be addressed under the principles of “simplicity,” “certainty,” and even “efficiency”. Or it may also be asserted that “administrative feasibility” can stand for all of these other principles and it may thus be assumed that these other principles are unnecessary repetitions of the principle of “administrative feasibility.” The problem is that none of these principles can really stand for the

³⁶ Amin Abdella and John Clifford, *The Impact of Tax Reform on Private Sector Development*, p. 5

³⁷ Sneed, *the Criteria for Federal Tax Policy*, p. 573

special issues of “administrative feasibility,” and nor can the principle of “administrative feasibility” be said to properly address the special issues and concerns addressed under the principles of “simplicity,” “certainty” or “efficiency”.

Similarly, “efficiency,” which is an even broader principle than the principles of “administrative feasibility,” “certainty,” “simplicity,” “convenience,” etc., can be a shorthand for all of these principles, but due to its generalities, the emphasis we wish to place upon specific issues of taxation may be lost as a result of the tendency to emphasize some aspects of “efficiency” in taxation at the expense of other aspects of taxation.

While it may be difficult to exhaust all the principles of taxation, it is therefore necessary to deal with more specific principles of taxation along with the general principles of “equity” and “efficiency.” The number of principles selected by any one writer is arbitrary. There is no reason why twelve is better than six (except that twelve is twice as much as six), or vice versa. The choice of principles should depend not on numbers but on factors, all of which have something to do with specific tax system. Richard M. Bird has listed three of these factors: i) the economic, political and administrative conditions of a country; ii) the objective of national (not just tax) policy; and iii) the existence of other (non-tax) instruments of public policy at the behest of a given government.³⁸

In the detailed review of the major principles of taxation, we have tried to strike a balance between the need to limit the number of principles of taxation and the relevance of these principles to a tax system like that of Ethiopia. Since the primary thesis of this dissertation is the

³⁸ See Bird, *Tax Policy & Economic Development*, pp. 13-14

“equitability” of the Ethiopian income tax system, the principle of “equity” has received greater attention and space than other principles, but other principles of special resonance to the Ethiopian tax system are also reviewed. After a detailed review of the principles of tax equity, we shall review the literature on “efficiency,” “administrative feasibility,” “neutrality,” “simplicity” and “certainty” and provide a synopsis of a whole raft of the “other” principles that are mentioned in the literature at the end. In conclusion, we address the vexing question of how to deal with the “multiplicity” of tax principles and goals.

a. Equity

i. The Meanings of Equity, Fairness, and Justice: The Elusive but Unavoidable Questions

The term “equity” is used in the literature along often with terms like “fairness” and “justice” and sometimes “equality”. It is therefore necessary to analyze the meaning of “equity” and cognate concepts before its special and perhaps technical meaning in taxation. The terms “equity,” “fairness” or “justice,” are frequently used in popular discourse, although hardly anyone seems to talk about the same thing.³⁹ Philosophers, lawyers, economists and theologians also use these terms frequently with little common understanding among them.⁴⁰ The protean presence of these terms in economics, politics, philosophy, law and other disciplines makes it difficult to pin the terms down into some fixed meanings.⁴¹

³⁹ Hall and Rabushka, the Flat Tax, p. 25

⁴⁰ Ibid

⁴¹ As Marjorie Kornhauser noted “the multifaceted components of fairness, including the economic, political and practical elements, make fairness too complex to determine,” quoted in Leo Martinez, The Trouble with Taxes, p. 420

In the literature, the terms “equity,” “fairness” or “justice,” are often used interchangeably.⁴² Some writers tend to use one of them almost in exclusive preference to the others, while others tend to use them in an interchangeable sense with little preference for one or the other.⁴³

The basic problem is that there is no agreement about what is “fair,” “equitable” or “just.” Many agree that part of the reason why there are tremendous differences in the meanings of these terms is that what is equitable in general is not a scientific one, capable of being reduced into some hard and fast rules, applicable in all cases, relevant for all situations.⁴⁴ Strong convictions about “equity,” “fairness” or “justice” belie the essential subjectivity of what is “equitable,” “fair” or “just”. Perceptions of equity are in the end value judgments subject to various shades of meaning and varied according to the perceptions of a given community.⁴⁵ As Joel Slemrod and John Bakija pointedly acknowledged:

Fairness is not ... a question of economics. Neither an A+ in Economics 101, a PhD in mathematical economics nor a lifetime study of the theory of political economy will reveal the one true answer. Fairness in taxation, like fairness of just about anything, involves ethical issues and value judgments that, by their nature, cannot be decisively resolved.⁴⁶

The fact that the terms “equity” or “fairness” or “justice” are irreducible to some precise meaning should not, however, discourage one from trying to come to terms as to what they mean and have meant for various writers. The sentiment that drives that perennial search is perhaps best

⁴² Due and Friedlaender, *Government Finance*, p. 233

⁴³ As someone is reported to have said, everyone seems to have a pet word of sorts, Gelp quoted in Due and Friedlaender, p. 233; see also Hall and Rabushka, *the Flat Tax*, p. 25

⁴⁴ Due and Friedlaender, *Government Finance*, p. 233

⁴⁵ *Ibid*

⁴⁶ See Slemrod and Bakija, *Taxing Ourselves*, p. 60

summed by Amartya Sen. It is perhaps because many are convinced that “it is better to be roughly right than precisely wrong.”⁴⁷

Some like the British utilitarian philosopher, John Stuart Mill, are undeterred by the essential subjectivism of justice and are convinced that “justice” can be reduced to one acceptable meaning. Mill first identified six different meanings of one of the analogous terms to equity: justice.⁴⁸ For Mill, justice may in different contexts connote “legal rights,”⁴⁹ or “moral rights,”⁵⁰ or “desert,”⁵¹ or “promise keeping,”⁵² or “impartiality”⁵³ or “equality.”⁵⁴

Although Mill identified at least six different senses of justice, he did not resign to the multiplicities of the meaning of justice. As an exponent of utilitarianism, he thought that utilitarianism would offer a resting place to the debate and concluded that “justice is a name for certain classes of moral rules, which concern the essentials of human well-being more nearly, and are therefore of more absolute obligation, than any rules for the guidance of life.”⁵⁵

Some with a skeptical and more relativistic cast of mind, however, have insisted that multiplicities of meaning are an essential quality of “justice.” One of these is R. C. Solomon who

⁴⁷ Quoted in Murphy and Nagel, *The Myth of Ownership*, p. 24

⁴⁸ Mill, *On Liberty and Other Essays*, see pp. 178-180

⁴⁹ In this sense, it is considered unjust to deprive a person of her legal rights, see Mill, *On Liberty and Other Essays* p. 178

⁵⁰ Injustice here consists in taking or withholding from any person that to which she has a moral right, see Mill, *On Liberty and Other Essays*, p. 179

⁵¹ It is universally considered just that each person obtain that which he deserves, whether it be good or evil, see Mill, *On Liberty and Other Essays*, p. 179

⁵² It is generally considered unjust to break faith with anyone, to violate an engagement or disappoint expectations, see Mill, *On Liberty and Other Essays*, p. 179

⁵³ It is regarded inconsistent with justice to be partial; see Mill, *On Liberty and Other Essays*, p. 180

⁵⁴ Mill considers this to be the essence of justice, Mill, *On Liberty and Other Essays*, p. 180

⁵⁵ See Mill, *On Liberty and Other Essays*, p. 195; Mill rejects any abstractions about justice grounded on bases other than utilitarianism; see Mill, *On Liberty and Other Essays*, p. 195

was keen to draw our attention to how the meaning of justice has remained unstable not only among different writers of the same era but also throughout the ages:

What we call justice would not have been recognized as such in Homeric Greece or in the Athens of Plato and Aristotle 400 years later. It is very different from the sense of justice that one would find in feudal France, in the Florentine renaissance, or in the bourgeois London society of Jane Austen. It is very different, indeed, from the sense of justice one finds in contemporary Japan or Iran.⁵⁶

R. C. Solomon then stresses the fickleness of the meaning of justice and urges against the very hope of finding a universal and complete agreement about justice:

The positions have been drawn, defined, refined, and redefined again. The qualifications have been qualified, the objections answered and answered again with more objections, and the ramifications further ramified and embellished. But the hope for a single neutral, rational position has been thwarted every time. The attempt itself betrays incommensurable ideologies and unexamined subjective preferences... We get no universal, strong, and complete system of justice.⁵⁷

The search for the ultimate meaning of “justice” has remained the Holy Grail in the literature. Every new attempt produces its own layer of understanding, revising and modifying the old, and at times rejecting the old altogether. The idea of justice thrives on its elusiveness. It is never captured in a few words. It appears that the pursuit rather than any hope of conquest has produced enough steam in every age to create new and abiding interests in justice.

The best contemporary defense for why we should try to engage in questions of “justice” came from Harvard philosopher Michael Sandel, who in his famous course “The Right Thing to Do,”

⁵⁶ Quoted by Carlin Romano, A Survey and an Assertion, Twelve potted philosophers and a theory of human values, book reviews, summer 2011, the American Scholar, accessed at theamericanscholar.org/a-survey-and-an-assertion/3.uakianh-gwo accessed on June 22, 2012 (reviewing Examined Lives: From Socrates to Nietzsche, by James Miller; Farrar, Straus & Giroux; 422 pp.)

⁵⁷ Quoted by Carlin Romano, A Survey and an Assertion, *ibid.*

said that the fact that centuries of engagement with the meaning of “justice” have produced no consensus is no reason not to continue to think about it. Sandel sets aside the concerns of what he called the “characteristic evasion of skepticism” which despairs over the fact that “Aristotle, Locke, Kant, Mill and others” have not resolved these questions once and for all. He noted that these questions have been debated for a very long time. But “the very fact that they have recurred and persisted may suggest that though they are impossible in one sense, they are unavoidable in another.” According to Sandel, therefore, the reason why these questions have persisted for such a long time is because “we leave some answers to these questions everyday.”⁵⁸

ii. The Need for Tax Equity

Before we review the idea of “tax equity” in the literature, it is necessary to answer the question of why tax equity should be considered as a norm of taxation. The idea of taxation by governments has generated strong sentiments of “fairness” or “equity” throughout the ages. While the drive for tax equity may ebb and flow as popular perceptions of equality and inequality fluctuate, there has hardly been a time when the demand for tax equity completely disappeared from the discourse about taxation.

This is perhaps because fairness is human, all too human. The desire for fairness is pervasive in human relationships, perhaps as a result of “moral and practical instructions inculcated in us since childhood.”⁵⁹ Taxation, as a conspicuous facet of life in government, partakes from that desire for fairness. Taxation represents, in the apt words of Lorenz von Stein, a community’s

⁵⁸ See Sandel, “Justice with Michael Sandel: The Moral Side of Murder,” available at www.justiceharvard.com last accessed on August 12, 2012

⁵⁹ Martinez, *The Trouble with Taxes*, p. 413

“entire civic sense on the economic plane”.⁶⁰ The first impulse for tax equity thus comes from the moral claim that it is only right and appropriate to treat people equally (equality is now a universally recognized constitutional norm).⁶¹

The second impulse for tax equity derives from utilitarian convention and pragmatic acceptance that a fair or equitable tax system is good for the tax system itself, as it encourages voluntary compliance among taxpayers (taxpayers are more likely to comply with taxes that are perceived as equitable).⁶² It has been held that the fairness of the tax system promotes popular confidence and enhances voluntary compliance by taxpayers.⁶³ Several writers have attested to the need to incorporate “equity” as a pillar of the tax system if only to bolster general compliance. Justice Marshall once wrote that “the tax system must be perceived to be fair by the taxpaying public in order to withstand the public’s scrutiny,”⁶⁴ and William Blackstone made the same point when he wrote that “the public perception of the government’s power to tax is a crucial element of tax enforcement.”⁶⁵

⁶⁰ Cited in Green, *Ethics and Taxation*, p. 146

⁶¹ Tiley, *Revenue Law*, p. 10; see also Bird, *Tax Policy and Economic Development*, p. 194; Universal Declaration of Human Rights, Article 7

⁶² Tiley, *Revenue Law*, p. 10; Torgler, *Tax Compliance and Tax Morale*, p. 18; Michael Graetz uses the reaction of Archie Bunker, in *All in the Family* TV Series, as an epigram to one of his articles; when Archie Bunker pointedly declares that he had no intention of paying taxes “from a second job,” he gave the reason that “all those rich guys have their tax shelter” and not paying taxes was his tax shelter, he was expressing the sentiment that people are generally unwilling to pay the taxes they perceive to be unfairly decked against them; Archie Bunker, *All in the Family*, Quoted in Graetz, *100 Million Unnecessary Returns*, p. 279

⁶³ Martinez, *The Trouble with Taxes*, p. 416

⁶⁴ Justice Marshall in *McCulloch v. Maryland* 17 U.S. (4 Wheat) 316, 431 (1819), quoted in Martinez, *The Trouble with Taxes*, p. 416, foot note 15

⁶⁵ William Blackstone, quoted in Martinez, *The Trouble with Taxes*, p. 417 ; Cooper, Krever, Vann and Rider write that “an equitable tax systems is critical not only to the attainment of economic and social

Two powerful impulses have therefore carried the impetus of incorporating equity in taxation: the basic human desire for fairness and the pragmatic understanding that compliance with taxation is driven essentially by the perception of the fairness of the tax system. It must be noted, however, that while the pragmatic need to bolster tax compliance drives some aspects of tax equity, the main driving factor why many countries insist in tax equity remains to be rooted in the long-standing social need to see equity manifested in the tax system.

iii. Theories of Tax Equity

As in the general discourse about the question of equity, we meet with multiplicities of meanings attributed to “equity,” “fairness” or “justice” in taxation. Justice in taxation has meant different things to different people. John Stuart Mill, who tried to synthesize the different versions out there, has done for taxation as he did for general theories of justice.⁶⁶ According to Mill, justice in taxation for some means that taxes “should be in numerical proportion to pecuniary means,”⁶⁷ while others argue that justice requires “graduated taxation,”⁶⁸ and those with a disposition for natural justice have argued that everyone should contribute the same absolute sum, “as subscribers to a ... club... whether they can all equally afford or not.”⁶⁹ And still others have argued that the rich should contribute more to the state as they stand to lose more from its absence than the poor.⁷⁰

objectives, but to the maintenance of a basic respect for the tax system from which a high degree of voluntary compliance derives;” Cooper, Krever & Vann’s *Income Taxation*, p. 5

⁶⁶ Mill, *On Liberty and Other Essays*, pp. 194-195

⁶⁷ *Id.*, p. 194

⁶⁸ *Ibid*

⁶⁹ *Ibid*

⁷⁰ *Id.*, p. 195

Many philosophers and economists have weighed in on the question of tax equity. To Thomas Hobbes, the burden of taxation should be distributed in accordance with the benefits people receive from the state:

... the equality whereof (taxes) dependeth not on the equality of riches, but on the equality of the debt, that every man oweth to the commonwealth for his defence..... the impositions, that are laid on the people by the sovereign power, are not else but wages, due to them that hold the public sword, to defend private men in the exercise of their several trades, and callings.... The equality of imposition, consisteth... in the equality of that which is consumed, than of the riches of the persons that consume them.⁷¹

Of all the moral philosophers, no one has probably given as much attention to the question of tax justice as Adam Smith, who in his monumental work: “The Wealth of Nations” devoted one of his books wholly to the question of taxation.⁷² In Book Five of his work, Adam Smith formulated what he called “maxims of taxation” for what he considered to be (or should be) characteristics of any good tax system.⁷³ Adam Smith is widely cited in the literature for his contribution in this regard.⁷⁴ Adam Smith developed four maxims of taxation, the first (although probably not the most important) of which was the maxim of equality or equity in taxation. To Adam Smith, a tax system should distribute the burden of taxation “in proportion to the ... respective abilities” of taxpayers and these abilities are measured by the “revenue which they [taxpayers] enjoy under the protection of the state.”⁷⁵

In the contemporary discourse of tax equity, two theoretical constructs with roots in the 17th and 18th century debates, have dominated the discourse of what constitute an equitable tax system:

⁷¹ Hobbes, *Leviathan*, p. 229

⁷² See Smith, *The Wealth of Nations*

⁷³ Smith, *The Wealth of Nations*, pp. 777-779

⁷⁴ See Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, p. 219; Herber, *Modern Public Finance*, p. 117

⁷⁵ Smith, *The Wealth of Nations*, p. 777

benefits received and ability-to-pay principles of taxation. We shall review below these constructs and examine their strengths and weaknesses in explaining tax equity.

1. The Benefit Theory of Taxation

One favorite theory of tax justice through the ages has been the idea that taxation, like the prices in the market, is a price for the benefits received from government.⁷⁶ This idea that taxation is based on benefits has been popular among those who liked to believe that government is a limited contract between citizens who need certain public services and the government which has the capacity to provide those services.⁷⁷ The views of those who believe that a just tax system is one that is premised on benefits was colored by the “contract theory of government” in which taxes serve as a consideration for the services provided by governments.⁷⁸ As prices, taxes are therefore just only in so long as they are based on benefits received by taxpayers from government services.

The idea of benefits theory of taxation has had some strong backers from the earliest times. One of the strongest proponents of this theory was the British philosopher, Thomas Hobbes, who, as mentioned above, believed that “the equality” of taxes depends “not on the equality of riches but

⁷⁶ Due and Friedlaender, p. 233; see also Kornhauser, Choosing A Rate Structure in the Face of Disagreement, p.1708

⁷⁷ Tiley, Revenue Law, p. 10

⁷⁸ Kornhauser, Choosing A Rate Structure in the Face of Disagreement, p.1708; over the years, offshoots of the benefit theory of taxation have appeared, with some justifying higher taxes on high income people on the grounds of a strange correlation between the benefits received and the income of individuals; see Kornhauser, Choosing A Rate Structure in the Face of Disagreement, p.1708; see also Dodge, Theories of Tax Justice, p. 402

on the equality of the debt that everyman owes to the common wealth for his defence.”⁷⁹ Another possible defender was none other than Adam Smith himself who wrote statements that could be interpreted as defending the idea of the benefit theory of taxation. When Adam Smith writes that “the subjects of every state ought to contribute... *in proportion to the revenue which they respectively enjoy under the protection of the state,*” (italics added) he may be read as a defender of the idea of benefits as a basis for distribution of tax burdens.⁸⁰ Adam Smith likens the expenses of government to the expenses for the “management to the joint tenants of a great estate,” and he wrote that the joint tenants should “contribute to the maintenance of the estate an amount in proportion to their respective interests in the estate.”⁸¹ However, what Adam Smith exactly means by these statements is a matter of some debate, and some have invoked his name as supporting benefits principle and ability-to-pay in equal order.⁸²

While the benefits theory of taxation has had wide appeal among prominent names, it is now generally acknowledged that the benefit theory of taxation occupies a marginal (though persistent and resilient) position in explaining the perceptions of tax equity in modern discourse.⁸³ This has largely been due to the obvious un-tenability of its assumptions. Due and

⁷⁹ Hobbes, *Leviathan*, p. 229

⁸⁰ Smith, *The Wealth of Nations*, p. 777; Joel Slemrod and Jon Bakija have interpreted Adam Smith as a proponent of the benefit theory of taxation; see Slemrod and Bakija, *Taxing Ourselves*, p. 63

⁸¹ Smith, *The Wealth of Nations*, p. 777

⁸² Richard and Peggy Musgrave believed that Adam Smith understood equity in both benefit and ability-to-pay terms. But they took his statements to be supporting the idea of benefits “in terms of protection received,” which to them is related to the income which is protected under the state. The benefit ideas of Adam Smith are, therefore, according to the Musgraves, more akin in spirit to ability-to-pay than anything else; see Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, p. 219, foot note 1

⁸³ See Slemrod and Bakija, *Taxing Ourselves*, pp. 62-64

Friedlaender have justly called the theory both “unworkable” and “unacceptable” in modern practice of taxation.⁸⁴

It is unworkable because the amounts individual citizens receive from public services cannot be determined or quantified in the majority of cases.⁸⁵ Governments have opted for taxes as coercive ways of raising revenues precisely for the reason that the benefits that accrue to individuals from government services remain indeterminate and indivisible. If governments are able to measure the individual benefits accruing from various government services, they will opt for direct charges, like fees and user charges, but these prices are not amenable for most government services whose benefits are not exclusive to specific individuals.⁸⁶

The benefit theory of taxation is also “unacceptable” in the context of the re-configuration of the duty of modern governments. The welfare of citizens, in social security and even transfer payments, is now considered as one of the duties of governments. Most governments, especially in the developed world, have taken up deliberate policies of redistributing income and wealth among their citizens, through the instrumentality, among others, of taxes.⁸⁷ Redistribution policies, as practiced by governments, are deliberate policy interventions to tax some with a view to benefitting others. There are, therefore, many who argue that basing taxation on benefits violates our “modern” sensibilities of fairness, which puts increasing demands upon governments to commit public resources to benefit low income groups either by relieving these

⁸⁴ Due and Friedlaender, *Government Finance*, p. 234

⁸⁵ Due and Friedlaender, *Government Finance*, p. 234; see also Hyman, *Public Finance*, p. 405

⁸⁶ As David N. Hyman puts it “if individuals know that their share of the financial burden depends on their declaration of benefits, they might have little or no incentive to declare their true benefits;” see Hyman, *Public Finance*, p. 405

⁸⁷ See Due and Friedlaender, *Government Finance*, p. 234; Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, pp. 9-11; Herber, *Modern Public Finance*, pp. 111-113

groups from heavy taxation or by using transfer payments.⁸⁸ If benefits were the standard for distribution of tax burden, these groups would shoulder many of the burdens of taxes, but it is inevitable that they would not be able to pay for the benefits⁸⁹ or we will have to call off programs that are beneficial to low income groups in which event we will have to accept the unpleasant reality that these groups would lose the ability to attain minimum living standards.⁹⁰

The implications of the benefits theory of taxation have appeared to its critics as heartless and indifferent to the plight of the poor. The theory has, nonetheless, found unlikely allies from those that have come to believe that the benefits of governments especially to the rich are being narrowly understood. The modern supporters of the benefits theory of taxation have come to the rescue not by repeating the old mantra but by recasting the arguments which view government benefits in a whole new and expanded light. They argue that the benefits of government services to the poor are being exaggerated by the critics of the benefits theory and the benefits of governments to the rich are being downplayed, all of which increase the implausibility of the benefits theory of taxation as a theory of justice.

One of these is Marjorie Kornhauser who, not content with the narrow understanding of the benefits of government to the rich, has drawn an extensive list of ways in which governments benefit the rich.⁹¹ She writes that governments provide large benefits to the rich both directly and indirectly through tax expenditures. She notes that governments extend tax deductions,

⁸⁸ See Due and Friedlaender, *Government Finance*, p. 234

⁸⁹ Ibid

⁹⁰ Ibid

⁹¹ See Kornhauser, *Choosing A Rate Structure in the Face of Disagreement*, p.1710

credits and exclusions to the rich to encourage certain investments.⁹² She also notes that the “financial elite” benefit from government expenditures in administrative and judicial systems, which not only create and enforce property rights but also increase their value. Even public education, which is apparently intended for the poor, benefits the rich by supplying them with educated and skilled workforce.⁹³ All these examples furnish plausible explanations for why taxes are based on benefits, but they do not really provide a convincing case for why high income groups should bear greater burden of taxation than low income groups.

Although the benefit theory occupies a marginal position in practical tax policy, it still has adherents both from the right and the left of the political spectrum.⁹⁴ Many conservatives and libertarians still would like to view taxation as a fiscal exchange and believe in the primacy of the market and of limited government.⁹⁵ Their view of a limited and small government appears in general to support the idea that taxation should be based on benefits received. Some on the political left have also embraced some version of the benefit theory as long as it accommodates their view that governments play an important role in the creation and the nurturing of economic wealth.⁹⁶ Marjorie E. Kornhauser who, as already indicated above drew up a large catalogue of government benefits for the rich, is willing to accept the benefit principle as plausible as long as it implies that governments create and increase the income and wealth of

⁹² Id, p.1711

⁹³ Id, p. 1712; this idea appears to be quite widespread. The father of Bill Gates, the founder of Microsoft and one of the richest men in the world, campaigned for progressive income and estate taxation arguing that rich people in the United States were able to achieve enormous wealth as a result of the favorable conditions created by the US government which funded scientific research, technological innovation and education; cited in Slemrod and Bakija, *Taxing Ourselves*, p. 63

⁹⁴ See Kornhauser, *Choosing A Rate Structure in the Face of Disagreement*, p.1708

⁹⁵ Ibid

⁹⁶ Ibid

individuals both directly and indirectly through various tax expenditure measures catering for the wealthy.⁹⁷

2. The “Ability-to-Pay” Theory of Taxation

The benefit principle is of relatively limited application in the actual design of tax systems.⁹⁸ In actual tax systems, the number of taxes inspired by “benefits-received” is limited to some specific taxes whose contribution to the overall fiscal economy is marginal at best.⁹⁹ Thus, those who sought a more convincing and pragmatic theory of tax equity have had to search for another theory of taxation. In traditional tax literature, the ability-to-pay theory of taxation has filled that role.¹⁰⁰

Like its counterpart, the ability-to-pay theory has been a popular slogan of tax equity for centuries.¹⁰¹ Indeed, according to Richard Musgrave, the ability-to-pay principle pre-dates the benefit principle, claiming as its adherents prominent thinkers like Jean Jacques Rousseau, Say

⁹⁷ Id, pp.1708-1712

⁹⁸ Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, p. 223

⁹⁹ Some of the taxes in Ethiopia are clearly inspired by benefits received. Excise taxes on petrol and vehicles are in part inspired by the desire to find at least additional financing for roads and highways from those that stand to benefit from these infrastructures; some of the taxes in Ethiopia were introduced with expressed intent to levy tax burdens upon those that benefitted from certain public services (e.g., the education and health taxes in the past); see Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, pp. 114-115, 130-132

¹⁰⁰ See Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, pp. 223; Due and Friedlaender, *Government Finance*, pp. 235-236; see also Gunn, *The Case for an Income Tax*, p. 379

¹⁰¹ Buehler, *Ability-to-Pay*, p. 243; Buehler mentions ancient authorities as supporters of some variant of ability-to-pay theory of taxation. According to Buehler, Manu, the 13th or 14th century Indian lawgiver advocated a variant of sacrifice theory, as did Herodotus, Livy and Cicero (Cicero in particular was said to have made wealth synonymous with faculty or ability); see Buehler, *Ability-to-Pay*, pp. 245-249; from the 18th and 19th centuries, Buehler cites Adam Smith and John Stuart Mill as proponents of ability-to-pay theory of taxation); many think Adam Smith advocated the ability-to-pay principle as a measure of tax equity, but some of his statements appear to betray his support for the benefit principle as well; see Musgrave, *Horizontal Equity: Once More*, p. 114

and John Stuart Mill.¹⁰² Despite its wide following and frequent mention in the literature of tax equity, the meaning of the ability-to-pay theory has remained one of the most elusive.¹⁰³

The first problem of the theory is the notion of “ability.” Even if we were all to agree that taxation be based on ability, a difficulty immediately arises in how to measure ability.¹⁰⁴ Some have understood ability in its negative sense, in terms of the pain or sacrifice caused by taxation while others have preferred to latch ability onto objective and positive tests such as net income, property or consumption.¹⁰⁵ Those who prefer the objective tests of ability accuse those who emphasize sacrifice of giving prominence to the negative side of ability (i.e., pain, sacrifice) and ignoring the positive elements of ability.¹⁰⁶

The divergent positions on what constitutes “ability” have given rise to a number of theories surrounding “ability-to-pay” in taxation. The most famous is the “equal sacrifice” theory. The “equal sacrifice” version of ability-to-pay theory posits that taxation is a burden and should therefore be imposed to ensure that each taxpayer sustain the same loss of welfare.¹⁰⁷ One of its prominent exponents, John Stuart Mill thus famously wrote:

A government ought to make no distinction of persons or classes in the strength of their claims on it. If anyone bears less than his fair share of the burden, some other person must suffer more than his share. *Equality in taxation, therefore, as a maxim of politics, means equality of sacrifice (italics added).*¹⁰⁸

¹⁰² See Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, p. 223, footnote 5; if we take Thomas Hobbes as an early exponent of the benefit theory of taxation, the contrary is probably the case.

¹⁰³ Buehler, *Ability-to-Pay*, p. 243

¹⁰⁴ *Ibid*

¹⁰⁵ *Ibid*

¹⁰⁶ *Id*, p. 249

¹⁰⁷ Murphy and Nagel, *The Myth of Ownership*, p. 24

¹⁰⁸ Mill, *Principles of Political Economy*, p. 622

Equal sacrifice theory views taxation as “a deprivation to the taxpayer.” But for taxation, a taxpayer would “have spent the money for her own purposes” instead of turning it over to government.¹⁰⁹ In order to ensure that “equal sacrifices” are “imposed on all,”¹¹⁰ the theory requires that the rich should pay at a higher rate than the poor, as equal sacrifice requires increasing the burden as income or wealth rises.¹¹¹ Based on the assumption that the marginal utility of money diminishes with its increase [money being the primary medium of paying taxes], the “equal-sacrifice” theory requires levying a higher tax as income increases “so that everyone shares the same proportion of the cost of the common burden.”¹¹²

Even if the “equal sacrifice” theory were to be accepted because it somehow makes intuitive sense, it is far from clear how “equal sacrifice” may be exacted from taxpayers. It is not clear, for example, if the theory “calls for progressive taxation” (not to speak of the proper degree of progression) or proportional taxation.¹¹³ Because of lack of agreement on how “equal sacrifice” is to be exacted from taxpayers, the “equal sacrifice” theory itself has splintered into at least three camps: “equal absolute sacrifice,” “equal proportional sacrifice” and “least sacrifice” theories.¹¹⁴

According to “equal absolute sacrifice” theory, an equitable tax is one in which “the sacrifices of all taxpayers are equal”- literally speaking.¹¹⁵ Supporters of this version of equal sacrifice seem to believe in the equality of the quantity of sacrifice and admit of no exception whatsoever as far as

¹⁰⁹ Kendrick, *The Ability-to-Pay Theory of Taxation*, p. 92; a telling example is provided by Slemrod and Bakija: “a \$ 100 more in taxes may require an affluent family to cut back on magazine subscriptions, but it may force a poor family to eat less”; see Slemrod and Bakija, *Taxing Ourselves*, p. 64

¹¹⁰ Henry Sidgwick quoted in Tapan-Mitra and Ok, *Personal Income Taxation and the Principle of Equal Sacrifice Revisited*, p. 925

¹¹¹ Tapan-Mitra and Ok, *Personal Income Taxation and the Principle of Equal Sacrifice Revisited*, p. 925

¹¹² See Murphy and Nagel, *The Myth of Ownership*, p 24; see also Herber, *Modern Public Finance*, p. 119

¹¹³ Tapan-Mitra and Ok, *Personal Income Taxation and the Principle of Equal Sacrifice Revisited*, p. 926

¹¹⁴ Kendrick, *The Ability-to-Pay Theory of Taxation*, p. 93

¹¹⁵ *Ibid*

sacrifice goes.¹¹⁶ If marginal utility were assumed to be constant, the theory of “equal absolute sacrifice” may be said to call for an equal sum payment from all taxpayers, in other words, a head tax. But, since marginal utility is usually assumed to fall with the rise in income, the theory might call for differential sacrifice, although it is not yet settled if it calls for progressive taxation or proportional taxation.¹¹⁷

In its classic sense, “equal absolute sacrifice” drew its supporters from those who, particularly during the French Revolution, were intent on abolishing “objectionable privileges” and exemptions for the privileged classes.¹¹⁸ “Equal absolute sacrifice” was opposed to any exemptions and privileges, either on account of wealth, or lack thereof.¹¹⁹ “Equal absolute sacrifice” is incredibly simple – given the total sum of government revenues needed at any given time, all one needs to figure out is the needed rate to raise the needed revenue from the number of people available for taxation.¹²⁰ But simplicity is not everything, and that probably accounts for why this theory “has been vehemently opposed as failing to give a just distribution of the public charges.”¹²¹

The second off-shoot of “equal sacrifice” theory – the theory of “equal proportional sacrifice” – calls for taxation in such a way that taxpayers bear an equal tax burden in proportion to their income.¹²² According to this theory, higher income groups should bear a greater sacrifice than lower income groups in absolute terms but in proportion to their income. The “equal

¹¹⁶ Ibid

¹¹⁷ Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, p. 229

¹¹⁸ Bastable, *Public Finance*, pp. 169-170

¹¹⁹ Id, p. 169

¹²⁰ Id, p. 170

¹²¹ Ibid

¹²² Kendrick, *The Ability-to-Pay Theory of Taxation*, p. 93

proportional sacrifice” theory seems to require imposing greater sacrifices on higher income groups in order to ensure the proportional sacrifice in relation to income.¹²³ Once again, the degree of progression in taxation seems to depend on the slope of marginal utility of income. If the utility of income remains constant with the rise in income, then, the theory of “equal proportional sacrifice” would call for proportional taxation, but if it falls, some level of progression in taxation is called for.¹²⁴

The third offshoot of sacrifice theory – the “least sacrifice” theory – is more interested in the impact of taxation upon groups of taxpayers than on individuals, tolerating disproportionate burdens upon the few as long as the total burden upon all remains the least.¹²⁵ As its name suggests, the objective of “least sacrifice” theory is to distribute tax burdens so that the group as a group suffers the “least sacrifice.”¹²⁶ If it has its way, the least sacrifice theory begins from the very rich and then proceeds to the rich and so on, calling for the progressive elimination of higher income by taxation.¹²⁷ Unlike the other versions of “sacrifice,” the “least sacrifice” theory calls for an “extreme form of progression, approximating to, if not actually attaining, a state of socialistic equality.”¹²⁸

Although the three versions of equal sacrifice theory might yield divergent results on how total burden should be distributed, they are all united by their belief in the declining marginal utility

¹²³ Ibid

¹²⁴ Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, p. 230

¹²⁵ Kendrick, *The Ability-to-Pay Theory of Taxation*, p. 93

¹²⁶ Ibid

¹²⁷ Ibid

¹²⁸ Bastable, *Public Finance*, p. 172

of money.¹²⁹ The theory of declining marginal utility is said to be derived from the declining marginal utility of consumption which is intuitively accepted by many. If the marginal utility of consumption declines with the rise in consumption, the theory runs, so should the marginal utility of money – which, after all, expresses command over goods and services (present and future consumption).¹³⁰

Like all the theories that have come and gone, the “equal sacrifice” theory has not gone without criticisms. The most powerful objection to the “equal sacrifice” theory has come from critics who dismiss the idea and/or possibility of “tax justice” as separate from the other issues of justice in society. These critics charge that the “equal sacrifice” theory “treats the justice of tax burdens as if it could be separated from the justice of the pattern of government expenditure”.¹³¹ In the powerful words of Liam Murphy and Thomas Nagel, the [equal sacrifice] theory treats:

...the collection of taxes as though it were only a common disaster – as though the tax money once collected were thrown into the sea. What matters is not whether taxes – considered in themselves – are justly imposed, but rather whether the totality of government’s treatment of its subjects, its expenditures along with its taxes, is just.¹³²

Some critics and skeptics of “equal sacrifice” theory of taxation remain unconvinced by the analogy of the value of money with the value of consumption.¹³³ Since money can be put to multiple uses like the acquisition of power and prestige, it has never been clear if the utility of money declines with the more of it.¹³⁴ Even more problematic has been the slope of the decline

¹²⁹ Kendrick, *The Ability-to-Pay Theory of Taxation*, p. 94; see also Due and Friedlaender, *Government Finance*, pp. 237-238

¹³⁰ Kendrick, *The Ability-to-Pay Theory of Taxation*, p. 94

¹³¹ Murphy and Nagel, *The Myth of Ownership*, p. 25.

¹³² *Ibid*; this objection, it must be owned, is not leveled against the “equal sacrifice theory” of tax justice per se. It is an objection, if true, can be leveled against all theories of tax justice as tax justice.

¹³³ See Kendrick, *The Ability-to-Pay Theory of Taxation*, p. 95

¹³⁴ *Ibid*

and the degree of progression that needs to be applied in order to ensure that the progressive rate structures maintain “equal sacrifice” among taxpayers.¹³⁵ The degrees of progression can be “infinite in number,” and none of them can be said to be based on some scientific reason that progression should rise in any particular slope.¹³⁶ In the final analysis, any support for a progressive taxation, particularly when that is grounded in the declining marginal utility of money, cannot escape from the conclusion drawn by Leon Say that “progression is naturally arbitrary.”¹³⁷

Critics of “equal sacrifice” theory have held that the theory like all theories about fairness in the end rests on sentiments. The theory may be “a sensible and even compelling proposition,” but it “is impossible to prove”.¹³⁸ As Slemrod and Bakija wrote, it is impossible “to quantitatively compare across individuals the sacrifice caused by having less money, just as it is impossible to compare the pain caused to two people by a pinprick.”¹³⁹ We cannot assert that two individuals (A and B), with identical amount of income, have made equal sacrifices simply because they are subject to the same tax rate. No two individuals can feel the pinch of taxation equally. A may not care as much about money as B does. A may derive great satisfaction from leisure, which is practically beyond the reach of taxation.

The “equal sacrifice” theory is not the only version of ability-to-pay theory of taxation out there. Alternative versions of “ability-to-pay” have emerged although they have not been able to command as much attention as the “sacrifice” theory. One version that has held some

¹³⁵ Id, p. 96

¹³⁶ Bastable, Public Finance, p. 172

¹³⁷ Leon Say, cited in Bastable, Public Finance, p. 172

¹³⁸ Slemrod and Bakija, Taxing Ourselves, p. 65

¹³⁹ Ibid

fascination in theoretical circles is the so-called “endowment theory” of ability. The “endowment theory” proposes the distribution of tax burden according to the potential income individuals earn rather than their actual income, as is usually the case.¹⁴⁰ The “endowment theory,” as its name suggests, rests the burden of taxation upon “endowment,” “which is defined as [the] ... ability to earn income and accumulate wealth”.¹⁴¹

For many people, potential income is usually higher than their actual income because of the choices individuals make in trading their income-earning potential for a pursuit of a career that promises less income-earning potential (e.g., if a corporate executive or a person with a potential to become one abandons her lucrative career for a life in literary writing, whose potential to earn income is precarious). The theory of resting tax burdens upon “endowment” may be appealing at first sight, but it is more easily said than done. As such, few have dared propose this theory for implementation in actual tax systems. Indeed, the reason why it has held attention in theoretical circles is not because of its potential for actual tax policy but because of its capacity to bring to light the disincentives income tax systems based on actual income have caused to those who choose to work (thus earn more) vis-à-vis those who choose leisure over work.¹⁴²

The theories of equality in taxation are as diverse as the theories of equality in general. Those who see equality in terms of creating level-playing fields and “entitlement” to one’s earnings are more likely to remain content with the idea of “equality of opportunity,” thus viewing the idea of

¹⁴⁰ Murphy and Nagel, *The Myth of Ownership*, p. 20; see also See Graetz and Schenk, *Federal Income Taxation*, p. 29

¹⁴¹ Murphy and Nagel, *The Myth of Ownership*, p. 20

¹⁴² See *Id.*, pp. 20-22

“equality in and through taxation” as an unjustified intrusion, while those with Rawlsian “egalitarian” sympathies are more likely to call for a tax system that distributes tax burdens in proportion to the level of welfare, with the result that the better-off persons should sacrifice more through taxation in order to benefit the least well-off.¹⁴³

In addition to what tax distribution assures distribution in accordance with “ability-to-pay,” the question of what indices to use to measure ability have remained controversial in the literature.¹⁴⁴ The objective indices of ability-to-pay have changed over the years. In the ancient times, the ability of individuals was measured by the conspicuous wealth they possessed, such as their ownership of land or cattle, and this allowed a lot of other forms of property to escape taxation.¹⁴⁵ And as the inadequacies of the ancient tax systems became apparent, some began suggesting that “the expenditures of individuals for consumption would provide an ideal indicator of ability.”¹⁴⁶ In time, both property and consumption taxes as they were practiced by governments proved defective as measures of ability.¹⁴⁷ One of the dissatisfactions with these taxes was that they were not adjusted to individual circumstances as to accord with the changing times.¹⁴⁸ In their place, the personal income tax, with its levy on the net income of individuals, after allowances for personal economic status, has come to be increasingly seen as “the most

¹⁴³ See Graetz and Schenk, *Federal Income Taxation: Principles and Policies*, p. 29; see also Elkins, *Horizontal Equity as a Principle of Tax Theory*, pp. 70-71; Sugin, *Property, Taxation and Distributive Justice*; Narveson, *Anarchy, State, and Utopia Thirty Years Later*.

¹⁴⁴ See Due and Friedlaender, *Government Finance*, pp. 236; Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, pp. 224-227

¹⁴⁵ Buehler, *Ability-to-Pay*, p. 249; in retrospect, the indices of ability in the ancient and medieval times were crude as the conspicuous measurement of ability were limited even in the best of times. At times, they appeared whimsical as in the case of medieval England in which the number of windows determined tax liability, apparently linking ability with the number of windows one’s mansion has; see Graetz and Schenk, *Federal Income Taxation* p. 37

¹⁴⁶ Buehler, *Ability-to-Pay*, 250

¹⁴⁷ *Id.*, 251

¹⁴⁸ *Ibid*

satisfactory measure of ability.”¹⁴⁹ Nonetheless, the battle between the alternative bases of taxation to measure ability-to-pay is unlikely to be resolved in a triumph of one over the others.¹⁵⁰

Lastly, the ability-to-pay theory has faced challenges finding a quantitative measure of ability-to-pay.¹⁵¹ Although a quantitative measurement should ideally reach “the entire welfare which a person can derive from all the options available to him or her,” such a comprehensive measure is not practicable, with most actual tax systems settling for “observable measures” like income, consumption or wealth.¹⁵² Actual tax systems have only been able to reach (even in the best of times) observable indices of ability such as income, consumption or wealth, and even then only a portion of those, leaving out difficult-to-measure satisfactions like leisure and imputed income.¹⁵³

a. The Two Strands of Tax Equity: Horizontal and Vertical Equity

Any tax theory that proposes to distribute tax burden in accordance with “ability-to-pay” must come to grips with twin questions of how to treat “equals” as well as “unequals,” assuming that “equality” as well as “inequality” can be known and measured in objective terms. In the literature, the ability-to-pay principle is often said to require two standards of equity – equal treatment of equals (*horizontal equity*), and unequal treatment of unequals (*vertical equity*).¹⁵⁴

¹⁴⁹ Ibid

¹⁵⁰ See Graetz and Schenk, *Federal Income Taxation*, 39

¹⁵¹ Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, 223

¹⁵² Ibid

¹⁵³ Ibid; see also Due and Friedlaender, *Government Finance*, pp. 235-238 and 256-262

¹⁵⁴ Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, p. 223; see also Musgrave, *Horizontal Equity: Once More*, p. 113; Kaplow, *Horizontal Equity: Measures in Search of a Principle*, p. 139

The two strands, while treated separately in the theoretical literature, are not really distinct theories of equity but dimensions along an equity spectrum.¹⁵⁵ The equal treatment of equals – which horizontal equity prescribes – is recognized as a basic treatment of “equality under the law” in many constitutions.¹⁵⁶ Vertical equity has also been said to be in line with equal treatment under the law.¹⁵⁷

Horizontal equity is intuitively appealing to anyone familiar with the constitutional guarantees of “equality under the law” or “equal protection of the law” but its practical implementation is not as easy as it at first sounds.¹⁵⁸ The chief problem in applying “horizontal equity” in taxation is that of defining the elements of “equal circumstances.”¹⁵⁹ Two individuals with the same amount of income may be “in equal circumstances” if we consider their income *per se*, but they may be different and unequal in many other situations – such as marital status, number of dependents and even medical conditions.¹⁶⁰

Some modern tax systems have grappled with these individual circumstances and attempted to take individual and family circumstances into account in distributing tax burden.¹⁶¹ The

¹⁵⁵ See Murphy and Nagel, *The Myth of Ownership*, p. 37

¹⁵⁶ See Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, p. 223; see also the Constitution of Ethiopia, Article 25; the U.S. Constitution, 14th Amendment; some constitutions have specific prescriptions of equality in taxation; see for example, Greek Constitution, Articles 4 and 5, cited in Forstakis, “Greece – National Report,” p. 331; the Constitution of Italy, Article 53, which requires citizens to contribute to public expenditure in accordance with “their ability to pay,” cited in Garbarino, “Italy – National Report,” p. 406.

¹⁵⁷ Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, p. 223; see also Kaplow, *The Theory of Taxation and Public Economics*, p. 396

¹⁵⁸ Due and Friedlaender, *Government Finance*, p. 234; see also Elkins, *Horizontal Equity as a Principle of Tax Theory*, p. 44

¹⁵⁹ Due and Friedlaender, *Government Finance*, p. 234

¹⁶⁰ *Id.*, pp. 234-235

¹⁶¹ The American Tax System has separate tax rate structures for single persons, married persons who file jointly, and taxpayers who are heads of households; the French income tax system applies income tax

experience so far is that “it is virtually impossible to obtain an operational definition of equal circumstances” for application in actual tax systems, so diverse and unique and at times incomparable individuals are in each comparison.¹⁶² That is why some are content to define it by what horizontal equity is not rather than what it is. Bernard Selanie thus defined it as a norm that specifies that “the effect of the tax system on individuals should not vary with respect to irrelevant individual circumstances,” but, as Bernard Selanie realizes, what constitutes “irrelevant individual circumstances” immediately begs the question.¹⁶³

Actual income tax systems have settled for a limited set of factors of comparison for measuring “equality” or “inequalities” among tax units. Interpersonal comparison in tax policy is often a rough and ready policy that aims at the modest goal of treating “similarly situated” individuals equally rather than aiming for the near impossible goal of treating “identically situated” individuals equally. For practical purposes, two individuals may be subject to the same tax rate schedule as long as their incomes broadly fall in the same income bracket category. It is impossible to produce an income tax rate schedule that varies tax rates for each rise in income.¹⁶⁴ Nonetheless, the whole exercise of trying to achieve a modicum of equality should not be viewed as an exercise in futility.¹⁶⁵

rates upon the income of families or households; see James R. Repetti, “United States,” p. 176.; West, “France,” p. 48

¹⁶² Due and Friedlaender, *Government Finance*, 235

¹⁶³ Selanie, *The Economics of Taxation*, p. 149

¹⁶⁴ See Elkins, *Horizontal Equity as a Principle of Tax Theory*, p. 45

¹⁶⁵ In the literature, horizontal equity has received greater attention than vertical equity, because of everyday encounters with apparent violations of horizontal equity in actual tax systems; see Murphy and Nagel, *The Myth of Ownership*, p. 37

While horizontal equity is chiefly concerned with obtaining parity in taxation between two tax units of equal circumstances, “vertical equity is concerned with the distribution of the tax burden along society’s socio-economic spectrum.”¹⁶⁶ Vertical equity helps us determine “the appropriate tax burden on households of different levels of well-being.”¹⁶⁷ As anything in this literature, the meaning of vertical equity has changed over the years. Originally, it was used to justify the levying of heavy tax burdens on wide segments of society for the benefits of the upper classes (the well-off). In its contemporary context, vertical equity aims at reducing the level of economic inequality in societies.¹⁶⁸

If horizontal equity in taxation means that those with equal taxpaying abilities should pay equal amounts of tax, it follows that those with unequal taxpaying abilities should be made to bear unequal burdens of taxation. The insight for unequal taxation of unequals is drawn from the equal sacrifice theory of taxation, which posits that only when individuals or tax units in general with unequal taxpaying abilities are required to pay unequal amounts that equality of sacrifice can be ensured.¹⁶⁹ It is generally agreed that anyone who accepts the insights of the theory of “equal sacrifice” in taxation must accept the consequence of tax units bearing differential tax burdens according to their respective abilities, although it is by no means clear by how much the tax burden should be raised as the ability of the person rises or the vice versa.¹⁷⁰

As in “sacrifice” theory, the notion of vertical equity has given rise to two basic questions: the question of “whether the tax burden ought to be distributed in a progressive fashion and if so,

¹⁶⁶ Elkins, *Horizontal Equity as a Principle of Tax Theory*, p. 51

¹⁶⁷ Slemrod and Bakija, *Taxing Ourselves*, p. 59

¹⁶⁸ Elkins, *Horizontal Equity as a Principle of Tax Theory*, p. 51

¹⁶⁹ Herber, *Modern Public Finance*, p. 119

¹⁷⁰ See *ibid*

how progressive it should be.”¹⁷¹ Positive economics has not been able to provide a scientific basis for determining and defining “ability,” and as a result the actual tax burden of taxpaying units has been determined through a political process, which by itself is presumed to be a product of collective and diffuse bargaining in every society.¹⁷²

In the Western democracies, income has often been used as proxy for measuring abilities, with consumption and wealth constituting other proxies to a lesser extent.¹⁷³ Practical revenue considerations have also forced most governments to restrict the measurement of “ability” by shorter time-frames like a year than an ideal life-time.¹⁷⁴ In the end, although the superficially scientific literature keeps piling up, it is the practical world of politics that legislates and executes its version of rough justice. Some theories are less or more plausible than others, but there is none that commands the voice of reason as to exclude all the other alternatives.

iv. Contemporary Concerns in Tax Equity: The Optimal Tax

Approach

While there is a general sense that the pursuit of tax equity may conflict with the other principles of taxation, the treatment of tax equity usually proceeded on the presumption that the question of equity could stand on its own as one of the primary goals of taxation. Those who dealt with the various principles of taxation treated tax equity on its own and were content to mention in passing that this principle of taxation may conflict with the other principles of taxation. The rise into prominence of the “optimal tax approach” since the 1970s appears to have

¹⁷¹ Slemrod and Bakija, *Taxing Ourselves*, p. 60

¹⁷² See Herber, *Modern Public Finance*, p. 119

¹⁷³ *Ibid*

¹⁷⁴ See *ibid*

changed that trajectory of the debate about the appropriate goals of taxation.¹⁷⁵ In some ways, the “optimal tax” approach represents a variant of the benefit principle of taxation, as both represent “an effort to integrate the efficiency and equity aspects of public sector economics.”¹⁷⁶

The optimal tax theory helps to integrate the various welfare effects of taxation and points to an “optimal” type of tax, the tax rate differential as well as progressivity.¹⁷⁷ Its adherents have developed a number of economic models to test the various taxes in terms of particularly “equity” and “efficiency” and have provided insights about how various taxes impact the behavior of tax payers and the allocation of goods and services.¹⁷⁸ The basic function of the optimal tax theory is purportedly to help governments decide the types and rates of taxes that maximize social welfare once they decide to raise a certain amount of revenues in taxes.¹⁷⁹

In the area of income taxation, the optimal theory of taxation posits that progressive income taxation results in allocational inefficiencies and interferes in personal decisions as to make the joint analysis of equity and efficiency imperative.¹⁸⁰ The optimal theory of taxation directs the attention of the analysis on the efficiency costs of taxation and aims to integrate that aim with equity concerns. It is known that progressive income taxation leads to what economists call “the excess burden” or “dead-weight loss” as the tax burden affects the work-leisure decisions of

¹⁷⁵ See Herber, *Modern Public Finance*, p. 125-126, citing J. A. Mirrlees, “An Exploration in the Theory of Optimal Income Taxation,” 1971; see also Kaplow, *The Theory of Taxation and Public Economics*, p. 391; Selanie, *The Economics of Taxation*, p. 59

¹⁷⁶ Herber, *Modern Public Finance*, p. 125

¹⁷⁷ See Gentry, “Optimal Taxation,” available at <http://www.urban.org/publications/1000539.html> accessed on August 12, 2012, p. 307

¹⁷⁸ Id., pp. 307-309; see also Zee, *Theory of Optimal Commodity Taxation*, pp. 71-74; Zee, *Theory of Optimal Income Taxation*, pp. 118-121

¹⁷⁹ See Selanie, *The Economics of Taxation*, p. 60

¹⁸⁰ See Herber, *Modern Public Finance*, p. 125; see also Zee, *Theory of Optimal Income Taxation*, pp. 118-121

taxpaying units.¹⁸¹ The steeper the progressivity of the income tax, the greater the “excess burden” of the tax.¹⁸²

While concerns about equity alone can lead to significant distortions, the optimal theory of income taxation directs our attention to the degree of vertical equity and the extent to which this leads to trade-offs. Instead of increasing progressivity of the income tax, the optimal theory suggests that a flatter marginal tax rate at the top end of the income scale would yield better results both in terms of ensuring equity of the tax system and economic efficiency.¹⁸³

The relevance of the optimal theory of taxation is also seen in its attempts to focus our attention to the expenditure side of tax policy. The revenues collected from progressive income taxes are transferred to individuals and this yields “a distributional gain to recipient lower-income taxpayers who receive part of these revenues.”¹⁸⁴ The virtue of the optimal theory of taxation is that it helps us to internalize the distributional impacts of expenditure policy as part of tax equity instead of merely focusing upon the distributional impacts of progressive income taxes.¹⁸⁵ According to the optimal theory of taxation, “the optimal income tax rate structure is said to be that which would balance” the “allocational excess burden and distributional-equity considerations” resulting from the transfer of government revenues to lower-income groups.¹⁸⁶

¹⁸¹ See Herber, *Modern Public Finance*, p. 125

¹⁸² *Ibid*

¹⁸³ See Tiley, *Revenue Law*, p. 14

¹⁸⁴ Herber, *Modern Public Finance*, p. 125

¹⁸⁵ See *ibid*

¹⁸⁶ See Herber, *Modern Public Finance*, p. 126

However, the optimal theory of taxation has introduced its own layer of complexity in understanding what tax systems actually constitute a fair tax system.¹⁸⁷ Its critics fear that it might “undermine the desirability of tax systems with an income benchmark for the attainment of vertical tax equity.”¹⁸⁸

Critics also maintain that even if the assertions of optimal tax theory were true, there are serious practical hurdles to employing the theory in actual tax policy.¹⁸⁹ The optimal tax theory appears to suggest that it is alright (in the case of commodity taxes) to impose differential rates of taxation upon various goods and services depending upon their demand-responsiveness to the rise in taxes, but identifying these goods and services is difficult.¹⁹⁰ Theoretical models may work upon one or two types of goods and services as scientifically and plausibly as possible, but in the world of practice, we are confronted with literally thousands and thousands of goods and services, and modulating tax rates according to the demand elasticity of these goods and services is not as easy as the theoretical models.

The other problem of the optimal tax approach is that, while it aims to strike a compromise between the goals of equity and efficiency, it conflicts with the goals of equity and simplicity in individual cases.¹⁹¹ Tax rate differentiation according to the demand elasticity of goods has the undesirable consequence of punishing those individuals whose taste happens to favor those

¹⁸⁷ See Kaplow, *The Theory of Taxation and Public Economics*, p. 391

¹⁸⁸ Herber, *Modern Public Finance*, p. 126

¹⁸⁹ See Slemrod and Bakija, *Taxing Ourselves*, p. 132; see also Selanie, *The Economic of Taxation*, pp.147-157; one problem for the implementation of the theory is that it requires tax systems to “reconstruct ex nihilo,” in order to meet its exacting standards, which real life tax reformers cannot do; see Selanie, *The Economic of Taxation*, p. 148

¹⁹⁰ See Slemrod and Bakija, *Taxing Ourselves*, p. 132

¹⁹¹ See *ibid*

goods that are taxed at high tax rates because of the demand inelasticity of these goods.¹⁹² This specifically means that because food items are generally demand inelastic, we have to impose higher tax rates upon these items, with the undesirable consequence of heavier burden falling on those who spend most of their earnings on food, in short, the poor.¹⁹³

The application of differential tax rates depending on the demand elasticity of goods is not also easy to administer.¹⁹⁴ If the system particularly has to accommodate tax credits for taxes paid on inputs, the administration will become prohibitively difficult. It should be remembered that the reason why tax advisers have consistently argued for uniform and standard tax rate in taxes like the VAT is in large part borne out of the concern that multiple tax rates are difficult for the tax administration to handle.¹⁹⁵ If the application of two or three tax rates is considered difficult to administer, how much more difficult will it be to have as many tax rates as the numbers of goods or categories of goods would suggest under the optimal tax theory?

b. Efficiency

Efficiency is often used as a twin evaluator of tax systems in general or individual taxes in particular. Some append an adjective¹⁹⁶ to “efficiency” while others are content to use “efficiency” alone.¹⁹⁷ Efficiency in broad terms relates to the costs of taxation. When an adjective “administrative” is added, it is often employed in order to emphasize the direct costs of taxation

¹⁹² Ibid

¹⁹³ Ibid

¹⁹⁴ Ibid

¹⁹⁵ See Williams, Value-Added Tax, pp. 213-214

¹⁹⁶ See, for example, Tiley, Revenue Law, p. 12; see also Zee, Taxation and Efficiency, p. 25

¹⁹⁷ See Richard and Peggy Musgrave, Public Finance in Theory and Practice, p. 60; sometimes, Pareto efficiency is used (called after the Italian economist); see, Richard and Peggy Musgrave, Public Finance in Theory and Practice, p. 60; see also Pilla, Ten Principles of Federal Tax Policy p. 8;

– namely, the cost of taxation to tax administration (administrative cost), and the cost of taxation to taxpayers (compliance cost).¹⁹⁸ When efficiency is used alone without any adjective, it implies much more than administrative and compliance costs of taxation. It implies the so-called “efficiency cost” of taxation, or what is sometimes referred to in economic literature as “the dead-weight loss” or “excess burden” of taxation. The dead-weight loss is the hidden cost of taxation to taxpayers, that which is accounted neither in the amount of tax paid to the government nor in the compliance cost incurred by taxpayers.¹⁹⁹

Many writers on tax have worried about the costs of taxation in their various forms. Adam Smith, for example, sensed that taxation could have significant costs over and above what is drawn by the public treasury, although he did not use the word “efficiency” to analyze this aspect of taxation. Under his maxim of “economy,” Adam Smith dealt with an issue that is today subsumed under the principle of efficiency. Adam Smith was able to pinpoint almost all aspects of “costs of taxation,” which are discussed under “efficiency” in contemporary literature. According to Adam Smith, the “costs of taxation” are manifested in overt cases if it requires for its administration “great number of officers whose salaries eat up the greater part of the produce of the tax and whose perquisites ... impose... additional tax upon the people” and in insidious ways when taxes obstruct “the industry of the people” and discourage “taxpayers from applying certain branches of business which might give maintenance and employment to great multitudes,” when “heavy penalties and forfeitures” tempt “taxpayers to evade taxes” and when tax administration is organized such that it subjects “taxpayers to frequent visits of tax-

¹⁹⁸ See Tiley, Revenue Law, p. 12; see also Kay, Tax Policy: A Survey, pp. 60-61

¹⁹⁹ See Kay, Tax Policy: A Survey, p. 48

gatherers” and exposes taxpayers to “unnecessary trouble, vexation and oppression.”²⁰⁰ It can be clearly seen from the writing of Adam Smith that he was fully aware of and warned against the administrative costs of taxation (taxation requiring great number of officers), compliance costs of taxation (taxation exposing taxpayers to frequent visits of tax-gatherers) and the efficiency costs of taxation (taxation obstructing the industry of the people and tempting taxpayers to evade taxes).

In spite of the tremendous attention “efficiency” has received in the literature, it remains to be the case that “efficiency” has meant different things to different people. Those who write from the limited concerns of tax administration may understand “efficiency” in terms only of the direct costs of taxation, such as the costs of personnel administration within the tax authorities.²⁰¹ Many economists today focus on the less obvious but more insidious aspects of taxation – the hidden costs of taxation, the costs of tax “distortions.”²⁰² Distortions or as some would call them “efficiency costs” or “excess burden” of taxation are those disincentives arising from the levying of taxes, the social or economic costs that are manifested in the form of deterrence of certain behaviors which would have yielded some social benefits (what Adam Smith referred to as those aspects of taxation that obstruct the industry of the people).²⁰³ These costs of taxation are not usually seen in the cost accounts of either the government

²⁰⁰ Smith, *The Wealth of Nations*, pp. 778-779

²⁰¹ Kay, *Tax Policy: A Survey*, p. 60

²⁰² See Richard and Peggy Musgrave, *Public Finance in Theory and Practice*, p. 292; Herber, *Modern Public Finance*, p. 96, Nagel and Murphy, *The Myth of Ownership*, p. 97; see also Pilla, *Ten Principles of Federal Tax Policy*, p. 8;

²⁰³ See Nagel and Murphy, *The Myth of Ownership*, p. 97; see Due and Friedlaender, *Government Finance*, pp.228-229; the excess burden of taxation may be manifested in the distortion of factor supplies in the labor markets, or in the substitution of the lesser taxed goods for the higher taxed goods, or in the misallocation of production activities; see Due and Friedlaender, *Government Finance*, p. 228

(administrative cost) or the taxpayers (compliance cost).²⁰⁴ Economists have paid more attention to these effects of taxation than the other costs of taxation presumably because they felt that these costs of taxation are undetected through the naked eyes of tax administrators.²⁰⁵ Many economists have, for example, maintained that income taxes in general have the undesirable consequence of encouraging individuals to choose leisure over labor, as the former is not reached by the income tax.²⁰⁶ By deterring work (in particular extra work), income taxes harm both the worker and the potential employer, as a result of which each of whom may be said to have lost the opportunity for gain.²⁰⁷

In general, taxes produce “dead-weight losses” through what is known as their “substitution effects.” The substitution effect is created, for example, when taxes influence the behavior of taxpayers in choosing “lower-taxed options,” such as leisure over work, or present over future consumption.²⁰⁸ The efficiency of a tax is a function of the tax base, and in this sense, taxes will be thoroughly efficient if we are able to find a completely inelastic tax base.²⁰⁹

The exact efficiency cost of taxation is a matter of great debate among analysts. Some dispute whether taxation has anything to do with the choice of taxpayers for leisure over work or whether taxation or any individual tax has any of the negative effects usually touted in the literature. In the most recent public debate about the effect of higher taxes on investment,

²⁰⁴ Pilla estimates that the cost of compliance to American taxpayers is 65 percent of the amount collected by the Federal Government; see Pilla, *Ten Principles of Federal Tax Policy*, p. 8.

²⁰⁵ See Kay, *Tax Policy: A Survey*, 18-75, p. 46

²⁰⁶ See Nagel and Murphy, *The Myth of Ownership*, p. 97

²⁰⁷ *Ibid*

²⁰⁸ See Elkins, *Horizontal Equity as a Principle of Tax Theory*, p. 47

²⁰⁹ See Elkins, *Horizontal Equity as a Principle of Tax Theory*, p. 50

Warren Buffet, one of the richest men on earth, cast doubts over whether higher taxes dissuaded rich investors from making investments.²¹⁰

It must generally be conceded that taxes interfere with economic choices. No tax comes with zero cost – except perhaps the lump-sum tax.²¹¹ The aim is to minimize these costs.²¹² One advice commonly doled out by tax analysts is to introduce broad-based taxes, whether the taxes are income taxes or indirect consumption taxes like VAT.²¹³ It is argued that broad-based taxes come with little distortions.²¹⁴

c. Administrative Feasibility

Administrative feasibility can be taken as subset of “efficiency” in as much as it deals with the cost implications of taxation, albeit from a limited and narrow perspective. Nonetheless, there is a need to deal with “administrative feasibility” separately from that of “efficiency,” for what is stressed under “administrative feasibility” is often buried in the generalities of “efficiency.” Indeed, in much of the literature on tax policy dealing with developed tax systems, “administrative feasibility” is seldom discussed as a separate tax policy norm. That is because

²¹⁰ See Warren Buffett, Stop Coddling the Super-Rich, *The New York Times*, August 14, 2011, at <http://www.nytimes.com/2011/08/15/opinion/stop-coddling-the-super-rich.html>? Accessed on March 19, 2012; Buffett claimed that in his more than 60 years of experience with investors, he had yet to see anyone “shy away from a sensible investment because of the tax rate on the potential gain.”

²¹¹ Kay, *Tax Policy: A Survey*, p. 48; lump-sum taxes impose identical tax burdens on every course of action taken by a taxpayer – whether the taxpayer chooses leisure over work or performs services for herself; while the lump-sum tax is intuitively appealing in this sense, it is obviously impractical; see Elkins, *Horizontal Equity as a Principle of Tax Theory*, p. 47.

²¹² See Murphy and Nagel, *The Myth of Ownership*, p. 98

²¹³ *Ibid*

²¹⁴ Slemrod and Bakija, *Taxing Ourselves*, pp. 184-197, cited in Murphy and Nagel, *The Myth of Ownership*, p. 98

“administrative feasibility” is not first of all as much of a worry in the developed tax systems as it is in many developing tax systems. Secondly, much of the concern of “administrative feasibility” is subsumed and channeled through the other goals of taxation like “simplicity” and “certainty.” If, as Joseph Sneed defined it, “administrative feasibility is *structural unity* and *simplicity* of the tax, *convenience and ease in assessment* and collection from the standpoint of both government and taxpayer, *certainty* of obligations imposed on both tax gatherer and taxpayer, *adequate powers* in government to deal effectively with the recalcitrant and fraudulent...” (italics added),²¹⁵ it is not surprising that much of the concerns of “administrative feasibility” have been taken over by other principles of taxation.

Administrative feasibility has emerged as one of the principal concerns of tax policy ever since it was realized that taxation has practical limitations which must not be discounted if taxation is to become effective in all other aspects. After all, as Justice Pechman is once reported to have said, taxation is “eminently practical.”²¹⁶ Adam Smith, as always, was keenly aware of the administrative side of taxation and, as pointed out above, stressed this in one of his maxims of taxation – “Economy.”²¹⁷ He can also be taken to have subsumed the need for “administrative feasibility” in his other maxim of “convenience.” In his maxim of “economy,” Adam Smith warned that that a bad tax may “eat up the greater part of the produce of the tax” and “impose ... additional tax upon the people” by requiring “a great number of officers.”²¹⁸ In his maxim of

²¹⁵ Sneed, the Criteria for Federal Tax Policy, p. 573

²¹⁶ In *Nicol v. Ames* 173 U.S. 509, 516 (1899), quoted in Sneed, the Criteria for Federal Tax Policy, p. 572, foot note 14.

²¹⁷ Smith, The Wealth of Nations, p. 778

²¹⁸ Ibid

“convenience,” he advised that taxes must be designed in such a way that the time as well as manner of payment is likely to be “convenient” for the taxpayer to pay them.²¹⁹

The principle of “administrative feasibility” has particular resonance for the tax systems of developing countries. It is therefore not surprising that “administrative feasibility” appears more frequently as one of the concerns of tax policy in the literature dealing with taxation in developing countries.²²⁰ Indeed those who write on tax policy for developing countries have seldom missed the opportunity for warning countries against “idealistic,” and “impractical” taxes solely on account of their appeal on other tax policy grounds. In her oft-quoted statement about the role of tax administration in tax policy, Milka Casanegra de Jantscher (1990) essentially summed it up when she wrote that “tax administration is tax policy” in developing countries.²²¹ Another well known authority on taxation in developing countries, Vito Tanzi wrote that “tax administration plays a crucial role in determining the real (or effective) tax system, as opposed to the statutory tax system.”²²² The World Bank in its 1991 Report similarly noted the importance of ensuring that “changes in tax policy are compatible with administrative capacity.”²²³

The need to design a tax system with an eye on the administrative feasibility of taxation cannot be emphasized enough, for all other aspects of tax policy depend for their success upon how well

²¹⁹ Ibid

²²⁰ See Vito Tanzi (1987), cited in Bird and Casanegra de Jantscher (eds.), *Improving Tax Administration in Developing Countries*, p. 1; see also Faria and Yucelik, *The Interrelationship between Tax Policy and Tax Administration*, pp. 267-272

²²¹ Casanegra de Jantscher (1990), cited in Bird and Casanegra de Jantscher (eds.), *Improving Tax Administration in Developing Countries*, p. 1

²²² Tanzi (1987), cited in Bird and Casanegra de Jantscher (eds.), *Improving Tax Administration in Developing Countries*, p. 1

²²³ World Bank (1991), cited in Bird and Casanegra de Jantscher (eds.), *Improving Tax Administration in Developing Countries*, p. 1

this side of taxation is taken into account. As Joseph Sneed rightly put it, “no tax, however ideally just and fair, is better than its actual operation.”²²⁴ Many tax systems are instinctively aware of the practical limitations and constraints of taxation, but there are many instances in which idealistic ambitions trump practical limitations and countries adopt taxes which are clearly good only on paper. The opposite is also true. Administrative feasibility becomes a pretext even when other ideals (e.g. of equity) can be said to be within reasonable reach of the tax administration.

d. Neutrality

The literature on principles of taxation attests that public as well as academic sentiments about various principles of taxation shifted at different times in history. This is particularly true of the principle of neutrality. This principle of taxation gained prominence in the tax policies of countries during the 1980s and 1990s, when the impact of taxation on economic growth became a matter of particular concern.²²⁵

Again, except for emphasis, “neutrality” can be taken as a subset of “efficiency.” As a tax norm, neutrality commands that taxes avoid distortions in the market.²²⁶ The problem is that no tax (except perhaps the lump-sum tax) is in reality neutral, as “any tax inevitably discourages the

²²⁴ Sneed, *the Criteria for Federal Tax Policy*, p. 56

²²⁵ See Tiley, *Revenue Law*, p. 11

²²⁶ *Ibid*

type of activity that is taxed.”²²⁷ The best one can hope for is that the tax system would interfere with decision-making “as little as possible.”²²⁸

Taxes that deviate from neutrality interfere with individual decisions in so many, multifarious and sometimes mysterious ways. The major areas in which taxes interfere with individual choices are best summarized in the 1984 US Treasury Report. According to the U.S. Treasury Report, a neutral tax would not:²²⁹

- i. “Unnecessarily distort choices about how income is earned and how it is spent;”
- ii. “Unduly favor leisure over work, or consumption over saving and investment;”
- iii. “Needlessly cause business firms to modify their production techniques or their decisions on how to finance their activities;”
- iv. Induce business acquisitions “merely for tax considerations;” and
- v. Discourage competition among businesses “by granting special preferences only to one industry or one type of financing institution.”

Over the years, many forms of taxes have been excoriated for deviating from the ideal of tax neutrality. One form of tax that has particularly come in for criticism in this regard is the corporate income tax.²³⁰ The corporate income tax is often panned for its violation of the norm

²²⁷ U.S. Department of Treasury, Tax Reform for Fairness, Simplicity and Economic Growth, p. 13 available at <http://www.treasury.gov/resource-center/tax-policy/Documents/tres84v1C-2.pdf>, last accessed August 14, 2012

²²⁸ Ibid

²²⁹ Ibid

²³⁰ See Tiley, Revenue Law, p. 11; Due and Friedlaender, Government Finance, p. 336-338

of neutrality because the separate taxation of corporations (with inevitable heavier burdens on this form of business organization) encourages taxpayers to opt for other forms of businesses, such as partnerships in order to avoid the corporate income tax.²³¹

Tax rules interfere with the way taxpayers do their business or go about their affairs, and the goal of taxation should be to minimize the level of interference in taxpayers' decision-making. There are, however, times when taxes are deliberately designed to interfere and when this is considered as good policy. For example, excise taxes on tobacco and alcohol are consciously designed to influence the consumption of these products by making these products more expensive. Since the consumption of these products is generally regarded undesirable, the use of taxation to reduce the consumption of these products is generally accepted. Overall, however, the norm of "neutrality" remains one of the major principles of taxation today.

e. Certainty

Certainty is identified as a norm very early in the history of the literature on tax policy. Adam Smith made it one of the four "maxims" of taxation, "equality," "convenience" and "economy" completing his quartet of principles.²³² Indeed, Adam Smith considered "certainty" to be his most important principle of taxation. Adam Smith was so emphatic about the principle of "certainty" that he wrote he would rather live with inequality than uncertainty:

²³¹ See Tiley, Revenue Law, p. 11; see also, U.S. Department of Treasury, Tax Reform for Fairness, Simplicity and Economic Growth, p. 18 available at <http://www.treasury.gov/resource-center/tax-policy/Documents/tres84v1C-2.pdf>, last accessed August 14, 2012

²³² Smith, The Wealth of Nations, p. 777-779

... the certainty of what each individual ought to pay is, in taxation, a matter of great importance, that *a very considerable degree of inequality... is not near so great an evil as a very small degree of uncertainty* (italics supplied).²³³

Some contemporary writers on taxation have also taken “certainty” to be an important tax norm. For example, John Tiley thought that the uncertainty of a tax has some insidious consequences upon the tax system. He wrote that uncertainty (the violation of the principle of certainty) undermines the principle of equity, increases the cost of taxation, leads to a decline in taxpayer morality and unpredictability of the tax system as a whole and discourages foreign direct investment.²³⁴ For John Tiley, almost all other aspects of taxation can go wrong when the tax system lacks certainty.

In the modern debate about the principles of taxation, “certainty” has been eclipsed by other principles of taxation. Certainty is less frequently used in the literature as a criterion for evaluating taxation in large part because of the increasing prominence of “simplicity” as a norm. Although “certainty” is less frequently used in the literature, its concerns are as alive as ever, only this time being taken over by broader criteria like “simplicity” and “efficiency.”

f. Simplicity

The movement for tax simplification has grown more vociferous with the increasing complexity of modern tax systems.²³⁵ Simplicity has undoubtedly become a modern obsession as tax norm, but it was not really unanticipated. Adam Smith sounded the early clarion call for “simplicity” of

²³³ Id, p. 778

²³⁴ See Tiley, Revenue Law, p. 12

²³⁵ See Gunn, the Case for an Income Tax, p. 388

taxes in at least two of his maxims of taxation: certainty and convenience.²³⁶ Adam Smith thought “uncertainty” was a cardinal sin of any tax system, even more grievous than “inequality.”²³⁷ In his principle of “convenience,” he echoed the modern concern of “simplicity” when he wrote that “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.”²³⁸ If Adam Smith were alive in the contemporary world, he would probably regard “simplicity” to be the chief tax norm for a good tax system.

Simplicity has frequently featured in the literature as one of the concerns of taxation, but it has not been easy to define what it really means. It is more often portrayed by its opposite, that of complexity.²³⁹ As the US Treasury Report of 1984 aptly put it, “simplicity in taxation may be difficult to define” but “everyone knows what it is not.”²⁴⁰ The U.S. Treasury Report then went on listing the many aspects of a tax system that make it “not simple”:

Simplicity is not reflected in a tax system that requires extensive recordkeeping by ordinary citizens. A simpler tax system would require fewer taxpayers to collect and retain receipts or cancelled checks in order to calculate and document tax deductions, adjustments, and credits. Simplicity is not wondering which receipts and checks to save because the tax law is too complex and is constantly changing. Simplicity is not computing dozens of deductions and credits, and wondering all the while whether other means of saving tax might have been missed through ignorance of the laws. Nor is simplicity being forced to wade through long and complicated instruction booklets or resort to professional assistance, in order to meet the civic responsibility to pay taxes. A

²³⁶ Smith, *The Wealth of Nations*, p. 778

²³⁷ *Ibid*

²³⁸ Smith, *The Wealth of Nations*, p. 778

²³⁹ Some are not even content with the word “complexity” to describe the opposite of “simplicity.” Obviously frustrated with the level of complexity of the U.S. tax system, the former IRS Commissioner *Doug Shulman once declared that the U.S. tax system has gone from complexity to perplexity*; see Pilla, *Ten Principles of Federal Tax Policy*, citing Shulman 2010, p. 5

²⁴⁰ U.S. Department of Treasury, *Tax Reform for Fairness, Simplicity and Economic Growth*, p. 15 available at <http://www.treasury.gov/resource-center/tax-policy/Documents/tres84v1C-2.pdf>, last accessed August 14, 2012

simple tax system would not require 41 percent of all taxpayers – and about 60 percent of those who itemize deductions – to engage professional assistance in preparing their tax returns. Under a simple tax system, most responsible taxpayers would be more certain of their tax liabilities.²⁴¹

The sources of complexity, as can be readily gleaned from the quote above, are many and varied. One source of complexity is vagueness. The virtue of simplicity is lost when a tax legislation uses “terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application.”²⁴² The sheer size of the tax rules that taxpayers have to consult in order to understand their obligations is another indicator of the level of complexity, although some details can throw many a light over a matter that is vague.²⁴³ Complexity is also generated by the existence of various exceptions, exclusions, deductions and credits, which add layers after layers of complexity over a tax code. These “exceptions, exclusions, deductions and credits” are not visible to all intended “beneficiaries.” Only those with the ability to “mine the complexity of the tax code” and “manipulate the tax code’s hidden loopholes” will be able to take advantage of these “loopholes.”²⁴⁴ A complex tax system thus leads to a curious situation in which “ability-to-

²⁴¹ Id, p. 15-16

²⁴² **Connally v. General Construction Co.**, 269 U.S. 385 (1926), quoted in Pilla, Ten Principles of Federal Tax Policy, p. 4

²⁴³ The complexity of the US tax code has become so legendary as to create its own stock of unflattering metaphors. Judge Learned Hand compared it to certain passages of Hegel, which despite being written with “a passion of rationality,” a reader cannot help wondering if “they have any significance save that the words are strung together with syntactical correctness;” Learned Hand, *The Spirit of Liberty* 213 (1952), quoted in Graetz and Schenk, *Federal Income Taxation*, p. 30. The one that tax theorists like to quote all the time is that of Einstein, perhaps because it flatters their intelligence. Einstein, no doubt frustrated with income tax returns in the U.S., reportedly said, with evident modesty that the income tax is “too difficult for a mathematician,” cited in Graetz and Schenk, *Federal Income Taxation*, p. 30. The more complex the tax system, the harder and the less likely it is for taxpayers to comply with their tax obligations; see Pilla, Ten Principles of Federal Tax Policy, p. 4; by the year 2000, the U.S. Tax Code contained more than 1.4 million words, which according to Michael Graetz is six times larger than Tolstoy’s *War and Peace*; see Graetz, *100 Million Unnecessary Returns*, p. 273.

²⁴⁴ President’s Advisory Panel 2004, p. 4, quoted in Pilla, Ten Principles of Federal Tax Policy, p. 5

pay” is turned on its head to become “ability-to-manipulate” the many loopholes littering the body of tax laws.

Complexity of tax laws has also come with the passage of time. With every passage of time, tax laws all over the world have grown more and more complex.²⁴⁵ Lawmaking bodies in many countries have found themselves grappling with the fast changing situations and generally responded by issuing additional layers of rules that have added to the complexity of tax laws. One of these pressures has been the increasing demand from the public to make the tax systems equitable, with consequent results on the complexity of the tax laws.²⁴⁶ Political processes in some countries have also created situations in which legislators have used tax codes for benefitting their own constituencies. Lawmakers in the US have been accused, for example, of increasing the complexity of the US tax code as they have found a more politically correct means of catering to their constituencies without increasing taxes, that is, by using the tax codes for various credits, subsidies, deductions and refunds in order to benefit their own constituencies.²⁴⁷

The loss of simplicity is shown by the addition of layers of complexity in the tax system, which apart from being a cause for a huge cost of tax administration and compliance, inflicts psychological pain upon taxpayers, causing further strain upon the relationship between taxpayers and tax authorities.²⁴⁸ Studies on the U.S. tax system (certainly one of the most complex tax systems in the world) have shown that more than 90 percent of taxpayers commit

²⁴⁵ Thuronyi, *Comparative Tax Law*, p. 19

²⁴⁶ *Ibid*

²⁴⁷ Altman, *A Tax Code Not Intended for Amateurs*, *New York Times*, February 04, 2003 available on www.nytimes.com, accessed last on August 12, 2012.

²⁴⁸ U.S. Department of Treasury, *Tax Reform for Fairness, Simplicity and Economic Growth*, p. 16 available at <http://www.treasury.gov/resource-center/tax-policy/Documents/tres84v1C-2.pdf>, last accessed August 14, 2012

at least one error but, perhaps fortunately for them, the IRS “simply does not have the capacity to audit all returns and either collect the tax due or make refunds to these taxpayers.”²⁴⁹ This state of affairs “fosters apprehension and resentment against the fiscal authorities” and erodes faith in the integrity of the whole tax system.²⁵⁰ A complex tax system imposes “psychic costs in the form of anxiety suffered by taxpayers concerned about getting their taxes done on time, having them done right, and worrying about an audit.”²⁵¹

Complexity of tax laws in many developing and transition countries has not reached a point where it has become a matter of utmost concern.²⁵² Some writers think that the tax laws of these countries are in fact too simple for taxpayers with sophisticated transactions as to create frustration for these taxpayers who are unable to find competent tax administrators able to provide guidance on complying with the tax laws and audit tax returns effectively.²⁵³

The supposed simplicity of tax laws of developing countries (which are undoubtedly simpler than the tax laws of developed tax systems) understates the magnitude of problems ordinary taxpayers face in trying to comply with these tax laws. There are a number of developments that have exacerbated the complexity of tax laws in developing tax systems. Many developing countries import their laws (sometimes with little adaptation) from developed tax systems thus

²⁴⁹ Ibid; just how complex the US tax system is getting has also become an annual lampooning ritual for one newspaper magazine: Money. The Magazine tested how uncertain and complex the US tax Code has gotten by asking 46 professionals to fill out hypothetical returns. The magazine got forty six different answers, which means that all of them thought differently of the answers they were giving to the questions; cited in Slemrod and Bakija, *Taxing Ourselves*, p. 159

²⁵⁰ U.S. Department of Treasury, *Tax Reform for Fairness, Simplicity and Economic Growth*, p. 16 available at <http://www.treasury.gov/resource-center/tax-policy/Documents/tres84v1C-2.pdf>, last accessed August 14, 2012

²⁵¹ See Slemrod and Bakija, *Taxing Ourselves*, p. 161

²⁵² See Thuronyi, *Comparative Tax Law*, p. 19

²⁵³ Ibid

importing the problem of complexity of tax laws with the imported laws.²⁵⁴ Some fairly complex tax laws and structures have been introduced by developing countries largely at the bidding of the developed countries and the international organizations affiliated with developed systems.²⁵⁵ Many developing countries have introduced the value added tax (VAT) although the jury is still out if these countries are able to administer this sophisticated tax with ease. Many taxpayers in Ethiopia have complained of difficulties understanding the operations of VAT.²⁵⁶ A number of provisions in the Ethiopian Income Tax laws of 2002 are frequently misunderstood by both the tax administrators and taxpayers.²⁵⁷ A study commissioned by the Addis Ababa Chamber of Commerce and Sectoral Associations found that over 80% of taxpayers surveyed thought the tax laws of Ethiopia were either “complex or very complex.”²⁵⁸

In addition, many developing tax systems are unable to provide assistance to taxpayers that would have made the tax laws considerably simpler. In many countries, not all tax laws are accessible and intelligible to average taxpayers. Tax laws are found scattered in individual pieces of legislations.²⁵⁹ The major tax statutes are often implemented without any supportive interpretative materials, and poorly-resourced tax authorities are often unable to provide the immediate support taxpayers need in order to fulfill their tax obligations.

²⁵⁴ For a critique of tax reform in developing countries driven by external agents, see Stewart, *Global Trajectories of Tax Reform*

²⁵⁵ See Stewart, *Global Trajectories of Tax Reform*, p. 143.

²⁵⁶ See Amin Abdella and John Clifford, *the Impact of Tax Reform on Private Sector Development*, pp. 37-38

²⁵⁷ See Estifanos Denbu, *Taxation of Income from Rental of Buildings under Schedule B*, pp. 10-17; Weynalem W/Senbet, *Taxation of Partnerships and Partners under Ethiopian Law, Comparative Study*, pp. 33-56; Solomon Teshome, *Tax Exclusion under the Ethiopian Employment Income Tax Law, Fringe Benefits in Kind*, pp. 12-26

²⁵⁸ See Amin Abdella and John Clifford, *the Impact of Tax Reform on Private Sector Development*, pp. 32-33

²⁵⁹ See Taddese Lencho, *The Ethiopian Tax System, Excesses and Gaps*, p. 355

Lack of simplicity breeds uncertainty. As Adam Smith said of “uncertainty,” this is the greatest evil in taxation.²⁶⁰ The virtue of simplicity cannot be pressed hard enough in taxation as taxation, unlike many other areas of the law “touches and affects” taxpayers with “a growing list of affirmative duties.”²⁶¹ The “civic responsibility to pay taxes” does not come with going to colleges and universities, nor even with coming of age, but because we have purchased goods and services or earned income. As the American saying goes, taxation, along with death, is something that nobody can avoid, and while death is perennially mysterious and never easy, taxation does not have to be that way.

g. Other Principles

An astonishing variety of principles have been suggested by various writers at different times in history. The diversity of these principles means that it is difficult to exhaust all the principles suggested by different writers every now and then. We will take one sample from Daniel J. Pilla, who (as pointed out at the beginning) developed ten principles of taxation. Many of the principles suggested by Pilla are already discussed at great length above and indeed by many writers, but some of the principles may be said to fall under the category of “other” principles. Pilla has suggested the principles of “stability,” “visibility,” “broad-based[ness],” and “constitutionality” in addition to the common principles of “equality,” “efficiency,” “simplicity,” and “neutrality.”²⁶² According to Daniel J. Pilla, “stability” requires avoiding frequent changes to the tax laws so that reasonable persons can plan ahead on matters that affect their livelihoods, such as marriage, children, home ownership, personal investing, charitable contributions,

²⁶⁰ Smith, *The Wealth of Nations*, p. 778

²⁶¹ See Pilla, *Ten Principles of Federal Tax Policy*, p. 5

²⁶² See *id.*, pp. 10-13, 18-19 and 23-24

obtaining education, changing employment, paying for medical expenses, purchasing property, making gifts and leaving an inheritance.²⁶³ Pilla has characterized “visibility” in taxation as requiring the transparency of the cost of government,²⁶⁴ and defined his principle of “broad-basedness” as the extension of tax bases to all possible bases so that the government will be able to collect enough revenues with lower tax rates.²⁶⁵ His principle of “constitutionality” is perhaps the most obvious and least controversial. Few would dispute that taxes must be consistent with the constitution as a supreme law of the land. But for Pilla, the principle of “constitutionality,” within the context of the U.S. Constitutional framework, requires taxes to be used solely to fund clearly defined constitutional function, thus tying the constitutionality of taxes to the uses for which tax revenues are put.²⁶⁶

The details with which one needs to deal with principles of taxation is obviously a matter of taste. For example, what most writers are content to refer to simply as “equity,” Neumark chose to break it down into three principles, that of “horizontal equity,” “ability to pay” and “redistribution.”²⁶⁷ There is also a certain degree of repetitiveness. Many writers have deemed it necessary to mention “equity” as a principle of taxation, under different names of “equity” like “fairness” (e.g., Adolph Wagner) or “equality” (e.g. Bhatia).²⁶⁸ What one writer calls

²⁶³ See *id.*, pp-10-11

²⁶⁴ See *id.*, pp. 12-13

²⁶⁵ *Id.*, p. 18

²⁶⁶ *Id.*, p. 23

²⁶⁷ See Neumark, cited in Perdices de Blas and Revuelta Lopez, *Markets and Taxation: Modern Taxation Principles and School of Salamanca*, Esic Market, vol. 138, 2011, p. 99

²⁶⁸ See Bhatia, *Public Finance*, p. 41; Bhatia lays down nine “canons” of taxation: equality, certainty, convenience, economy, productivity, buoyancy, flexibility, simplicity and diversity; see Bhatia, *Public Finance*, pp. 41-43

“sufficiency,” another might call “revenue productivity” or simply “productivity.”²⁶⁹ What one writer calls “buoyancy” (e.g. Bhatia), another might call “adaptability” (e.g., Neumark). What Adam Smith called “convenience,” Adolph Wagner called “comfort,” but they are all essentially writing about the same thing. The same can be said for Daniel Pilla’s principle of “stability,” which is what Adam Smith called “certainty.” The enormous variety of names for principles and details of principles is perhaps one reason why a consensus seems to be building around certain common principles like “efficiency” and “equity.” The fact that some writers are content with fewer principles does not show that they are less concerned with the other principles. It simply proves that some writers would rather discuss principles with some degree of generality than others.

III. Multiple Goals and Principles: Interaction, Conflicts and Implementation

Multiple principles of taxation are often uneasy bedfellows. It is now recognized that the existence of multiple policy goals in taxation gives rise to at least three problems: trade-offs, weighting and implementation.²⁷⁰ A trade-off arises when all factors are considered desirable goals but are not attainable at the same time and a need arises for balancing these factors.²⁷¹ An analysis of “trade-offs” involves sorting out “the sources and extent of mutual interactions among” multiple goals of taxation.²⁷² Once a “trade-off” is known to exist, one must come to terms with the issue of “weighting.” “Weighting” involves the assignment of relative importance

²⁶⁹ See Bhatia, *Public Finance*, p. 42

²⁷⁰ Reform of the Australian Tax System, Draft White Paper (1985), cited in Cooper, Krever & Vann’s *Income Taxation*, p. 9

²⁷¹ Webster’s Ninth New Collegiate Dictionary, s. v. “trade-off”

²⁷² Cooper, Krever, & Vann’s *Income Taxation*, p. 9

of each goal of taxation in the design of a tax system.²⁷³ And “implementation” addresses issues of how the goals can be given operational content.²⁷⁴

Multiple tax goals interact in complex and intricate ways. There is now a general consensus that these goals at times come into heads-on conflict.²⁷⁵ Attempts by governments to increase and ensure the equitability of the tax system may end up in adding layers of complexity to the tax system as equity inevitably requires taking individual taxpayer circumstances.²⁷⁶ Paradoxically, the increased complexity of the tax system, which is itself brought about by attempts to ensure equity, can diminish the equitability of the tax system, leading to a vicious circle in which neither equity nor simplicity are gained.²⁷⁷ We have already seen above how the emphases upon tax equity led to the development of the “optimal” tax approach.

It is therefore critical to understand the complex ways in which the multiple goals of taxation interact. A better understanding of their interactions can lead to a more optimal use of multiple goals rather than focusing upon one or two goals of taxation in exclusion of all the other goals of taxation. Having determined the interactions of multiple goals of taxation, it is then necessary to realize that when multiple goals of taxation are clearly in conflict, it is necessary to rank the goals through schemes of “weighting.”²⁷⁸ There are no hard and fast rules for weighting among multiple and often conflicting goals of taxation. The relative weight that is to be given to each goal of taxation “is a matter for the government of the day, so that any modification of the

²⁷³ Ibid

²⁷⁴ Ibid

²⁷⁵ Id, pp. 9-10

²⁷⁶ Id, p. 9; see also Due and Friedlaender, *Government Finance*, p. 279-300

²⁷⁷ Ibid

²⁷⁸ Id, p. 10

system should not impinge on the prerogative of government to determine policy in any field, not only in respect of taxation.”²⁷⁹

The relative weight attached to a specific goal of taxation varies from country to country. Some governments give priority to the efficiency of the tax system while others are more concerned with the equity implications of the system.²⁸⁰ In many instances, governments do not even bother to set some hierarchy among the multiple goals of taxation and pursue their policies as if all the policies were of equal weight. Sometimes, based on the assessments of the tax system at a given moment, a commission or committee may suggest giving priority to one of the goals of taxation. A case in point in this regard is a recommendation by the “Taxation Review Committee” of Australia which in its review of the business taxation system of Australia in 1975 suggested that “*substantially increased weighting be accorded the national objective of simplification*” (italics mine).²⁸¹ Another telling example is that of the analysis of the Ethiopian Tax System by the Governing Political Party (EPRDF) in 2011, which having weighed the multiple of goals of taxation concluded that in the context of Ethiopia, next to raising revenues for the government finance, encouraging investment and stimulating economic growth would receive priority in the Ethiopian tax policy.²⁸²

In this connection, one must be careful not to confuse weighting with complete abandonment of second-ranked or in general lower-ranked or subsidiary policy choices. The question of

²⁷⁹ Reform of the Australian Tax System, Draft White Paper (1985) quoted in Cooper, Krever, & Vann’s Income Taxation, p. 10

²⁸⁰ Cooper, Krever, & Vann’s Income Taxation, p. 10

²⁸¹ Taxation Review Committee, Full Report, Canberra, AGPS, 1975, cited in Cooper, Krever & Vann’s Income Taxation, Income Taxation, p. 10

²⁸² See *Addis Ra’iy*, p. 13

weighting comes into the picture only when the government makes conscious choices to set aside second or lower-ranked policy choices in favor of its priorities. This does not or should not mean that second or lower-ranked policy objectives are no longer part of the policy but only that in those instances when these policy goals conflict with higher order goals of taxation, the government will give priority to the higher order goals of taxation. In many other instances, the government must be willing to achieve all of its tax policy goals.

CHAPTER TWO

ETHIOPIAN TAX POLICY: SOURCES, FUNDAMENTAL GOALS AND PRINCIPLES

I. Introduction

There is no shortage of policy documents and statements in Ethiopia. Over the last two decades alone, the Ethiopian Government (headed by EPRDF) has formulated and issued official public policy statements in various aspects of public life.¹ If we only count official policy statements, we find that Ethiopian Government has issued policies on the economy in general, on education, health, fiscal and monetary matters.² Some of the policy statements of Ethiopian Government incorporate almost all the policies of the Government (e.g., Economic Policy during the Transitional Period, the Sustainable Development and Poverty Reduction Program (SDPRP), the Plan for Accelerated and Sustained Development to End Poverty (PASDEP), and, at the time of writing, the Growth and Transformation Plan (GTP)), while others are specific to particular socio-economic sectors (e.g., industrial policy, foreign policy).³ Ethiopian public discourse has also become a platform for the prominence of public policies as the Government has

¹ See in this regard Taye Assefa (ed.), *Digest of Ethiopia's National Policies, Strategies and Programs*

² The field of public policy is very crowded; if we stick to the public and official public policy documents, we can count more than two dozen public policy documents in Ethiopia; the most prominent ones are, the Growth and Transformation Plan (GTP), Capacity Building Strategy and Program, Democratic System Building Program, Education and Training Policy, Environmental Policy, Foreign Affairs and National Security Policy and Strategy, Industrial Development Strategy, National Adult Education Policy, National Drug Policy, National Energy Policy, National Technical and Vocational Education Strategy, Pastoral Education Policy, Anti-retroviral drugs supply and Use Policy; see Taye Assefa (ed.), *Digest of Ethiopia's National Policies, Strategies and Programs*

³ The GTP, for example, contains the public policies of Ethiopian Government on all aspects of public life, from agriculture and rural development to democracy and good governance; see Growth and Transformation Plan

underscored its penchant to rule by well-defined and duly articulated policies on a broad range of issues.

A cursory survey of the policy landscape of Ethiopia shows that Ethiopian Government has been fairly prolific in formulating and issuing public policy statements on a number of social, economic and political issues. In view of this, it may be a little surprising to come up with nothing in the area of taxation – which as a subject has received a fair amount of government attention. It is surprising also because some public policy areas have received a fair amount of attention, perhaps more attention than is ordinarily accorded to some governmental activities. Education is a case in point. In addition to one general education policy, dubbed “Education and Training Policy,” the Government of Ethiopia has issued a number of policies on education in specific areas, such as on adult education, dubbed “National Education Strategy,” on pastoral education, called “Pastoral Education Policy,” and on technical and vocational education, called “National Technical and Vocational Education Strategy.”⁴ In view of this policy galore, it is more than surprising that Ethiopian Government has not yet issued an official document on tax policy.

Information gathered from the officials involved in recent tax reforms in Ethiopia reveals that the idea of having a specific tax policy document was floated in various discussions but it was abandoned because some made a persuasive alternative case of subsuming tax policy goals in general policy documents of the government (e.g., economic policy).⁵ There are reportedly

⁴ See Education and Training Policy, National Technical and Vocational Education Strategy; Pastoral Education Strategy; National Education Strategy, Ministry of Education Nehassie 2000 E.C.

⁵ Interview with Ato Wasihun Abate, Legal Advisor to the Minister of Finance and Economic Development, December 1, 2011; Ato Mamo Abdi, legal advisor to the Director of ERCA, June 29, 2011; Ato Wolde Gebriel Naizghi, former Deputy Director of Federal Inland Revenues Authority, June 23, 2011 .

attempts to revive the idea of formulating a tax policy for Ethiopia and it might become a reality in the future, perhaps in the near future.⁶

In the face of the lack of a specific government document on tax policy, we are left with the option of searching for tax policy statements from other public policy documents and legislations of Ethiopia. While it might have been easier to assert with greater certainty Ethiopia's tax policy if Ethiopian Government had officially formulated and issued a separate document on tax policy, it is wrong to conclude therefore that Ethiopia does not have a tax policy. Ethiopian tax policies are found expressed and scattered almost in haphazard manner in various official and unofficial documents of the Government of Ethiopia. This state of affairs is one of the factors that contribute to the uncertainty surrounding Ethiopian tax policy.

II. Principal Sources of Tax Policy in Ethiopia

In spite of uncertainties surrounding the precise nature and scope of tax policies in Ethiopia, it is possible to point to a few well organized sources of policy and regard these as the primary sources of tax policy in Ethiopia. The principal sources of tax policy in Ethiopia can be grouped into three major categories:

- i) General Policy Documents (e.g., at the time of writing, the Growth and Transformation Plan (GTP), previously the Economic Policy During the Transition Period)
- ii) The Ethiopian Constitution (of 1995); and
- iii) The Tax Laws of Ethiopia (the Income Tax Proclamation, the VAT Proclamation, etc).

⁶ Interview with Ato Mamo Abdi, Legal Advisor to the Director of ERCA, June 29, 2011

General Policy Documents and the Constitution of Ethiopia are the primary sources of tax policy while tax laws are mainly declarative and derivative of the general tax policies enunciated in the General Policy Documents and the Constitution. Even in their declarative or derivative status, the importance of tax laws must not be discounted, however, as the enunciation of policies in these laws puts beyond doubt as to the very existence of tax policies.

a. General Policy Documents

General Policy documents, particularly the ones on Economic Policy, have an obvious direct relevance to understanding tax policy in Ethiopian income taxation. General policy documents almost always precede the actual tax laws, sometimes by half a dozen years. The Government may issue its general statement of public policy and wait for years before it acts on them through executable tax laws, or as is often the case, the Government may choose to implement its general policies by installments, as it were, by issuing pieces of legislations that implement aspects of its general public policy. When the government is well prepared and is compelled to draw up policies with a sense of urgency, the tax laws may immediately follow general public policy documents. In any case, there is little doubt that general public policy documents serve as a foundation and source of tax policy in Ethiopia.

Some of the tax laws of Ethiopia acknowledge this role of general public policy documents. The Income Tax Law of 2002, for example, cites the “new economic policy of Ethiopia” at the time as

a reason for the reform of Ethiopian income tax system.⁷ As the ultimate sources of tax policy norms in Ethiopia, it is necessary to examine the Economic Policy of Ethiopia in particular and articulate what the tax policy of Ethiopia is. Unfortunately, the economic policies of Ethiopia are not always fully articulated in one policy document alone but may be found buried in multiple policy documents. The challenge is therefore not just understanding and articulating tax policies as such but also finding the documents with authoritative statements on economic policy in Ethiopia.

The other challenge with respect to general policy documents in Ethiopia is that tax policy is not necessarily expressed unambiguously so as to state Ethiopian tax policies with any degree of confidence. To be sure, in some of the so-called “policy documents,” tax policies are at times expressed boldly, clearly and unambiguously, although it is not clear if such statements should be taken seriously. In others, tax policies form part of an overarching government policy, which itself is expressed in a much broader policy document of the Government. We shall take up examples of both types of policy documents to highlight the current “articulation” of Ethiopian tax policies.

The Growth and Transformation Plan (GTP) of Ethiopia (2010/2011- 2014/15) may be cited as an example of a policy document that includes “tax policy” as part of more general public policies. Issued in 2010 under the aegis of the Ministry of Finance and Economic Development (MoFED), the GTP is without doubt one of the most highly publicized policy statements to be issued by the Government of Ethiopia. The GTP provides general statements of policy as well as

⁷ The “new economic policy” was a reference to the economic policy adopted by the Ethiopian Government after the fall of the Dergue in 1991; see Ethiopia’s Economic Policy during the Transitional Period.

detailed financial figures and statistics that delineate the political, economic and social direction of Ethiopia as envisioned by the Government for a five period ending in year 2015. The GTP defines and sets targets for macroeconomic outlook of Ethiopia over the said period and determines the plans for a number of public sectors, ranging from that of agriculture and rural development to education and health (see Table 2.1 below).⁸

Table 2.1: Real GDP Projection Annual Growth Rate during the GTP period (2010/2011-2014/2015)

Sector	2009/10	2010/2011	2011/12	2012/13	2013/14	2014/15	Average
Agriculture & allied activities	7.6	8.5	8.5	8.6	8.6	8.7	8.6
Industry	10.6	14.0	17.9	21.4	23.0	23.7	20.0
Services	13.0	12.5	11.5	10.5	9.5	9.0	10.6
Real GDP	10.4	11.0	11.1	11.3	11.2	11.4	11.2

Source: Growth and Transformation Plan, p. 28

The GTP does not devote a separate slot to tax policy as such, and like many public policy documents before it, the GTP is content to situate tax policy in other general policies outlined in the Plan.⁹ It is therefore instructive and fruitful to search for tax policies in general policies that are cognate to taxation, such as fiscal policy. The GTP states that the fiscal policy of Ethiopia is “to strengthen domestic revenue generation capacity, finance major investment projects with own revenue, mobilize external grants, arrange external borrowing according to the borrowing policy of the country, and to mobilize domestic borrowing in a way that does not adversely affect

⁸ Growth and Transformation Plan pp. 9-21

⁹ Id, pp. 32-33

macroeconomic stability.”¹⁰ Building upon the tax reforms of the country during the previous decade, the Government has committed itself in the GTP to pushing ahead with enhancing the “on-going tax reform program,” and “strengthening tax administration and collection.”¹¹ With a view to strengthening tax administration, the GTP envisions “promoting compliance and equipping tax collection agencies with adequate enforcement powers,” “strengthening the capacity of tax collection agencies, implementing the Tax Identification Number [TIN] system throughout the country, improving the presumptive tax system, developing and implementing an audit program to cover all taxes, and improving the administration of the Value Added Tax [VAT].”¹²

While the primary accent of the GTP is that of improving the enforcement powers of Ethiopian tax administration (so as to raise enough revenues and meet the huge targets set out in the GTP), the GTP also affects other aspects of Ethiopian tax policy, including that of tax equity. For example, the GTP aims “to improve the tax base and bring new businesses into the tax net.”¹³ The GTP also anticipates that more and more businesses which were erstwhile beneficiaries of the tax incentive regimes (particularly the tax holiday regime) will join the tax-paying community as their incentive regimes expire.¹⁴ The overall tone of the GTP is one of mobilizing revenues from tax and non-tax sources, but the broadening of the tax base has the effect of indirectly improving the equitability of the Ethiopian tax system in general.

¹⁰ Id, p. 32

¹¹ Ibid

¹² Id, pp. 32-33

¹³ Id, p. 33

¹⁴ Ibid

In some policy documents of the Government of Ethiopia, tax policy objectives are stated more specifically, clearly, unambiguously and boldly. We shall take a few examples of these types to indicate where the tax policies of Ethiopia may be found. Whenever new tax bills are tabled for approval by the parliament or old taxes are revised in a major way, it is customary for sponsoring government bodies (mainly the MoFED in the case of taxation) to prepare explanatory guidelines for the newly proposed or revised tax laws. When the draft of the Income Tax Proclamation of 2002 was tabled, the MoFED prepared an explanatory Guideline to persuade the Government why a new law was needed. Apart from providing explanatory notes for the changes to the existing income tax law of Ethiopia, the Guideline also included the tax policies that informed, imbued and guided the draft income tax law at the time. According to this Guideline, the chief objectives of the new Income Tax Proclamation were stated to be four, namely:¹⁵

- i) Encouraging saving and investment by lowering tax rates;
- ii) Redefining the Ethiopian income tax jurisdiction;
- iii) Modernizing the Ethiopian (income) tax system; and
- iv) Strengthening tax administration by improving tax enforcement powers.

The Guideline in effect articulated the income tax policies of Ethiopia for which the Income Tax Proclamation of 2002 was viewed as instrumental. Along similar lines may be mentioned the Statistical Bulletin issued by ERCA in February 2011. The aim of the Statistical Bulletin of ERCA

¹⁵ See *Be Gabi Gibir Awaj Quxir 286/94 sila takatatu Wana Wana Hasaboch Mabrarriya* (Main Issues incorporated in the Income Tax Proclamation No. 286/2002, Explanatory Guideline 1994 E.C., in Amharic, unpublished)

in the main was to provide government statistics regarding taxation but along the way, the Bulletin restated the tax policy objectives of the tax system. The Bulletin articulated Ethiopian tax policy in general to be one of “promoting investment, supporting industrial development, and broadening the tax base and decreasing the tax rate.”¹⁶

Tax policies are also expressed and articulated in Ethiopia in the various government documents intended to explain the various tax laws of Ethiopia. These government documents are invariably issued after tax laws are promulgated. These types of documents are often prepared by the Tax Authorities as part of their drive to educate members of the public about the various tax laws of Ethiopia. In an ERCA Document (issued by ERCA) that purports to explain the Income Tax Proclamation of 2002, for example, we have the following statement:

የታክስ ህጉ የፓሊሲ ነፃ-በራቅ ስለሚሆን የታክስ አሰባሰቡን ብቃት ባለው መንገድ ባግባቡ ለመሰብሰብና ህብረተሰቡም ገቢውን አስታውቆ ግብሩን ወደና ፈቅዶ ሳይደብቅ እንዲከፍል ለማድረግ እንዲሁም ንግድና ኢንቨስትመንት በማበረታታት የሀገር ውስጥ ምርትን በማሳደግ መንግስት ከታክስ የሚገኘውን ገቢ ማሳደግ የሚለው የመንግስት የፓሊሲ አቅጣጫ ነው ማለት ይቻላል።¹⁷

This roughly translates as:

Since the [income tax] law is a reflection of government [tax] policy, the proposed law is intended to strengthen the tax collection process, encourage voluntary compliance, provide incentives for investment and in particular help support the domestic production thereby increase government revenue from taxes (translation mine).

The said Document gives a number of examples from the Income Tax Proclamation of 2002 to show how the Income Tax law would achieve government policies particularly in the area of

¹⁶ Ethiopian Revenues and Customs Authority (ERCA), Statistical Bulletin, p. 2

¹⁷ See *Be Gabi Gibir Awaj Quxir 286/1994 lay Ye Qarabe Mabirariya, Be Itiyophiya Gabiwochina Gumruk Balesiltan Aqabe Hig Directorate Befitihabher Gudayoch Budin Astebabari Yetezegaje, Tahisas 2003*, Addis Ababa, in Amharic, unpublished

encouraging investment. It states, for example, that the provisions allowing the carrying forward of losses and reinvestment deductions are intended to help encourage investment.¹⁸

In general, it can be seen that Ethiopian tax policies are expressed in various forms and shapes in different tax policy documents issued by the Government of Ethiopia. Whether expressed specifically or as part of the overall government policy, it is quite clear that the Ethiopian Government has relied upon general policy documents as vectors of its tax policy.

b. The Ethiopian Constitution

Another principal source of tax policy in Ethiopia is the Constitution of 1995. As the supreme law of the land, the Ethiopian Constitution is the most credible and authoritative document to search for evidence of tax policy in Ethiopia.¹⁹ The Constitution contains a number of provisions which are relevant to understanding tax policy in Ethiopia. The general provisions of the Constitution on rights and freedoms can be the source of tax policy norms although they are generally considered more relevant to civil liberties and freedoms.²⁰ There is hardly an aspect of taxation powers that does not impinge upon constitutional rights and freedoms. The constitutional rights of freedom of movement, privacy, free speech, equality and of property are equally, if not more, relevant in the realm of taxation powers. Whether they are considered relevant in actual fact depends on how the Constitution is understood in its limitation of government powers. The Ethiopian Constitution has all the usual stocks of constitutional rights and freedoms.

¹⁸ See *id.*, p. 3; see Income Tax Proclamation No. 286/2002, Articles 27 and 28; see also Income Tax Regulations No. 78/2002, Article 16

¹⁹ See The Constitution of Ethiopia, Article 9

²⁰ See Taddese Lencho, *The Ethiopian Tax System: Excesses and Gaps*, pp. 334-335

Apart from its general prescriptions on rights and freedoms of citizens, the Constitution of Ethiopia contains specific norms relevant to taxation. The revenue provisions of the Ethiopian Constitution (Articles 94-99 in particular), the provisions of the Constitution on policy objectives of Ethiopian Government (Articles 87-90), and Directives on Taxation in Article 100 are of obvious direct importance in understanding tax policy norms in Ethiopia.

As the supreme law of the land, the Constitution of Ethiopia can become a source of a number of fundamental tax policy norms in the future. The Constitution places specific limitations upon both the Federal Government and the Regional States in respect of taxation. The scope and extent of these limitations remains shrouded in mystery, but some principles of taxation can be derived directly from the limitations upon taxation powers in the Ethiopian Constitution, especially those stipulated in Article 100 of the Constitution.²¹

It can be deduced from the language of Article 100, for example, that the Constitution stipulates limitations in respect of taxation power in order to a) protect and preserve the integrity of the federal structure (limitations that preserve the integrity of the federal system in Ethiopia) and b) protect taxpayers against arbitrary exercise of taxation powers by either the Federal Government or the Regional States.²² These limitations, whatever names we assign to them, may be the sources of fundamental tax policy in Ethiopia.

²¹ See in general, Taddese Lencho, *The Ethiopian Tax System: Excesses and Gaps*, pp. 330-346

²² For details, see *ibid*; see also Taddese Lencho, *Be Itiyophiya Higa Mangist Sila Takatatut Ye Taksina Gibir Siltanat Andand Natiboch* (Some Points About Taxation Powers in the Ethiopian Constitution), 2004 E.C., in Amharic unpublished

c. Tax Laws of Ethiopia

The third principal sources of tax policy statements in Ethiopia are the tax laws themselves. It is fortunate in this regard that Ethiopia has a long-established tradition of drafting laws (including tax laws) in which general policy statements are often expressed in succinct terms in the preambles of Ethiopian tax laws (particularly tax proclamations).²³ The Income Tax, the Value Added Tax, the Turnover Tax, the Excise Tax and many other tax proclamations all contain preambles stating the general policy objectives that justify and inform the respective tax laws. Some of the tax laws of Ethiopia have specific sections or provisions devoted to the explication of general policy objectives and goals.²⁴ In addition, many substantive provisions of the tax laws often contain specific policy statements, which, through interpretation, give effect to the general policy statements expressed in general policy documents and/or the preambles of the tax laws. Tax laws are usually viewed as declarative and derivative sources of tax policies in Ethiopia, but even in this understated sense, tax laws furnish important information on tax policies of Ethiopia, as they sometimes articulate what has remained unstated and unarticulated in the general policy documents and the Constitution of Ethiopia.

III. The Four Fundamental Goals of the Ethiopian Tax System

The absence of separate tax policy government documents in Ethiopia and the consequent subsuming of tax policy in other general policy statements of the Government all contribute to the current uncertainty about the precise language and meaning of tax policies in Ethiopia. A close reading of multiple policy documents most relevant to taxation, however, yields a number

²³ See the Income Tax Proclamation No. 286/2002; the Value-Added Tax Proclamation No. 285/2002; the Turnover Tax Proclamation No. 308/2002; the Excise Tax Proclamation No. 307/2002.

²⁴ See, for example, the new Investment Proclamation No. 769/2012, Article 5

of tax policy goals for the Ethiopian tax system. It is difficult to exhaust all the tax policy goals of the Ethiopian tax system. It is by no means necessary to exhaust all the tax policies of Ethiopia, major and minor, general and specific. It is also important to remember that the goals of taxation in Ethiopia (as in elsewhere) are not fixed in time but dynamic. The goals as well as the emphases on goals change from one period to another. It is in general fair to say that the four fundamental goals of the Ethiopian tax system at the moment are:

- a. Raising revenues,
- b. Stimulating economic growth/development,
- c. Tax equity, and;
- d. Modernizing the Ethiopian tax system and tax administration.

We shall review the four fundamental goals below.

a. Raising Revenues

Raising revenues is ordinarily taken in the tax literature as a given, but there is a reason for listing “raising revenue” as a goal in and of itself in the Ethiopian context. Indeed, raising revenues at the moment constitutes the most important goal of the Ethiopian tax system. The need to meet the targets set by the GTP by raising revenues provided the major impetus for the Government to redouble all its efforts to maximize its tax revenues. The Government needs to raise more than half a trillion ETB (615, 591 billion ETB) in order to meet the targets of the GTP, out of which 431, 022 billion ETB (or more than 70%) is to be covered by tax revenues.²⁵ The

²⁵ Growth and Transformation Plan, p. 39

GTP has set an ambitious target of improving the tax-to-GDP ratio in Ethiopia from 11.3% at the beginning of the GTP period to 15% at the end of the GTP period (see Table 2.2 below).²⁶

At the beginning of the GTP period (2010/11), the projected revenue expected from tax revenues was 53, 861 billion ETB, and this was expected to grow steadily and reach 145, 299 billion ETB during the final year of the GTP period(see Table 2.3 below). Tax revenues need to show an average annual growth rate of 22% to reach this target. Or, to put it differently, the total revenue expected from taxes should grow by three-fold in just five years time to meet the GTP tax revenue projection or by twice as much as the average projected GDP growth over the period. We are at the time of writing in the middle of the GTP period, and the actual revenue performance shows that the actual revenue collected so far falls far short of the GTP forecast – one reason why the GTP may be said to be too ambitious. In 2009/10 (the first year of the GTP period), the Government actually collected 35, 229 billion ETB, which is 52.78% short of the GTP projection.²⁷

Table 2.2: Tax-to-GDP Ratio Growth during the GTP period (2010/2011 – 2014/2015)

Items	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	Average (2010/10 -14/15)
Tax revenue	11.3	11.7	12.1	13.2	14.7	15.0	13.3

Source: Growth and Transformation Plan, p. 33

²⁶ Id, p. 33

²⁷ See Ethiopian Revenues and Customs Authority (ERCA), Statistical Bulletin, Ethiopia, p. 13

Table 2.3: Projected GTP Revenue Requirements (in min ETB)

Items	2009/2010	2010/11	2011/12	2012/13	2013/14	2014/15	Total (2010/11- 2014/15)
Total revenue including grants	66, 237	79, 806	96, 841	118, 281	147, 524	173, 040	615, 591
Domestic revenue	53, 861	63, 315	74, 585	94, 119	121, 660	145, 299	498, 978 (81.057%)
Tax revenue	43, 315	52, 434 (growth 17.6%)	63, 588 (17.8%)	81, 288 (26%)	106, 460 (29%)	127, 212 (19%)	431, 022 (70.01759)%
Non-tax revenue	10, 546	10,781	10, 997	12, 891	15, 200	18, 087	67, 956 (11.03915%)
Grants	12, 376	16, 491	22, 356	24, 162	25, 864	27, 741	116, 613 (18.94326%)

Source: Growth and Transformation Plan, p. 39

All these growth targets of the GTP unmistakably point to the conclusion that raising revenues is at the moment the most important goal of the Ethiopian tax system. The GTP, which is presently the most authoritative policy document of the Government, emphasizes the need to mobilize revenues to achieve major GTP goals. The GTP states that the fiscal policy of Ethiopia is “to *strengthen domestic revenue generation capacity, finance major investment projects with own revenue, mobilize external grants, arrange external borrowing... and to mobilize domestic borrowing in a way that does not adversely affect macroeconomic stability*” (italics added).²⁸

²⁸ Growth and Transformation Plan, p. 32

The Tax Authorities, evidently taking the cues from the GTP, have made raising revenues their number one priority.²⁹ The Ethiopian Revenues and Customs Authority (ERCA) has drawn its own version of the “ERCA/GTP” in order to meet the GTP expectations, and this “ERCA/GTP” has, not surprisingly, placed “increasing revenues” as the number one goal of the Authority. ERCA has projected in its own version of “ERCA/GTP” that tax revenues will grow from 35 billion ETB at the beginning of the GTP to 150 billion ETB at the end of the GTP period (more than a four-fold revenue growth during the GTP period).³⁰

In view of the huge growth targets set for the Ethiopian tax system, it is surprising that the Government does not intend to introduce new taxes or raise tax rates as such. The whole idea of the growth appears to be premised on the assumption that improving the gaps of the existing tax system and tax administration will help the Government achieve its revenue targets in respect of taxation. The GTP assumes that enhancing the “on-going tax reform program,” “strengthening tax administration and collection,” “promoting compliance and equipping tax collection agencies with adequate enforcement powers,” “strengthening the capacity of tax collection agencies” in general will help the Government raise the huge revenues needed to reach the GTP targets.³¹ Other specific measures that the Government plans to undertake during the GTP period to improve revenue mobilization include: the implementation of the Tax Identification Number (TIN) system throughout the country, improving the presumptive tax regime, developing and implementing an audit program to cover all taxes, and improving the

²⁹ See *Ye Agaritu Ye Amist Amat /2003-2007/ Ye Idigatina Tiransformashin Iqid Le Itiyophiya Gabiwochina Gumruk Balsiltan Yeminoraw Indamta*, Yekatit 2003 E.C., Addis Ababa, in Amharic, unpublished, p. 18

³⁰ Ibid

³¹ Growth and Transformation Plan, pp. 32-33

administration of the Value-Added Tax.”³² The Government also expects a boost in government revenue as a result of the phasing-out of the tax holidays and other tax incentives for many businesses, which have been receiving tax breaks for a holiday period of up to 7 years.³³ None of these developments during the GTP period entail the introduction of new taxes or raising tax rates.

While the GTP has brought to prominence the goal of raising revenues as the primary goal of the Ethiopian tax system, the Ethiopian Government has been pushing this goal to the fore front for more than a decade now. The comprehensive tax reforms of 2002 were in large part driven by the desire of the Government to reform existing taxes and tax administration and introduce new and more productive taxes with a view to generating adequate revenues for the various projects of the Government.³⁴ The revision of the income tax system in 2002 was in part motivated by the desire to ensure that the income taxes generate revenues commensurate with their potentials. The introduction of the VAT along with the Turnover Tax was touted on their superior revenue generation potentials over the previous sales tax regime of Ethiopia the operation of which was limited to manufacturers and producers.³⁵ In the last decade alone, the Ethiopian Government introduced major tax administration reforms with a view to improving the performance of Ethiopian tax administration in generating revenues for the Government. Some of these reforms included the introduction of the Tax Identification Numbers (TIN), the

³² Id, pp. 32-33

³³ Id, p. 33

³⁴ See Ethiopia: Sustainable Development and Poverty Reduction Program, p. 131

³⁵ Ibid

obligatory use of the cash-register machines by many taxpayers and the installation of a number of information technologies to improve the performance of Ethiopian Tax Administration.³⁶

As a result of all these tax reforms, the performance of the Ethiopian tax system has improved quite considerably over the last decade, as can be seen in the following tables (**Table 2.4 and 2.5**).³⁷

Table 2.4: Growth of Government Revenue and Tax-to-GDP ratio from 2005 to 2010

Items	2004/2005	2005/2006	2006/2007	2007/2008	2008/2009	2009/2010
Tax Revenue (in Billions ETB)		11, 173.71	14, 012	19, 205	23, 224.31	35, 229.95
Tax-to-GDP ratio	11.6	10.8	10.1	9.6	8.6	11.3

Source: Growth and Transformation Plan, p. 7, and Ethiopian Revenues and Customs Authority (ERCA), Statistical Bulletin (vol. I), p. 12

³⁶ Ibid; see also Cover Interview with Ato Sufian Ahmed, Minister of Finance and Economic Development, “Ethiopia Ready to Compete,” in the African Economy, p. 19; Ayalew Werota, Standard Integrated Government Tax Administration System (SIGTAS), pp. 43-44

³⁷ Ethiopia: Sustainable Development and Poverty Reduction Program, p. 131

Table 2.5: Revenue Collection by Major Tax Types (2005/06-2009/10)

Tax type	Fiscal years					Annual average revenue	Annual average share
	2005/2006	2006/2007	2007/2008	2008/2009	2009/2010		
Total Tax Revenue	11, 173.71	14, 012.85	19, 205.55	23, 224.31	35, 229, 95	20, 569.27	98.84
Direct taxes	2, 053.46	2, 646.08	3, 781.41	5, 396.26	8, 693.44	4, 514.13	20.74
Indirect taxes	9, 120.25	11, 366.77	15, 424.14	17, 828.05	26, 536.52	16, 055.15	48.19
Non-tax revenue	68.3	168.53	46.44	329.80	427.69	208.15	0.93
Revenue from lottery sales	19.23	18.8	23.86	29.15	50.82	28.37	0.14
Grand total	11, 261.24	14, 200.18	19, 275.85	23, 583.26	35, 708.46	20, 805.80	
Annual growth rate		26.0978	35.7437	22.34615	51.4144	33.90	

Source: Ethiopian Revenues and Customs Authority (ERCA), Statistical Bulletin, p. 12

In spite of the major drives of the government to generate as much revenue as the economy can handle, there are significant snags to the capacity of the Ethiopian tax system to generate tax revenues. The first problem, as the Government has readily acknowledged, is that much of the revenue of the Government is being collected from taxes on international trade, underscoring

the continuing dependence of the Ethiopian Government upon these taxes, which are generally easy to collect but unreliable sources of revenue, as international efforts (most notably by the WTO) are exerted to reduce and eliminate these taxes as sources of government revenue.³⁸ The Ethiopian Government realizes the need to reduce its dependence upon these taxes and shift its revenue mobilization efforts to domestic tax sources, like the VAT and income taxes.³⁹ The other major stumbling block to raising revenues is the problem of tax evasion by certain economic sectors. The exponential growth of the private sector in Ethiopia over the last couple of decades has not resulted in the proportional growth in tax revenues from the private sector.⁴⁰ It is widely held that the level of tax compliance among businesses is very low, affecting the amount of revenue the Government expects from the growth of the private sector.⁴¹

b. Economic Development

Besides raising revenues, stimulating economic growth is perhaps one of the most important goals of the Ethiopian tax system over the last couple of decades. A recent publication of the Ruling party places stimulating “economic growth” at the center of the country’s tax policy:

የመንግስት ቀረጥና ታክስ የሚጣለው የመንግስትን የልማት ዕቅዶች ለማስፈጸም የሚያስችል ገንዘብ ለመስብስብ ብቻ አይደለም። ... በኛ ተጨባጭ ሁኔታ ልማትን ማፋጠንና ኢንቨስትመንትንና ልማታዊ ባለሀብቱን ማበረታታት በግንባር ቀደምትነት ሊጠቀሱ የሚችሉ ናቸው።

Taxes and duties are not levied simply to derive revenues for carrying out the developmental plans of government. ... In the context of [Ethiopia], *stimulating economic growth, encouraging investment and providing incentives to*

³⁸ See *Addis Ra'iy*, p. 11

³⁹ *Id.*, p. 12

⁴⁰ *Id.*, p. 13

⁴¹ *Ibid*

“developmental” investors can be mentioned as the major goals of the [Ethiopian] tax system.⁴² (Translations mine and italics added)

Whether under the rubrics of “eradicating poverty” or “fighting poverty” or just “reducing poverty” and as the Government gets more and more confident in recent years “economic growth,” “economic development” has been the *weltanschauung* of Ethiopian Government policy over the last two decades.⁴³ During the first decade of EPRDF leadership, the main emphasis of the Government of Ethiopia was on reduction of poverty. Encouraged by the continuous economic growth since 2003, the Government of Ethiopia has shifted its attention from reducing poverty to spurring economic growth not simply to reduce poverty but also to make Ethiopia a middle-income country by the first half of 2020s.

The goal of “economic growth” has occupied center stage in all of the general policy documents of the Government of Ethiopia, including the Sustainable Development and Poverty Reduction Programme (SDPRD) (2002/03-2004/05), the Plan for Accelerated and Sustained Development to End Poverty (PASDEP) (2005/06-2009/2010), and the current Growth and Transformation Plan (GTP)(2009/10-2014-2015).⁴⁴ In all of these policy documents of Ethiopia, taxation has served as a key source of finance for the government to either reduce poverty and accelerate economic growth. As the Minister of Finance and Economic Development once said,

⁴² Ibid

⁴³ See Cover Interviews with Ato Sufian Ahmed, Minister of Finance and Economic Development, in the African Economy, “Our Focus is Poverty Eradication,” “We are Laying the Foundation to Transform Economy,” “Ethiopian Business Climate Improving,” “Ethiopia Ready to Compete,” in the African Economy, September – November 2011, October- December 2010, October – December 2009

⁴⁴ See Cover Interview with Ato Sufian Ahmed, Minister of Finance and Economic Development, “Ethiopia is Ready to compete,” in The African Economy, p. 19

“The Major sustainable financial source for poverty reduction [strategy for the Ethiopian Government] is domestic revenues from tax and non-tax sources.”⁴⁵

The GTP places “economic growth, savings and investments” as the first priority of the Government, although the frequency with which tax incentives will be used as instruments of economic growth might decline as a result of the GTP’s all out focus upon generating revenues.⁴⁶ Indeed, the GTP’s huge revenue growth forecast is projected upon a number of assumptions, one of which, as already pointed out, is the re-entry of many beneficiaries of income tax holidays and other tax breaks into the taxpaying community.⁴⁷

The Government of Ethiopia has taken a number of measures to achieve the goal of “economic development” on many fronts, and it has not shied away from using taxes and duties as instruments for stimulating economic growth over the last couple of decades. Beginning with tax incentives in 1992,⁴⁸ the current Ethiopian Government has issued a number of tax incentive laws in which “income tax holidays” featured as a major pillar of incentive schemes for investors engaged in certain priority areas (mainly in agriculture).⁴⁹ The Government of Ethiopia has also used the income tax laws themselves to extend various types of tax incentives for saving and investment. These include re-investment deduction provisions, provisions allowing carrying

⁴⁵ Ibid, p. 19

⁴⁶ Growth and Transformation Plan, p. 28

⁴⁷ Ibid

⁴⁸ See Proclamation to provide for the Encouragement, Expansion and Coordination of Investment No. 15/1992

⁴⁹ See Taddese Lencho: Towards Legislative History of Modern Taxes in Ethiopia, pp. 149-154

forward of losses, exemption from dividend taxation for reinvested dividends⁵⁰ and according non-recognition of income to transfers of assets in the context of business reorganizations.⁵¹

c. Tax Equity

The need to ensure the equitability of the Ethiopian tax system is often overshadowed by the rhetoric of raising revenues and encouraging investment and stimulating economic growth, when it is not trumped by administrative feasibility considerations, but tax equity remains one of the major policy objectives of the Government of Ethiopia.⁵² In a recent analysis of the Ethiopian tax system by the Ruling party, tax equity features as one of the three goals of the Ethiopian tax system:

የታክስ ስርዐቱ ፍትሐዊ፣ ዘመናዊና ለማስተዳደር ቀላል ይሆን ዘንድ የግብር ህጉን በማደስና የታክስ አስተዳደሩን በማሻሻል ላይ በማተኮር እንቅስቃሴ ሲደረግ ቆይታል።⁵³

Roughly translated, it reads:

The Government [of Ethiopia] has revised tax laws and reformed tax administration to ensure that the Ethiopian tax system is **equitable**, **modernized** and **easy to administer** (translation and italics mine).

Equity was one of the major motivations for the comprehensive tax reforms of 2002.⁵⁴ The major policy program of the Government at the time, the Sustainable Development and Poverty Reduction Program (SDPRP) stated that ensuring “equity and fairness in the tax system through

⁵⁰ See *Kapitalin Le Masadeg Yewale Aksiyon Tirf Dirshan Ka Gabi Gibir Netsa Indihon Le Madreg Yetefeqadu Maskochin Le Mastawok Ye Wexa Ye Gabiwoch Minister Memeriya Quxir 17/1996*, in Amharic, unpublished.

⁵¹ See Income Tax Proclamation No. 286/2002, Articles 24, 27, and 28

⁵² *Addis Ra'iy*, p. 8

⁵³ *Ibid*

⁵⁴ See Ethiopia: Sustainable Development and Poverty Reduction Program, p. 184

a comprehensive overhaul of” of tax laws was one of the objectives of the tax reform program of 2002.⁵⁵

Many of the tax reforms of the Government of Ethiopia have equity maximizing effects in the Ethiopian tax system, although in many of these cases the chief objective of the government has not been to ensure equity but mainly to encourage investment and stimulate economic growth. Some of these reforms include the reduction of tax rates from the steep marginal income tax rates (of up to 89% in the 1980s) to the current 35%, the broadening of the income tax bases, the introduction of uniform income brackets and tax rates for major sources of income and strengthening the presumptive tax regimes for small businesses.⁵⁶

One of the major equity-maximizing reform measures in Ethiopia has been the increasing drive by the Ethiopian Government to broaden the tax bases in Ethiopia, which is sometimes separately stated as the goal of taxation in Ethiopia in its own right.⁵⁷ Ethiopia’s income tax base was historically limited to three known income tax sources at best: employment, rental of land and buildings and businesses. Ever since its biggest expansion in 1978, the income tax base of the Ethiopian income tax system has progressively expanded bringing under the income tax system such sources like dividends, royalties, income from games of chance, capital gains and most recently windfall profits.⁵⁸ Broadening the income tax base has gone on two important fronts: revising the income tax laws of Ethiopia to expand the income tax base, and improving the enforcement arm of the Tax Administration to enhance its capacity of drawing income taxes from bases ordinarily susceptible to low compliance rates.

⁵⁵ Ibid

⁵⁶ Id, p. 109

⁵⁷ See *Addis Ra'iy*, p. 26

⁵⁸ See Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, pp. 115-124

On the front of revising the income tax laws, Ethiopia's income tax bases have expanded to include bases which were previously not subject to income tax: some gains from capital became chargeable with income tax in 1994, interest accruing on bank deposits became chargeable with income tax in 2001 and windfall profits were included in 2010.⁵⁹ On the front of income tax administration, the Ethiopian Government has sought to buttress income tax bases which were known to have yielded little to government revenues. One of these bases was the income of small businesses. As a result of the income tax reforms of 2002, the Ethiopian Government introduced a new method of presumptive assessment with a view to raising more revenues and in the process expanding the income tax base of the Ethiopian tax system.⁶⁰ The Government of Ethiopia has also sought to expand the income tax base by introducing two essentially new fronts of withholding income taxation. In 2001, the Government introduced an income tax amendment that mandated the collection of advance income tax from imports and from payments for goods and services by juridical bodies.⁶¹ All these developments indicate that the expansion of the income tax base has been one of the major policies of the Ethiopian government over the last couple of decades.

d. Modernizing the Tax System and Tax Administration

In view of the well-known weaknesses of the Ethiopian tax system, modernizing the tax system and tax administration as a major policy objective of the Ethiopian government should come as

⁵⁹ See Income Tax (Amendment) No. 227/2001; Payment of Tax on Gains from Capital Proclamation No. 108/1994

⁶⁰ See Income Tax No. 286/2002, Article 68

⁶¹ See Income Tax (Amendment) No. 227/2001

no surprise.⁶² The Ethiopian Government has acknowledged repeatedly that its tax administration leaves a lot to be desired in terms of collecting revenues commensurate with the productivity of the economy and ensuring overall equitability of the tax system and tax administration.⁶³ In this regard, the major policy program at the time of the comprehensive tax reform in 2002, the Sustainable Development and Poverty Reduction Program (SDPRP) states:

There had been revisions in the tax regime many times in the past reducing income tax [rates] from 89% to 40%. But, overall, the measures taken were piece-meal and essentially left the system of tax assessment and collection full of loopholes for evasion and non-payment of taxes. A comprehensive tax reform is currently underway with the objective of removing past weaknesses. The tax reform program has measures to ... build the capacity of tax administrators.⁶⁴

The Ethiopian Tax Administration has fallen short in many areas of performance measurement. The tax-to-GDP ratio has been far lower than even the Sub-Saharan average. Ethiopian current tax-to-GDP ratio of 11% is far lower than the average for developed tax systems (25-35%), developing countries (18-25%) and even of the Sub-Saharan average (16%).⁶⁵ Amazingly, in spite of the ambitious targets of the GTP, the Government does not expect to get to the sub-Saharan average even at the end of the GTP period.⁶⁶

The need to modernize the Ethiopian tax system in general, and tax administration in particular has been emphasized in many government documents, including the GTP. The GTP, as repeatedly stated before, aims to mobilize the revenue-generating potential of the Ethiopian tax

⁶² The Minister of Finance and Economic Development attributed the low tax-to-GDP ratio of Ethiopia to the weak tax administration and tax compliance in Ethiopia; see Cover Interview, with Ato Sufian Ahmed, Minister of Finance and Economic Development, “We Are Laying Foundation to Transform the Economy,” the African Economy, September – November 2011, p. 16

⁶³ See *Addis Ra'iy*, pp. 11-13

⁶⁴ See Ethiopia: Sustainable Development and Poverty Reduction Program, p. 109

⁶⁵ See *Addis Ra'iy*, p. 11

⁶⁶ The GTP target is to reach 15%, which is still lower than the average for Sub-Saharan Africa (16%); see Growth and Transformation Plan, p. 33

system. The GTP underscores that modernizing the Ethiopian tax system and tax administration is an area that requires attention if the tax system is to generate the revenues the GTP expects from it. Some of the modernizing efforts include enhancing “on-going tax reform program,” “equipping tax collection agencies with adequate enforcement powers,” “implementing the Tax identification Number (TIN) throughout the country,” “improving the presumptive tax” regime, and improving the administration of the Value-Added Tax.”⁶⁷

Modernization of the Ethiopian tax system has gone on two major fronts over the last decade: in the introduction of new taxes or revision of the old taxes of Ethiopia, and modernization of the Ethiopian tax administration.

Introduction of Modern Tax Legislations

In the comprehensive tax reforms of 2002, the Government of Ethiopia saw existing tax legislations at the time as inadequate for meeting its revenue needs and achieving the major policy goals of the Government.⁶⁸ The sales taxes of Ethiopia at the time were viewed as having a narrow tax base, as their application was limited to manufacturer’s and/or importers’ level. The customs tariff band rates were considered too high. The income tax laws also suffered from narrow income tax bases. The Government implemented comprehensive tax reforms and oversaw the replacement of existing sales taxes by VAT (along with the supplementary turnover tax), the major revision of existing income taxes and the reduction of tariff rates from the high of 230% to the current high of 35%.⁶⁹

⁶⁷ Id, pp. 32-33

⁶⁸ See Ethiopia: Sustainable Development and Poverty Reduction Program, p. 109

⁶⁹ See *Addis Ra'iy*, p. 8

The revision of the income taxes in particular was quite significant in modernizing the income tax system of Ethiopia. The 2002 income tax laws brought together many scattered pieces of income tax legislation and introduced some modern principles of income taxation, including the introduction of some anti-avoidance rules, modern tax accounting provisions and the extension of Ethiopian income tax jurisdiction to the worldwide income of residents.⁷⁰ The introduction of the VAT brought with it momentous changes in the way transactions are handled by businesses, such as the introduction of mandatory VAT invoicing and later the introduction of cash register machines.⁷¹ The very infrastructure of the VAT enabled the Government to combat tax fraud and tax evasion better than it was ever able before. These tax reform processes are ongoing.⁷²

Modernization of Ethiopian Tax Administration

Reform of the Ethiopian Tax Administration is another major front of modernization of the Ethiopian Tax System. The vision of the Ethiopian Revenues and Customs Authority (ERCA) says it all: *“To be a leading, fair and modern Tax and Customs Administration in Africa by 2020 that (sic) will finance Government expenditure through domestic tax revenue collection.”*(Italics added) It is also reflected in the establishment law of ERCA, which states modernization among the first objectives of the Authority: *“To establish modern revenue assessment and collection system.”*⁷³ (Italics added)

For a long time, the Government of Ethiopia has viewed the gaps and weaknesses in Ethiopian Tax Administration as a major stumbling block to achieving its aims of generating revenues

⁷⁰ See Income Tax Proclamation No. 286/2002, Articles 2, 3, 5, 59-63

⁷¹ See Council of Ministers Regulations for the Obligatory Use of Sales Register Machines No. 139/2007 and Directive No. 46/2007, Issued to Provide for the Use of Sales Register Machines

⁷² Growth and Transformation Plan, p. 32

⁷³ Ethiopian Revenues and Customs Authority Establishment Proclamation 587/2008, Article 5(1).

commensurate with the potentials of the Ethiopian economy and of meeting its other major tax policy goals.⁷⁴ Tax administration reform has therefore received a fair amount of attention in the tax reform programs of the Ethiopian Government. Indeed, the recent tax reforms in Ethiopia have witnessed some of the most momentous changes in the Ethiopian Tax Administration. The reform of Ethiopian tax administration has gone on a number of fronts.

The first area of reform in tax administration is the complete reorganization and overhaul of the Tax Authorities at the federal level.⁷⁵ Beginning with the establishment of a separate tax administration body in 1995, successive reforms were undertaken in the organization of tax administration culminating in the merger of the separate tax authorities and establishment of the Ethiopian Revenues and Customs Authority (ERCA) in 2008.⁷⁶ This reorganization did not simply merge the separate authorities at the time but affected many other areas of Ethiopian tax administration. The upshot of those reforms was to strengthen the arm of ERCA in many areas of tax administration: assessment, collection, investigation and enforcement.⁷⁷ ERCA's powers of investigation and prosecution were strengthened quite considerably when the establishment laws conferred original jurisdiction over the investigation and prosecution of tax and customs offenses.⁷⁸ As a result of these reforms in tax administration, ERCA has emerged as one of the most powerful government bodies of the Federal Government.

⁷⁴ See *Addis Ra'iy*, p. 13

⁷⁵ See Cover Interview with Ato Sufian Ahmed, Ministry of Finance and Economic Development, Ethiopian Business Climate Improving, the African Economy, October – December 2010, p. 19

⁷⁶ See Taddese Lencho, *The Ethiopian Tax System: Excesses and Gaps*, p. 347-352

⁷⁷ Ethiopian Revenues and Customs Authority Establishment Proclamation No. 587/2008, Article 6; see also Taddese Lencho, *The Ethiopian Tax System: Excesses and Gaps*, pp. 347-352

⁷⁸ See Ethiopian Revenues and Customs Authority Establishment Proclamation No. 587/ 2008,, Articles 16-18

Another area of reform in tax administration has affected the processes and working procedures of the Ethiopian Tax Administration. Aided in part by the advances in information technology, a number of reforms in tax administration have increased the capacity of the Ethiopian tax administration in the collection and analysis of information for assessment, and collection of taxes as well as investigation and prosecution of tax and customs offenders. The introduction of the Tax Identification Number (TIN) system in 2001, the computerization of tax assessments and taxpayers' data, and the authorization of the cash register machines, are all part of the major drive by the Ethiopian Government of modernizing the Ethiopian Tax Administration.⁷⁹

IV. Major Principles of Taxation in the Ethiopian Tax System

Relying principally upon the three main sources of tax policy described above (namely policy documents, the Constitution and tax laws), we shall now articulate Ethiopia's tax policy based on the well-known tax policy norms in the literature. As usual, there is an apparent overlap between what are generally known as "goals" and "principles." As asserted in the first chapter, "goals" express the ends for which taxes are deployed while "principles" are there to serve as criteria or gauge for whether the existing taxes are "good" or "bad," "desirable" or "undesirable," etc. Once again, it is difficult to give an exhaustive account of all the principles of taxation that are probably incorporated in the various sources of tax policy. It is therefore prudent to confine oneself to those principles that are of special significance in the Ethiopian context. In this sense,

⁷⁹ See Cover Interview with Ato Sufian Ahmed, Ministry of Finance and Economic Development, Ethiopian Business Climate Improving, the African Economy, October – December 2010, p. 19

the following principles are deemed germane to the Ethiopian tax policy and thus treated hereunder:⁸⁰

- i) Equity;
- ii) Neutrality;
- iii) Simplicity;
- iv) Efficiency
- v) Administrative Feasibility
- vi) Economic Growth or Investment; and
- vii) Benefits Received

For reasons alluded to in the Introduction, the emphasis on the question of “equity” with particular reference to the Ethiopian income tax system means that the recognition of “equity” [or a variant of it] in the three principal sources of tax policy mentioned above receives larger space than the other principles. Some of these tax policy norms are directly taken from the words used in the sources cited above while others are approximations of the language used in the various sources of tax policy at the beginning of the present chapter.

⁸⁰ For an interesting restatement of these principles, see *Be Addis Ababa Ketema Astedadar Fayinansina Ikonomi Limat Biro Ye Gebiwoch Ejensi, Gibir, Le Gibir Kefayu Hibretasab Ye Tezegaje Ye Ginizabe Maschabacha ena Maraja Sachi Tsihuf*, Tahsas 1996 E.C., in Amharic, unpublished, pp. 7-8 (where principles like equity (both horizontal and vertical), neutrality, administrability, certainty and convenience are enunciated)

a. Equity

i. Tax Equity in General Policy Documents

The Government of Ethiopia is keenly aware of the equity deficits of the Ethiopian income tax system. In a recent analysis of the Ethiopian Tax System, the Government has noted with regret that the income tax system of Ethiopia is not able to collect revenues commensurate with the productivity of the economy and cites the huge disparity that exists between income taxes collected from employees' vis-à-vis other income earners like lessors and owners of businesses.⁸¹

Taking the revenues collected by the City Administration of Addis Ababa as an example, the Report notes that out of the 4.5 billion ETB collected by the City, direct taxes accounted for 2.5 billion Birr (55%), indirect taxes 1.5 billion ETB (33%) and municipality taxes and fees accounted for 0.6 billion ETB (13.33%).⁸² In the area of direct taxes, taxes on wages and salaries accounted for 1.8 billion ETB (40% of total revenue), and taxes on business profits and on rental income accounted for 0.5 billion ETB (11%) and 0.136 billion ETB respectively (0.03%). It can be seen from the figures that most of the revenues of the City came from the tax on wages and salaries, which has been the most effective source of income tax as a result of the use of withholding schemes. The Government attributes these disparities to massive underreporting of income by the other sectors like businesses and earners of rental income.⁸³

The Government of Ethiopia is concerned about the equitability of the tax system because it has stated “equity” to be one of the principal goals of taxation in Ethiopia. It is also concerned about “equity” because the limited reach of the Ethiopian tax system in general and the income tax in

⁸¹ *Addis Ra'iy*, p. 13

⁸² *Ibid*

⁸³ *Ibid*

particular has deprived the Government of much needed revenues. As a tax policy goal or objective, equity is mentioned in all the sources of tax policy in Ethiopia.

The GTP's focus, as repeatedly pointed out before, has been on the mobilization of huge revenues, but the GTP has many equity maximizing measures included in it. The GTP stakes its huge revenue growth forecasts upon the proper enforcement of taxes in Ethiopia. It stakes its targets upon the "implementation of the on-going tax reform program," the intensification of the "Tax Identification Number system throughout the country," the improvement in the administration of the "presumptive tax" regime of Ethiopia and other reform measures.⁸⁴ Interestingly, the GTP also anticipates that many business sectors which erstwhile enjoyed tax breaks and tax holidays will be brought into the tax fold, which, in addition to boosting government revenues, will maximize the equitability of the Ethiopian tax system.⁸⁵ So while "equity" is not the priority of the Ethiopian Government as far as the GTP is concerned, many of the measures to be taken primarily to boost government revenue will have undoubted spillover effects upon the equitability of the Ethiopian tax system over the GTP period.

Apart from the GTP, there are numerous other government policy documents which make reference to "tax equity" either directly or indirectly. A Statistical Bulletin of ERCA, released in 2011, for example, states that the current tax policy [of Ethiopia] is one, among others, of "broadening the tax base."⁸⁶ This can be taken as an offshoot of the overall government strategy to improve the equitability of the Ethiopian tax system.⁸⁷ The link between "broadening the tax base" with "tax equity" does not become immediately apparent unless one understands the

⁸⁴ Growth and Transformation Plan, pp. 32-33

⁸⁵ Id, p. 33

⁸⁶ Ethiopian Revenues and Customs Authority (ERCA), Statistical Bulletin, p. 2

⁸⁷ See *ibid*

context in which the move for broadening the tax base became a mantra for Ethiopian government tax reform in 2002. One of the charges against the Ethiopian tax system back in 2000 was that the income tax base was not broad enough (e.g., it did not tax interest income) and therefore was inequitable.⁸⁸ It was suggested that broadening the income tax base would improve the equitability of the tax system.⁸⁹ The Government Report at the time (SDPRP) records the deficit in the “equitability” of the Ethiopian tax system as the main reason why the Government launched the comprehensive tax reforms of 2002.⁹⁰

The Ethiopian Tax Authorities do not always respond to perceived tax inequities of the Ethiopian tax system, but in the few occasions they have done so, they have invoked “equity” or rather “inequity” as the main reason for their actions.⁹¹ One of these signal actions was a letter written by ERCA in 2009 to ensure that all cash benefits from employment were made taxable by all government institutions as set out in the Income Tax Laws.⁹² A letter written to Addis Ababa Revenues Bureau deploras the practice in some City Administration Offices of not deducting income tax from “housing allowances, transportation allowances, bonus, etc” received in cash and concludes that this was contrary to the spirit of the Income Tax Proclamation.⁹³ The Letter warns that this practice would narrow the tax base and result in tax unfairness as some

⁸⁸ See Muzondo, Courneyea, Brooks and Amina, Ethiopia: Introduction of a VAT and Presumptive Income Tax and Reform of the Income Tax, p. 48

⁸⁹ See *ibid*

⁹⁰ See Ethiopia: Sustainable Development and Poverty Reduction Program, pp. 109 and 184

⁹¹ Many within the Tax Authorities will acknowledge individually that the absence of specific rules on the taxation of employment fringe benefits is a source of inequity, but the Ethiopian tax administration has so far lacked the political will to issue such rules; for the treatment of employment fringe benefits, see Chapter Five, below. The Tax Authorities have adopted various slogans at various times, and equity has been used as a rallying policy of the Government. One of these slogans was: “*Le Zemenawina Fitawi Ya Tax ena Qarax Astedadar Siri’at Ginbata Tegitan Enisaralan!*,” which roughly translates “We shall strive to build a modern and equitable tax administration!”

⁹² See Ethiopian Revenues and Customs Authority, *Be Addis Ababa Ketema Astedadar Le Fayinansina Economy Limat Biro Le Gebiwoch Agency*, Addis Ababa, 22 Sene 2001, in Amharic, unpublished

⁹³ See *ibid*

government institutions deducted income taxes from the same payments and others failed to do so.

ii. Tax Equity in the Ethiopian Constitution

The Ethiopian Constitution recognizes “equity” as a norm if we understand equity to mean “equality” in a general, constitutional sense.⁹⁴ The Constitution recognizes the right to equality as one of the fundamental rights and freedoms of citizens. According to the Constitution, the right to equality encompasses equality before the law and protection of all persons against discrimination “on grounds of race, nation, nationality, or other social origin, color, sex, language, religion, political or other opinion, property, birth or other status.”⁹⁵

The extent to which the equality clause of the Ethiopian Constitution may be used to enforce a particular brand of tax equity depends on the development of constitutional jurisprudence in this regard, of which we can adduce none at the moment.⁹⁶ The experience of selected countries in this regard has been a mixed bag. In some countries, courts have shown themselves willing to interpret general equality clauses in the constitutions to enforce specific norms of equality in taxation while others have expressed reluctance to apply general equality clauses in taxation.⁹⁷ As there are no cases on record in this regard in Ethiopia, we cannot tell which way the Ethiopian Constitution would go.

⁹⁴ See The Constitution of Ethiopia, Article 25

⁹⁵ See *ibid*

⁹⁶ See Taddese Lencho, *The Ethiopian Tax System: Excesses and Gaps*, p. 334

⁹⁷ Germany and the United States can be taken as studies in contrasts in this regard. The German Constitutional Court showed itself to be willing to strike down tax laws on the ground that these taxes violated the general rule of equality enshrined in the German Constitution; in contrast, the US Supreme Court has been reluctant to intervene in a number of constitutional challenges to the power of the US government to impose taxes, apparently in violation of the principles of equality; see Thuronyi, *Comparative Tax Law*, p. 82

The “equality” clause of the Ethiopian Constitution is not the only place to turn to for evidence of recognition of equity in Ethiopia. In Chapter Ten of the Ethiopian Constitution, we find various policies and objectives expressed on “external relations,” “national defense,” “political objectives,” “economic objectives,” “social objectives,” “cultural objectives” and “environmental objectives.”⁹⁸ As part of “economic objectives,” for instance, we have equity (at least a variant of equity) expressed in Article 89 (2), which states the duty of the [Ethiopian] Government as ensuring “*that all Ethiopians get equal opportunity to improve their economic conditions and to promote equitable distribution of wealth among them*” (Italics added). It is once again unclear how far this provision may be used to recognize tax equity as a constitutional norm, but the language of the Constitution is broad enough to accommodate tax equity as a constitutional norm.⁹⁹

The extent to which the Ethiopian Constitution may be invoked in support of any substantive version of tax equity (substantive tax equity) remains debatable and must remain open until the Constitution is entrenched with real cases. But it is not just substantive tax equity that is important to the welfare of ordinary taxpayers. It has been repeatedly asserted that tax policy in and of itself carries little weight if it is not fully implemented. The procedural aspect of tax equity is therefore perhaps as important as the substantive content of equity. In this regard as

⁹⁸ See The Constitution of Ethiopia, Articles 86-92

⁹⁹ Redistribution of income and wealth is now recognized as one of the major functions of modern governments – although the extent to which governments engage in a redistributive activity varies from country to country, and indeed from one period to another. Governments have traditionally employed a range of public instruments to fulfill their redistributive responsibilities. It is generally recognized that governments may use taxes as “redistributive” tools in addition to using their budgetary appropriations. In Ethiopia, direct public expenditures on merit goods like education and health services have traditionally been used in meeting the goals of “equitable distribution of wealth” and improving the economic conditions of Ethiopians. But there is enough authority in the Ethiopian Constitution to justify redistributive taxes, such as progressive income taxation in Ethiopia; see Due and Friedlaender, Government Finance, 108-148; Avi-Yonah, Three Three Goals of Taxation, pp. 10-21; see also Rawls, The Theory of Justice, pp. 245-246

well, the provisions of the Ethiopian Constitution may be invoked to deploy fairness in the administration of the tax system at various stages of tax administration. The Ethiopian Constitution is more direct in this regard than that of substantive tax equity. Article 100(1) of the Constitution recognizes “procedural fairness,” under a principle of what it calls “due considerations” as a tax norm, which means that taxpayers can directly appeal to the Constitution when taxes are levied without “due considerations” – whatever that may mean. If the experience of some other tax systems is any clue, it is possible that taxpayers may use this provision of the Ethiopian Constitution to demand procedural fairness in all aspects of tax administration, which may mean that taxpayers are entitled to expect that the Ethiopian Tax Administration will apply tax laws “completely and impartially, regardless of the person involved.”¹⁰⁰

iii. Tax Equity in the Tax Laws of Ethiopia

Tax laws provide the most immediate and probably the most authoritative evidence for recognition of tax equity (or at least a variant of tax equity) in Ethiopia. If we take the income tax laws of Ethiopia as representative in this regard, tax equity may be said to be recognized in two principal places in the income tax laws of Ethiopia: in the preambles (which are the traditional sections for policy statements in Ethiopian legal system) and substantive provisions.

The preambles of successive income tax laws of Ethiopia have given adequate recognition to tax equity as a justification for income taxation in Ethiopia. As far back as 1949, we have preambles of income tax laws of Ethiopia according due recognition to “equity” as tax norm in Ethiopia. The 1949 Income Tax Law (now repealed) – which was incidentally the second modern income

¹⁰⁰ See Vanistendael, “The Legal Framework for Taxation,” p. 19

tax law in Ethiopian history – incorporated “equity” as one of the goals of income taxation in Ethiopia, along with the norms of “simplicity” and “economic development.”¹⁰¹

Forty years later, the introduction of the first capital gains taxation (which was added to the main income tax system of Ethiopia in the form of an amendment) was similarly justified by appeal to “equity.” The preamble of the 1994 capital gains tax law states in part:

...levying tax on all gainful activities in the economy maintains ... *equitability in the tax system* (italics added).¹⁰²

The preamble of the current income tax law (issued in 2002) does not explicitly recognize “equity” as one of the norms of the Ethiopian income tax system, but close analysis of the income tax laws of the previous period and the 2002 income tax law shows that the current income tax law is perhaps more equitable in spirit than any of the previous income tax laws of Ethiopia.

We shall examine the substantive provisions of the 2002 income tax law to establish that “equity” is as much a norm as it was previously the case. We argue that the preambles of income tax laws are not the only place where equity is recognized as a tax norm in Ethiopia. Some of the substantive provisions of Ethiopian income tax laws in fact represent stronger cases for equity than the preambles. We shall take three examples from the current income tax laws to establish

¹⁰¹ See a Proclamation to Provide for the Payment of Tax by All Individuals and Businesses No. 107/1949; tax equity often supplies a rationale for introducing new taxes. In this regard, it may be instructive to cite the preamble of the 1954 cattle tax law of Ethiopia: “We consider it necessary to ensure *equity of taxation as between ... subjects who obtain their livelihood from agricultural pursuits and pastoral activities*; and ... recognize that while farmers pay tithes and land tax it is but appropriate that cattle breeders should pay cattle tax; see a Proclamation to Provide for Cattle Tax No. 142/1954

¹⁰² Payment of Tax on Gains from Capital Proclamation No. 108/1994

whether tax equity is recognized under the current income tax system: provisions defining income tax jurisdiction, schedules fixing uniform income brackets and tax rate structures, and rules requiring aggregation of income.

In the area of income tax jurisdiction, the 2002 income tax laws of Ethiopia introduced a major transformation on the jurisdictional reach of Ethiopian income tax system, which was, up until 2002, territorial or source based jurisdiction. Prior to 2002, the jurisdictional reach of Ethiopian income tax system was based on the source of income in Ethiopia (so-called source-based or territorial jurisdiction). The 2002 income tax law of Ethiopia for the first time extended the jurisdictional reach (at least notionally) to the world-wide income of residents.¹⁰³ Given the administrative limitations and constraints of Ethiopian tax administration, and given the limited pool of Ethiopian residents deriving income from sources outside Ethiopia, this jurisdictional extension may sound facetious, but the legislative aim is clear. Apart from potentially increasing the revenue of the government from this source, the world-wide taxation of residents ensures (as the literature attests) equal treatment between residents of Ethiopia who derive their income exclusively from domestic activities and those residents who derive part or whole of their income from sources outside Ethiopia.¹⁰⁴ In its own sense, this is an expression of tax policy of treating equals equally (horizontal equity) and unequals unequally (vertical equity).

The income brackets and tax rate structures introduced by the 2002 income tax laws reveal another specific tendency towards improving the equitability of Ethiopian income tax system.

¹⁰³ Non-residents are subject to Ethiopian income tax jurisdiction if they derive income from sources in Ethiopia, see Income Tax Proclamation No. 286/2002, Article 3(2)

¹⁰⁴ See Arnold and McIntyre, *International Tax Primer*, p. 5

The current income tax laws show that an attempt (imperfect as it might be) has been made to ensure some semblance of “uniformity” in income brackets and tax rate structures among the three major schedules of Ethiopian income tax law – A, B, and C.

Prior to 2002, income brackets and tax rate structures for the various schedules of Ethiopian income tax system lacked uniformity (**See Table 2.7 below**).¹⁰⁵ To cite the tax rates that prevailed in the 1990s, the marginal tax rates for income from employment (Schedule “A”) and income from business (Schedule “C”) ranged between 0%-40% while the marginal tax rates for income from rental of buildings (Schedule “B”) ranged between 0%-45%.¹⁰⁶ The income brackets of the schedules were not uniform either. The 2002 income tax laws put an end to these bracket and tax rate differentials in respect of the three major schedules of Ethiopian income tax system (A, B, and C) and instituted uniform income brackets and tax rates for the three schedules (**see Table 2.7 below**).¹⁰⁷

Uniformity of income brackets and tax rates, even when the income tax structure is schedular, is a feature of equitability of the tax system, however imperfect the outcome of equality might be. The 2002 income tax laws have improved the equitability of Ethiopian income tax system by introducing uniform income brackets and tax rate structures.

¹⁰⁵ See Income Tax (Amendment) No. 62/1993; Income Tax Amendment Proclamation No. 107/1994

¹⁰⁶ See *ibid*

¹⁰⁷ See Income Tax Proclamation No. 286/2002, Articles 11, 15, and 19

Table 2.6: Income Brackets and Tax Rates for Schedules A, B, and C under 1993/1994 Income Tax Laws and 2002 Income Tax Proclamation

Schedule “A”

1994			2002		
Employment Income Per Month		Income Tax Rate	Employment Income Per Month	Income Tax Rate	
Over Birr	To Birr		Over Birr	To Birr	
0	120	Exempt	0	150	Exempt
120	600	10	151	650	10
600	1200	15	651	1400	15
1200	2000	20	1401	2350	20
2000	3000	30	2351	3550	25
Over 3000		40	3551	5000	30
			Over 5000		35

Source: Income Tax Proclamation No. 107/1994 and Income Tax Proclamation No. 286/2002, Article 11

Schedule “B”

1993			2002		
Taxable Income from Rental (per year)		Income Tax Rate	Taxable Income from Rental (per year)	Income Tax Rate	
Over Birr	To Birr		Over Birr	To Birr	
0	1200	Exempt	0	1800	Exempt
1200	6000	10	1801	7800	10
6000	12,500	15	7801	16800	15

12, 500	21, 500	21	16801	28200	20
21, 500	33, 500	28	28201	42600	25
33, 500	50, 000	36	42601	60000	30
Over 50, 000		45	Over 60, 000.		35

Source: Income Tax Proclamation No. 62/1993 and Income Tax Proclamation No. 286/2002

Schedule “C”

1994			2002		
Taxable Income from Business (per year)		Income Tax Rate	Taxable Income from Business (per year)		Income Tax Rate
Over Birr	To Birr		Over Birr	To Birr	
0	1200	Exempt	0	1800	Exempt
1200	6000	10	1801	7800	10
6000	15, 600	15	7801	16800	15
15, 600	30, 000	20	16801	28200	20
30, 000	50, 000	30	28201	42600	25
Over 50, 000		40	42601	60000	30
			Over 60, 000.		35

Source: Income Tax Proclamation No. 107/1994 and Income Tax Proclamation No. 286/2002

The third area of the substance of income tax laws where tax equity may be said to inhere is in the rules of aggregation, which with all their imperfections, seem to convey the idea that those who obtain income from multiple sources should be made to pay tax on their total income rather than income from individual sources. The rules of aggregation in Ethiopian income tax laws

represent the desire on the part of the Government to treat equals equally (horizontal equity) and unequals unequally (vertical equity), regardless of the number of sources of income.

The current income tax law of Ethiopia has rules of aggregation which require computation of income tax liability of individuals on the basis of the aggregate of income from various sources falling within one income tax schedule. The basis for these rules is that since the tax rate structures for individuals are progressive, income tax liabilities might vary depending on whether the rates are applicable on total income or separate income sources. Without the requirement of aggregation, two individuals with the same amount of income might pay different amounts of taxes, violating the principle of horizontal equity. These concerns of equity appear to inform the rules of income aggregation in Ethiopian income tax system.

Under Schedule “A” rules of Ethiopian income tax, employees who derive income from multiple employments are required to aggregate their income [from multiple employments] and pay the tax due on their total income.¹⁰⁸ Since most employment income tax is paid through withholding by employers, it is the employers who are required to undertake the duty of aggregating, but employees are not exempted from the duty to aggregate. In fact, employees who obtain income from multiple employments are required to compute the tax due on their total employment income and pay the difference between the tax withheld by their [multiple] employers and the tax due on their total income.¹⁰⁹ These special rules of aggregation are intended to eliminate the tax burden difference between those employees who receive all of their income from one employment and those who receive income from multiple employments.

¹⁰⁸ See Income Tax Proclamation No. 286/ 2002, Article 65(4) &(5)

¹⁰⁹ See id, Article 65(4)

There are similar rules of requirement of aggregation for those subject to tax under Schedule “B” and “C” of Ethiopian income tax (lessors, business persons, and professionals).¹¹⁰ Individuals who obtain income from multiple businesses falling under Schedule “C” are required to aggregate their income from multiple businesses.¹¹¹ Like employment income tax, the tax rates for Schedule “C” taxpayers are progressive with the result that the tax due on the total of multiple businesses is likely to be different from the tax due on taxable income of individual businesses.

Now that a number of provisions in the current income tax laws of Ethiopia have been cited in support of the contention that “equity” as a tax norm is accorded due recognition, a number of caveats must be entered. These caveats suggest that the case for “equity” as an income tax norm is not as strong as one might have supposed at the beginning.

We have argued that the adoption of worldwide income tax jurisdiction represents an example of the acceptance of tax equity in the Ethiopian income tax system. It is necessary to qualify this by stating that the worldwide jurisdiction of Ethiopian income tax system has so far been of theoretical importance only. Not many Ethiopians generate income from abroad anyway and the Ethiopian tax administration has yet to enforce the rules of worldwide taxation with any degree of consistency.¹¹²

We have also argued that the adoption of uniform income brackets and tax rate structures in the current income tax laws represent another case of tax equity as a norm in the Ethiopian income

¹¹⁰ See *id.*, Article 70

¹¹¹ In practice, if one of the businesses happens to be a category C business (small business), that business is exempted from aggregation as it is presently subject to presumptive income taxation; see Chapter Seven below

¹¹² See Eyerusalem Ejigu, *The Foreign Tax Credit System*; and Kalkidan Negash, *The Taxation of Multinational Enterprises under Ethiopian Law*

tax system. This assertion requires a number of qualifications. While the 2002 income tax laws represent quite an improvement over the previous income tax laws, we must remember that the 2002 income tax laws have continued a number of subtle differences among different sources of income currently subject to tax under Ethiopian income tax laws.

We shall begin from the obvious discriminatory treatments of different sources of income under the current income tax rules. The uniformity of income brackets and tax rate structures applies to three of the four current schedules of Ethiopian income tax system only. The ideal of uniformity is not carried over to Schedule “D” income tax, which applies to “miscellaneous” sources of income.

Schedule “D” of Ethiopian income tax laws openly legislates differential tax rates for the different sources of income currently being subject to tax under Schedule “D”. “Royalties” are subject to 5% final withholding tax rate, “income from technical services” to 10% final withholding tax rate, “income from games of chance” to 15% final withholding tax rate, “dividends” to 10% final withholding tax rate, “interest from bank deposits” to 5% final withholding tax rate, “income from casual rental of property” to 15% tax rate, and “capital gains” are subject to 30% and 15% respectively for gains from sales of shares and from buildings held for business.¹¹³ Schedule “D” income tax rules do not require aggregation and do not even pretend to apply uniform tax rates across the various sources of income subject to tax under Schedule “D”. It is sufficient to look at the tax rates for different sources of income and conclude that the rules of equity have no place for sources of income subject to tax under Schedule “D” of Ethiopian income tax system.

¹¹³ See Income Tax Proclamation No.286/2002, Articles 31-37

While we may point to the rules of aggregation to argue that Ethiopian income tax rules recognize tax equity in its widest sense, we must qualify this by pointing out that the rules of aggregation do not carry the insight of aggregation far enough. One of the defining features and strictures of Ethiopian income tax system in this regard is that the rules of aggregation never cross over the boundaries of each schedule for which aggregation is required. While employees are required to aggregate their income from multiple employments, they are not required to aggregate income from employment under Schedule “A” with income from rental of buildings (Schedule “B”) and/or income from business or professional activities (Schedule “C”). We can conclude from this that aggregation has a strangely schedular flavor or accent to it under the Ethiopian income tax system. We can also see from discussion above that even where income technically falls under a single schedule, there are exceptions to aggregation requirements. These exceptions militate against the argument that Ethiopian income tax rules recognize equity as a tax norm.

We can also point to subtle differences among the income sources subject to tax under the different schedules of Ethiopian income tax to qualify the statements made above for a case of tax equity in Ethiopian income taxation. One of the subtle differences among the different sources arises as a result of the accounting differences that exist among the different sources of income. Schedule “A” taxpayers account for tax on a monthly basis (much of which is withheld by employers) while Schedule “B” and C taxpayers are required to account for tax on a yearly basis. Due to the progressive tax rate structures, those who account for tax on a monthly basis and those who account for tax on a yearly basis might pay different amounts of tax (even if their income is equal) because Ethiopian income tax rules do not allow those who account for tax on a monthly basis to adjust their final tax liability based on their annual income at the end of the tax

year (in other words, Ethiopian income tax rules apply the so-called simple PAYE tax for employment income).

b. The Recognition of Other Principles of Taxation in the Ethiopian Tax System

We have seen above the recognition of “equity” as a tax norm in the Ethiopian tax system and we have expressed a number of reservations regarding the Ethiopian acceptance of “equity” as a tax norm. No country is single-mindedly committed to the question of tax equity, in all its varieties. The levying of various taxes is often a juggling of multiple policy goals, which as seen in the previous chapter, are not always easy to apply all at once. In the Ethiopian context, it is possible to provide a dozen tax policy principles, but for our purposes we have selected “efficiency,” “simplicity,” administrative feasibility,” “neutrality,” “economic growth” and “benefits received” as the chief principles of the Ethiopian tax system. We shall attempt to provide a brief account of the recognition of these principles in the Ethiopian tax system, by reference, to the extent possible, to the three principal sources of tax policy identified above.

i. Efficiency

As far as policy documents go, we find “efficiency” mentioned or at least intimated as the driver for tax reforms in Ethiopia. In the Economic Policy of the Transitional Government of Ethiopia (TGE), for example, we find a statement which declares that “taxes” were one of the areas of government policy that would be changed in line with the new economic policy direction of the transition period.¹¹⁴ The Economic Policy of the Transition Period states that the macro-

¹¹⁴ The Economic Policy During the Transitional Period, p. 20

economic policies of the previous regime were “inconsistent with the new economic policy,” aimed as the latter was at encouraging “private sector participation” and facilitating and encouraging “*economic establishments to operate efficiently*” (italics added).¹¹⁵ The Government made good on its promises in the Economic Policy by introducing changes into the income tax system (just to take the income taxes as examples), by reducing the corporate and individual tax rates considerably (from what was then the high of 59% to 40% marginal tax rates for individuals and from the high of 50% to 35% for companies).¹¹⁶

The major economic policy documents of the Ethiopian Government after the end of the transitional period (1991-1995) also emphasized “efficiency” as one of the pillars of tax reform in Ethiopia.¹¹⁷ The Structural Adjustment Facility of 1998/99 – 2000/01, which was drawn up in consultation with the international financial institutions – the IMF and the World Bank – for example, expresses the tax policy of the Government to be one of broadening the tax base, increasing the revenue-to- GDP ratio, improving equity and enhancing *efficiency*(italics added).¹¹⁸ In order to achieve these aims or goals, the Strategic Program envisioned at the time taking measures such as introducing withholding taxes on imports and interest income and reducing the number of exemptions in sales taxes and increasing the excise tax on beer and

¹¹⁵ Ibid

¹¹⁶ See Taddese Lencho, Towards Legislative History of Modern Taxes in Ethiopia, p. 122; during the first decade of Derg Rule, the marginal tax rates for individuals reached 89% and the corporate tax rates reached 50% with additional dividend taxes at the rate of 25%; see also Income Tax (Amendment) Proclamation No. 155/1978; Eshetu Chole, Income Taxation in Pre- and Post-Revolutionary Ethiopia, pp. 60-65

¹¹⁷ It is important to remember that much of the economic outlook which defined the transition period continued unabated after the transition period, because the major political actor during and after the transitional period remained one political party, the EPRDF

¹¹⁸ Ethiopia – Enhanced Structural Adjustment Facility, Table 1. Ethiopia: Policy Matrix 1998/99 – 2000/01, available at www.imf.org/external/np/pfp/eth/etpta.htm#1 last accessed July 08, 2012

spirits, tobacco and petroleum products.¹¹⁹ In the context of “efficiency” as a tax policy norm, the Program envisaged institutional reform of the Ethiopian tax administration, the introduction and greater use of information technologies to support tax administration and the reduction of the costs associated with tax administration in general.¹²⁰

Most recently, a reference is made to the norm of “efficiency” in the official publication of the Ethiopian Ruling party, which states in one relevant passage:

በአጠቃላይ የታክስ ስርዓቱን ፍትሐዊና ውጤታማ የማድረግ ስራ የድርጅት፣ የመንግስትና የህዝብን ተሳትፎ ርብርብ የሚጠይቅ ነው።¹²¹

Roughly, this translates as:

...in general, ensuring the equitability and efficiency of the [Ethiopian] tax system requires the close cooperation of the party, the government and the people.

It is not, however, clear how much the Government is concerned about all aspects of the efficiency costs of the Ethiopian tax system. Much of the energy of the Government has been predictably directed to the goal of ensuring the “efficiency of the tax administration” in collecting much needed government revenues, and probably not in minimizing the other costs of taxation, namely the cost of compliance with the various taxes of Ethiopia and the more insidious costs imposed upon taxpayers as a result of what economists call “excess burden” of taxation.

Apart from policy documents, “efficiency” as a tax norm is recognized in the various tax laws of Ethiopia. In the tax laws of Ethiopia, “efficiency” is mentioned as a tax norm in different guises.

¹¹⁹ Ibid

¹²⁰ Ibid

¹²¹ See *Addis Ra'iy*, p. 7

The preamble of the Income Tax Proclamation of 2002 makes an indirect reference to “efficiency.” When the Income Tax Proclamation declares that the new income tax law must reflect the “economic policy of the Government,” the Proclamation is giving effect to the economic policy of the Government, which, as stated earlier, incorporates “efficiency” as one of the core norms of tax policy. And when it announces the need for “modernizing the tax system and broadening the tax.” the Proclamation is recognizing efficiency as a fundamental tax norm.

The relevant parts of the preamble state:

Whereas, the Declaration on Economic Policy of the Government of the FDRE inaugurates a new era in social and economic relations and institutions..., ... the existing system of Income Tax needs to be changed and adjusted to the basic principles of fiscal treatment in a free market economy... it is believed that modernizing the tax system and broadening the tax base promotes economic growth by encouraging saving and investment....

Similarly the VAT law of 2002 declares an aspect of efficiency to be the reason for introducing the VAT for the first time into Ethiopia. The preamble of the 2002 VAT Proclamation touts the merits of the new tax –VAT – as one that “*minimizes the damage that may be caused by attempts to avoid and evade the tax...* (italics added).”¹²² This is clearly a direct nod to the norm of “efficiency.” To use the technical language of the literature, the VAT law appears to declare that “VAT is more efficient than the previous sales taxation” because a) it is more neutral and b) it is difficult to evade and avoid and therefore discourages taxpayers from wasting their time and resources trying to evade and avoid the tax – in short, VAT is an efficient tax.¹²³

¹²² See Value Added Tax Proclamation No. 285/2002, preamble, second sentence

¹²³ Schenk and Oldman, Value Added Tax, p. 28

In the literature of optimal commodity taxation, pioneered by Ramsey, differential or selective taxation of “demand-inelastic” goods is justified by an appeal to its efficiency.¹²⁴ Well, it is bracing to know that the Ethiopian tax system is not a pristine island that remains unaffected by the winds of opinion in the literature. There are instances in which the tax laws of Ethiopia give a policy nod to a development in the literature. One such nod is found in the current excise tax regime of Ethiopia in the preamble of which the optimality of differential taxation of commodities is justified as a tax policy. In the relevant part, the preamble of the current excise tax Proclamation runs:

Whereas it is believed that [excise taxes] should be imposed on luxury goods and *basic goods which are demand inelastic* (italics added).¹²⁵

The phrase that runs “basic goods which are demand inelastic” is a direct reference to the widely held belief in the literature that it is justified to select “demand inelastic” goods for taxation as the differential taxation of these goods results in little distortion.

It can therefore generally be stated that “efficiency” is implicitly recognized in the general tax policy documents and tax laws of Ethiopia. Whether the tax laws of Ethiopia, together or individually, meet the goals of efficiency, in all its forms, is quite a different matter.

ii. Simplicity

Appeals to tax equity in Ethiopia can be made by explicit references to or implicit recognition in the Constitution and perhaps tax policy documents. The same cannot be said for simplicity, which while accorded some recognition, is not given explicit recognition at constitutional level. In fact, it may be argued that simplicity is an implicit norm of Ethiopian tax system as a whole

¹²⁴ See Zee, *Theory of Optimal Commodity Taxation*, pp. 71-74

¹²⁵ Excise Tax Proclamation No. 307/2002, preamble

rather than a declared objective. We can examine the overall organization of Ethiopian tax system and the selection of the types of taxes to conclude that simplicity pervades the Ethiopian tax system.¹²⁶

We can take the very structure of Ethiopian income tax system as proof of simplicity as a rationale for the choice of the structure. From the very beginning of modern income taxation, Ethiopia chose the schedular system of income taxation largely because of the administrative simplicity of this structure for a weak tax administration like that of Ethiopia. Many developing countries have preferred the schedular mode of income taxation primarily because of its simplicity in administration.¹²⁷ The schedular structure of income taxation is ideally suited for weak tax administrations because of its segmentation of income by sources, some of which are easily capturable through final withholding schemes.¹²⁸

Another reason why we argue that simplicity pervades Ethiopian income tax system is because of the pervasive use of withholding taxes as final taxes for many sources of income in Ethiopia. Most employment income is taxed through final withholding taxes, as are many of the sources currently subject to taxation under Schedule “D” (royalties, dividends, interest, etc).¹²⁹ Ethiopian income tax system uses withholding income taxes on payments for goods and services

¹²⁶ An exception in this regard is the 1949 Income Tax Law of Ethiopia which made specific reference to “simplicity” as a tax policy justification for introducing that tax law. The relevant part of the preamble of that law states: “*to facilitate and simplify the collection of the tax*” (italics added); Proclamation to Provide for the Payment of Tax by All Individuals and Businesses No. 107/1949, Article 2(2); see also the Personal and Business Tax Regulations No. 138/1949; although this reference to “simplicity” disappeared in later revisions of the income tax, the preoccupations of Ethiopian governments with simplicity in the area of income taxation has not changed at all since then

¹²⁷ See Bird, Tax Policy and Economic Development, pp. 14-16

¹²⁸ See *ibid*

¹²⁹ See Income Tax Proclamation 286/2002, Articles 31-37

and on imports.¹³⁰ The incidents of withholding taxation are far higher than many other countries. In sum, although simplicity is not acknowledged as one of the rationales for the adoption of the current income taxation, it is very clear that “simplicity” pervades as a tax norm throughout the structure of Ethiopian income tax system.

An investigation of the background of several tax reforms in Ethiopia also shows that “simplicity” acted as *raison d’etre* for revision of the income tax laws and systems of Ethiopia. When the sales and excise tax laws of Ethiopia were consolidated in 1990 bringing together hitherto scattered pieces of sales and excise tax laws at the time, simplicity was cited as a reason for consolidation. The preamble of the 1990 sales and excise tax law states:

Whereas it is believed that the consolidation of many and scattered indirect taxes ... in force can facilitate tax administration and collection as well as the settlement of tax liabilities by taxpayers ...¹³¹

The 2002 income tax laws failed to mention simplicity as a reason but simplifying the income tax system was cited as one of the reasons why the Government at the time undertook “comprehensive tax reforms.”¹³² Like the sales and excise tax regimes of Ethiopia at the time, the income tax legislation field was plagued with the problem of fragmentation up to the end of the 1990s. According to an IMF mission of technical experts that visited Ethiopia in 2000, the organization of income tax legislation got so scattered that it was necessary at the time to refer to at least fifteen different pieces of income tax legislation to properly grasp the nature of

¹³⁰ See *id.*, Articles 52 and 53

¹³¹ See Sales Tax Council of State Special Decree No.16/1990

¹³² See Ethiopia: Sustainable Development and Poverty Reduction Program, p. 109; Muzondo, Courneyea, Brooks and Amina, Ethiopia: Introduction of a VAT and Presumptive Income Tax and Reform of the Income Tax, p. 46

income taxation in Ethiopia.¹³³ This state of affairs created enormous problems both for the tax administration and taxpaying community at the time. The 2002 tax reforms were meant to put an end to this state of affairs, and temporarily at least, it appeared that the 2002 income tax reforms were able to consolidate disparate pieces of income tax legislation into a single body of income tax law.¹³⁴

As in the case of tax equity, the argument that Ethiopian income tax system is informed by “simplicity” requires some qualifications. One of the practices that militate against “simplicity” of Ethiopian income tax system is the very process of revision of the income tax laws. Income tax provisions are revised haphazardly, which multiplies the number of pieces of legislations that taxpayers need to consult in order to understand their tax obligations at any one time. For every principal income tax legislation that was issued, there are multiple amendments in subsequent legislations and numerous other subsidiary pieces of legislations, some of which are not even available in the public domain.¹³⁵ The Ethiopian income tax system is not codified, consolidated, not even compiled properly as to make it easier for an average taxpayer to consult. The result of this state of affairs is unwarranted complexity.

Another factor that militates against the simplicity of Ethiopian income tax system is the transplantation of several ultra-modern concepts into the Ethiopian income tax legislations whose only utility so far has been confounding tax administration and taxpayers in equal

¹³³ See Muzondo, Courneyea, Brooks and Amina, Ethiopia: Introduction of a VAT and Presumptive Income Tax and Reform of the Income Tax, p. 46

¹³⁴ This feat was temporary, as later income tax reforms went back to the old habits of revising income tax laws piecemeal without any attempt to consolidate them as a whole; see Taddese Lencho, The Ethiopian Tax System: Excesses and Gaps, p. 354

¹³⁵ See Taddese Lencho, the Ethiopian Tax System: Excesses and Gaps, p. 356

measure.¹³⁶ The income tax laws are studded with terminologies that are borrowed from other tax systems without any consideration for whether they can be used in the Ethiopian income tax system. These terminologies have increased the complexity of the Ethiopian income tax system without adding anything new to the existing structure of income taxation, which, in spite of the many changes, remains simple and rudimentary.

iii. Administrative Feasibility

Closely affiliated with and assimilated to the norm of tax simplicity is “administrative feasibility.” In their aims and objectives, both simplicity and “administrative feasibility” are geared towards facilitating easy administration and comprehension of the tax system, although they might be different in emphases. Those who write about “simplicity” as a tax policy are normally more preoccupied with the impact of the tax system upon the average taxpayer while “administrative feasibility” has as its aims one of making the tax system easier to administer and implement for the tax administration. Therefore, while the target of “simplicity” is the taxpayer, the target of “administrative feasibility” is primarily the tax administration. However, as both relate to the overall comprehensibility and intelligibility of the tax system, both simplicity and administrative feasibility share some common concerns.

For a tax system like that of Ethiopia, it is not really necessary to appeal to specific section or provision of the law to argue that “administrative feasibility” is the principal tax policy norm (or at least ought to be one). That famous statement from Casanegra de Jantscher applies to

¹³⁶ This state of affairs has prompted me to call this situation “mis-implantation”; see Taddese Lencho, *Legal Transplantation and Mis-Implantation: Evidence from the Tax Reforms of 2002*, a monograph, unpublished, 2010

Ethiopia, as for all other developing tax systems: tax administration is tax policy.¹³⁷ All the other norms of tax policy are truly afterthoughts of what is at first administratively feasible. The whole organization of the Ethiopian tax system may be explained by the conscious and unconscious choice of administratively feasible taxes. The heavy dependence of Ethiopian taxation upon easy-to-administer taxes like customs duties and the use of withholding as final taxation upon many sources of income in Ethiopia, the continued schedularization of income by sources, are all examples of how “administrative feasibility” permeates Ethiopian tax system. While it is not often admitted as a tax policy norm in the preambles of tax laws or in policy documents, it is a tax norm whose presence is immediately felt upon cursory familiarity with the Ethiopian tax system.

As a general matter, “administrative feasibility” is rarely acknowledged in the tax laws or policy documents of Ethiopia – perhaps it is taken for granted in the choice of various tax laws and tax administrative structures. There have, however, been a few occasions when “administrative feasibility” has been openly acknowledged as a reason for introducing some taxes. When Ethiopia considered introducing the Value Added Tax back in 2000 to replace its sales taxes at the time, it was faced with the dilemma of either abandoning the VAT completely or finding a compromise in which VAT would be introduced to apply upon some taxpayers whose annual turnover is large enough to cope with the administrative complexities of complying with the VAT and another tax comparable to VAT would be introduced to apply on those taxpayers that could not comply with the VAT regime.

¹³⁷ Cited in Milka Casanegra de Jantscher and Richard M. Bird, “The Reform of Tax Administration,” p. 1

The turnover tax, which is routinely condemned as a “bad” tax in tax policy circles was considered at the time as a necessary evil largely on account of “administrative feasibility.” The Ethiopian Government was aware that the turnover tax was not an ideal form of sales taxation but given the administrative limitation of the Ethiopian tax system, it was accepted as a supplementary tax to the VAT upon small and medium sized businesses that could not comply with the administrative complexities of the VAT.¹³⁸ The preamble of the turnover tax law of 2002, which was introduced along with the VAT, states administrative feasibility as a reason (almost as an apology) for the introduction of what is otherwise an undesirable tax. The preamble of the 2002 Turnover Tax law states in part:

Whereas administrative feasibility considerations limit the registration of persons under the value-added tax to those with annual taxable transaction the total value of which exceeds 500, 000 Birr [it is therefore necessary to accept the turnover tax as a supplementary tax to the VAT regime].¹³⁹

The Ethiopian income tax laws do not explicitly acknowledge “administrative feasibility” as a tax norm which drives the Ethiopian income tax system – except in the above cited preamble of the 1949 income tax law which takes “simplicity” as a policy justification back then. It is, however, possible to cite several features of Ethiopian income tax system to demonstrate how “administrative feasibility” pervades the system, but we shall limit ourselves to two prominent cases.

The first case is of course the structure of Ethiopian income tax system itself. We don’t know if the first tax reformers were motivated by administrative considerations to introduce the British

¹³⁸ Ethiopia had turnover taxes in the 1960s-1980s and then abandoned them in the 1990s as a result of the increasing liberalization of the economy and probably because the Government was convinced of their distortionary impact; see Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, pp. 138-139

¹³⁹ See the Turnover Tax No. 307/2002

prototype income taxation – the schedular form of income taxation, but any sensible tax reformer would have preferred the schedular format of income taxation as opposed to the global/unitary form of income taxation (in 1944), given the administrative limitations of Ethiopia at the time. While historical inertia may have played a part in the survival of the schedular system of income taxation in Ethiopia, successive tax administrators must have felt the pull of “administrative feasibility” as a reason for maintaining the schedular income tax system, which survives almost unscathed to this day. How much other policy norms must give way to “administrative feasibility” and how long is debatable, but it is undeniable that “administrative feasibility” informs and pervades the structure of Ethiopian income tax system.

The second case for the primacy of “administrative feasibility” in the Ethiopian income tax system can be made by appeal to the withholding tax structure in the Ethiopian income tax system. Two of the four schedules of the Ethiopian income tax rely almost exclusively upon withholding scheme as a final tax. The withholding tax obligations are imposed upon intermediaries that are more accessible to the tax administration – employers (as opposed to employees), companies (as opposed to shareholders), banks (as opposed to recipients of interest upon bank deposits), etc. Ethiopia could have used these withholding taxes as discount/advance payments and later allowed the real taxpayers (employees, shareholders, depositors, etc) to settle their tax liability based on their tax status at the end of the tax year, but these possibilities were apparently foreclosed by administrative considerations. For reasons of administrative feasibility, it is assumed, for example, that the tax withheld monthly from employee payments and benefits is the final tax even though the final tax liabilities could have been different had Ethiopian tax rules allowed employees to adjust their monthly tax liabilities against their annual tax liabilities.

iv. Neutrality

Like simplicity, neutrality has not received constitutional nod even indirectly in Ethiopia. But, as in simplicity, neutrality pervades the milieu of many of the tax laws of Ethiopia. If neutrality is understood in the sense of “avoiding” distortions in the market,¹⁴⁰ it is evident that many of the tax laws of Ethiopia were introduced with the backdrop of “neutrality” as a tax policy.

Outside the income tax, the introduction of the Value Added Tax in 2002 to replace the old sales tax regime of Ethiopia was justified by an appeal to neutrality. The preamble of the 2002 Value Added Tax law of Ethiopia states in part that:

Whereas the current sales tax does not allow collection of the tax on the added value created wherever a sales transaction is conducted;

Whereas the value added tax minimizes the damage ...caused by attempts to avoid and evade the tax...

At the time of the introduction of the VAT, it was admitted that VAT could not reach all the sales points in Ethiopia as its reach was limited (prudently at the time) to those businesses having an annual sales turnover in excess of 500, 000 ETB. It was also acknowledged that the narrow base of the VAT in Ethiopia would discriminate against big businesses unless a supplementary tax was introduced to apply on small and medium-sized businesses whose annual turnovers did not reach the 500, 000 ETB mark. The turnover taxes were conceived as supplementary taxes to achieve a modicum of neutrality in the Ethiopian sales tax system. The preamble of the Turnover tax of 2002 makes this abundantly clear although nowhere in the preamble do we find “neutrality” mentioned. The relevant part of the preamble states:

¹⁴⁰ See Tiley, Revenue Law, p. 11

Whereas an equalization tax imposed on persons not registered for value added tax allows them [i.e., those with annual turnovers of less than 500, 000 ETB] to fulfill their obligations and also enhances fairness in commercial relations and (sic) makes complete the coverage of the tax system.

In the area of income taxation, we have the 1994 capital gains tax laws explicitly citing “neutrality” as a reason for introducing the first capital gains taxation in the history of income taxation in Ethiopia. The preamble of the 1994 capital gains tax law states in part:

Levying tax on all gainful activities in the economy maintains *neutrality ... in the tax system* (italics added).¹⁴¹

The acceptance of the principle of neutrality in the Ethiopian tax system must be rounded off with a number of qualifications. Indeed, neutrality is probably a principle more observed in its breach than in its observance. We can take many examples from the income tax system of Ethiopia to present a case against neutrality. The tax rate differentials between the various sources of income subject to tax under Schedule “D” of Ethiopian income tax encourage taxpayers to opt for or to structure their transactions in order to make their income fall under a lower tax-rated source. For example, the difference in the tax rate between “royalties” (5%) and “income from technical services” (10%) is an invitation to taxpayers to structure their transactions in order to characterize their income as “royalties” rather than as “income from technical services.”

The taxation of dividends when profits of companies are distributed as dividends is known to violate principle of neutrality, as it encourages companies to distribute their profits in other forms of distribution not subject to income tax (e.g., interest). In Ethiopian context, the problem

¹⁴¹ Payment of Tax on Gains from Capital Proclamation No.108/1994; although the preamble of the 2010 windfall profits tax is silent on this matter, it is clear that the windfall profits tax was as much motivated by the desire to ensure neutrality as the previous income tax laws

of neutrality is even more pronounced as a result of the peculiar features of income tax rules treating dividends (**see Chapter Eight below**).

In short, there are numerous cases in which the income tax system of Ethiopia trumps the principle of “neutrality” as to compel a rethinking about this principle. Some of these “transgressions” of the principle of “neutrality” are unintended spillovers of the attempt by the government to simply derive revenue (in the case of dividend taxation) or of simple indifference to the consequences of taxation. In some cases, however, the violation of the principle of neutrality appears to be deliberate. The tax incentive regimes of Ethiopia provide a perfect example of a tax policy that sets aside neutrality to attract, promote and direct investment in certain “priority” sectors – namely, agriculture and export industries, and during the GTP, the manufacturing sector.

v. Economic Growth/ Investment

In terms of the frequency of appearance in the various sources of tax policies in Ethiopia (public policy documents, the Constitution and tax laws), “economic development” (or one of its variants, like economic growth) is by far the most important tax policy norm in Ethiopia. This is hardly surprising. Ethiopia has been haunted by the malaise of economic underdevelopment for years and underdevelopment (expressed variously as poverty, famine, etc) has come to represent this arch-foe that Ethiopian Governments have had to fight for years.¹⁴² The rhetoric of the fight against underdevelopment and poverty has changed very little over the years and that rhetoric is often expressed in the various policy documents.

¹⁴² See Eshetu Chole, *The Dismal Economy*, pp. 209-235; Ethiopia’s long identification with “famine” and “poverty” has resulted in the reification of “poverty” as that enemy which has as much physical presence as some of its sometimes hostile neighbors and “historic” enemies, near and far.

The latest example in the long line of policy documents expressing the policy of economic development is the GTP. The vision of the GTP is one of laying the groundwork so that Ethiopia will “become a country where democratic rule, good governance and social justice reign” and the country “reach the level of a middle-income economy as of 2020-2023.”¹⁴³

Of all aspects of Ethiopian public life, the GTP is most emphatic about economic growth, as expressed in the vision of the GTP:

Building an economy which has a modern and productive agricultural sector with enhanced technology and an industrial sector that plays a leading role in the economy, sustaining economic development and securing social justice and increasing per capita income of the citizens so as to reach the level of those in middle-income countries.¹⁴⁴

There is no question that “economic growth” or “economic development” are the major drive in the GTP as a whole, both as vision and as strategic pillars of the GTP.¹⁴⁵ The question is how much the Government of Ethiopia sees taxes as drivers of this fundamental policy objective. In one sense, the GTP might be read as shifting the objective of the Ethiopian Government from using taxes as instruments for attracting investment to one of using all the tax sources available to generate the last cent of tax available in the economy in order to meet the huge government expenditures required to meet the GTP goals. As pointed out above, the GTP document stakes the growth of government revenue during the GTP period on the expiry of the tax holiday periods for many members of the private sector.¹⁴⁶

¹⁴³ Growth and Transformation Plan, p. 21

¹⁴⁴ Ibid

¹⁴⁵ Id, p. 22

¹⁴⁶ The relevant sentence of the GTP states in this regard: “Efforts will also be made to improve the tax base and bring new businesses into the tax net, particularly where they were beneficiaries of tax incentives (tax holidays);” see Growth and Transformation Plan, p. 33

Paradoxically, this shift from the use of tax incentives to encourage private investment to the use of tax revenues to generate huge government revenues reflects only that the Government of Ethiopia has slightly shifted its policy from attracting investment [to stimulate economic growth] to that of generating huge government revenues for huge public investments in order to stimulate economic growth. Of the public policy documents issued by the Government of Ethiopia, therefore, the GTP represents a shift in some ways of a public policy that views the state as the major driver of economic growth (e.g., through infrastructural development and creation of key industries).¹⁴⁷ The objective of the Government has not changed: it remains to be “economic development.” What has changed is the role of the Government in the stimulation of “economic development.”

While the GTP anticipates the phasing out of tax incentives for many businesses during the GTP period, it also anticipates the next generation of tax incentives for a different economic sector. In the past, the tax incentive regimes of Ethiopia were primarily aimed at the agricultural sector.¹⁴⁸ As a result of the shift in economic development, the GTP anticipates that the country will see (or hopes to see) a huge leap in the growth of the manufacturing and/or industrial sector, although agriculture will continue to play an important role in the economy of Ethiopia.¹⁴⁹ While

¹⁴⁷ The GTP in many ways represents a perceptible shift in the role of government in the economy; the GTP, for example, envisions the establishment by the Ethiopian state of some key industries, like fertilizer industry complexes, soap and detergent factories, paper and paper product industries; see Growth and Transformation Plan, p. 60. Since the change of government in 1991, the Ethiopian Government was busy transferring erstwhile state industries to the private sector and focused primarily upon the building of infrastructure, roads and electricity; it appears that the GTP casts the Government as something other than what it was over the last 20 years of rule by the EPRDF.

¹⁴⁸ See Proclamation to provide for the Encouragement, Expansion and Coordination of Investment No. 15/ 1992, ; Investment (Amendment) Proclamation No. 373/2003; Council of Ministers Regulations on Investment Incentives and Investment Areas Reserved for Domestic Incentives No. 84/2003

¹⁴⁹ Growth and Transformation Plan, pp. 23-24; the GTP projects that the “industrial sector” will see an average annual growth of 20%, which is twice as high as that of agriculture (8.6%), and services (10.6%); see Growth and Transformation Plan, p. 28, Table 5.

the Government expects the phasing out of tax incentive packages for the agricultural sector, the Government expects to dole out tax incentives for the nascent industrial sector.¹⁵⁰ Tax incentives will, therefore, continue to be used as instruments for stimulating economic growth this time in the industrial sector. Indeed, the Government has issued new investment laws recently to implement this policy shift from agriculture to the manufacturing industries.¹⁵¹

Economic development as a public policy goal is also stated in the Ethiopian Constitution. Since a constitution is ordinarily reserved for expression of fundamental rights and freedoms and organization of the structures of government, it may at first seem curious to search for aspirations like “economic development” in a constitutional document. But the Ethiopian Constitution has the unusual distinction of incorporating policy objectives and goals in the body of the Constitution.¹⁵² It is highly debatable whether a constitution (as a legally binding document) should contain “aspirations,” but we can view these provisions of the Ethiopian Constitution as guiding principles for the future actions of Ethiopian Government(s).

The Ethiopian Constitution incorporates “economic development” as a policy objective in a number of provisions in Chapter Ten.¹⁵³ The provision of the Constitution on “Economic Objectives” (Article 89) in particular is permeated with aspirations of economic development. If the literal wording of the Constitution is to be taken seriously, the Government of Ethiopia has committed itself to ensuring that “all Ethiopians ... benefit from the country’s legacy of

¹⁵⁰ Growth and Transformation Plan, p. 62; the GTP states that “creating favorable conditions for industry to play a key role in the economy” is one of the strategic pillars of the GTP; the “favorable conditions” include providing tax incentive schemes for those involved in the industrial sector; see also Investment Proclamation No. 769/2012, whose preamble states in this regard: “Whereas, the encouragement and expansion of investment, especially in the manufacturing sector has become necessary....,”

¹⁵¹ See Investment Proclamation No. 769/2012; Export Trade Duty Incentive Schemes Proclamation No. 768/2012

¹⁵² See The Constitution of Ethiopia, Articles 87-92

¹⁵³ See *ibid*

intellectual and material resources,” or that “all Ethiopians get equal opportunity to improve their economic conditions...,” to providing “special assistance to Nations, Nationalities and Peoples least advantaged in economic and social development,” to promoting “the participation of the people in the formulation of national development policies and programmes..., to ensuring “the participation of women in equality with men in all economic and social development endeavors” and to protecting and promoting “the health, welfare and living standards of the working population of the country.”¹⁵⁴

Apart from policy documents and the Constitution, we find “economic development” as a justification for the introduction of many tax laws in Ethiopia. Ethiopia has attempted to use taxes as instruments for stimulating domestic investment and attracting foreign direct investment since 1949.¹⁵⁵ The preambles of successive tax incentive (investment incentive) laws cite “economic development” or “economic growth” as a reason for the use of taxes as instruments.¹⁵⁶ The latest investment law (Investment Proclamation of 2012) mentions “economic development” as an objective in at least six of the eight objectives of the investment law (*italics added*):¹⁵⁷

- To *accelerate the country’s economic growth*;
- To *develop the domestic market* through the growth of production and services;
- To *encourage balanced development and integrated economic activity among the regions...*;

¹⁵⁴ See *id.*, Article 89 (1), (2) (4) (6), (7), and (8)

¹⁵⁵ See Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, pp. 149-154

¹⁵⁶ see the Investment Proclamation No. 280/2002; Proclamation to provide for the Encouragement, Expansion and Coordination of Investment No. 15/1992

¹⁵⁷ Investment Proclamation No. 769/2012

- To *enhance the role of the private sector* in the *acceleration of the country's economic development*;
- To *enable foreign investment* *play its role in the country's economic development*;
- To create ample employment opportunities for Ethiopians and to *advance the transfer of technology required for the development of the country*;

The priorities of the Ethiopian Government may have shifted over the years, but the objectives of investments laws in general and tax incentive regimes of Ethiopia in particular have remained virtually unchanged: economic growth.

It is not just in investment incentive laws that we find “economic development” expressed as objectives of taxes in Ethiopia. Mainstream tax laws routinely express “economic development” as the objectives of the tax laws or as the reason for introduction of specific tax laws. The preamble of the Value Added Tax law of 2002 states in its relevant part that “... the replacement of the ... sales tax [in force since 1993] by value added tax *enhances economic growth...*” (Italics added)

The current income tax law of Ethiopia, issued in 2002, mentions “economic development” as a reason for the revision of the existing income tax system. The preamble of the 2002 income tax law states in its relevant part:

Whereas it is believed that modernizing the [income] tax system and broadening the tax base *promotes economic growth by encouraging saving and investment* (italics added).

We can also move beyond the generalities of preambles and examine the substance of some of the tax laws of Ethiopia for evidence of “economic development” as a tax policy norm in Ethiopia. It is of course difficult to substantiate the rhetoric of “economic development” with concrete examples of how particular tax provisions contribute (in a negative way) to economic development. The investment incentive laws have for a long time now extended income tax holidays and customs duties exemptions to businesses that are considered the engine of economic growth. These incentive schemes are traditionally extended to those businesses that fulfill certain minimum requirements, such as investment of substantial capital or investment in priority areas (e.g., agro-industry) or investment in underdeveloped regions (e.g., businesses that venture to invest in Gambella).¹⁵⁸ Customs duties exemptions are extended to facilitate imports of capital goods and spare parts for starting and expanding existing businesses.¹⁵⁹

The export sector industry has particularly been the beneficiary of various incentive schemes in Ethiopian tax and investment incentive laws.¹⁶⁰ Due to its direct contribution to foreign currency earnings of the Government, the export sector industry has been accorded more tax benefits than many other domestic industries involved.¹⁶¹ Export sector industries are entitled to full duty draw-back of all taxes and duties paid on inputs and they are entitled to zero-rating privilege in the VAT laws.¹⁶² The Ethiopian VAT law makes good on its promises (or premises) to

¹⁵⁸ See the Investment Proclamation No. 280/2002

¹⁵⁹ See, for example, the Revised Duty Incentives Schemes Proclamation No. 543/2007

¹⁶⁰ At the moment, the export sector is accorded at least five duty incentive schemes: duty draw-back scheme, voucher scheme, bonded export factory scheme, the bonded manufacturing warehouse scheme, bonded input supplies warehouse scheme and the industrial zone scheme; see Export Trade Duty Incentive Schemes Proclamation No. 768/2012

¹⁶¹ See Export Trade Duty Incentive Schemes Proclamation No. 768/2012

¹⁶² See Export Trade Duty Incentive Schemes Proclamation No. 768/2012; VAT Proclamation 285/2002, Article 7(2)

limit the reach of VAT to consumption goods by extending full tax credit for VAT paid on capital goods – in the process freeing production goods from the burden or encumbrance of VAT.¹⁶³

Although the Ethiopian income tax law devotes most of its provisions to taxation of businesses, it too extends special deduction benefits to those companies that claw their profits back into investment in other companies and businesses.¹⁶⁴ Ethiopian income tax law also extends non-recognition of gain or loss benefits to transfers of assets in the context of reorganization of businesses, no doubt to encourage transfer of businesses.¹⁶⁵ While distribution of dividends normally carries 10% of withholding tax, shareholders who decide to reinvest the dividends in the same company are exempted from dividend taxation.¹⁶⁶ Loss carry-forward provisions in income tax laws are generally regarded as standard income tax dispensations, many within the Tax Authorities regard loss-carry-forward provisions of the Ethiopian income tax law as special dispensations to encourage the investment climate in Ethiopia.¹⁶⁷

To sum up, there is plenty of evidence in the body of Ethiopian tax laws to conclude that Ethiopian tax laws are driven by the policy to promote and stimulate economic development. Whether these laws have in actual fact brought about economic development is quite another question.

¹⁶³ See VAT Proclamation 285/2002

¹⁶⁴ See Income Tax Proclamation No. 286/2002, Article 27

¹⁶⁵ See *id.*, Article 24

¹⁶⁶ See *Kapitalin Le Masadeg Yewale Aksiyon Tirf Dirshan Ka Gabi Gibir Netsa Indihon Le Madreg Yetefeqadu Maskochin Le Mastawok Ye Wexa Ye Gabiwoch Minister Memeriya Quxir 17/1996*, in Amharic, unpublished.

¹⁶⁷ This argument makes sense only when one considers the recognition of the carry-forward of losses in light of the previous income tax regime of Ethiopia in which business losses were not carried forward; see Income Tax Proclamation No. 173/1961, Article 20, which states that “A loss sustained by an enterprise in one accounting period is not transferable to another period.”

vi. Benefits Received

The benefit principle is traditionally one of the twin theories of taxation but has come to occupy increasingly marginal (if still sentimentally strong) appeal in modern tax policy.¹⁶⁸ If only marginally, this principle still furnishes a rationale for the use of certain specific taxes and for much of user charges and fees.¹⁶⁹ Where it is feasible, the benefit approach to taxation has a strong appeal on efficiency grounds as well, as it enables the fiscal system to determine “both the level and structure of public expenditures and the level and distribution of taxation” in accordance with the marginal benefit each individual derives from the provision of public services.¹⁷⁰

Perhaps a little surprisingly, the benefits principle of taxation has a constitutional recognition in Ethiopia. Article 100 (2) of the Ethiopian Constitution imposes a duty upon both the Federal Government and the Regional States to “ensure that the taxes they levy” are related to the benefits derived from public services. Given the imprecise nature of government services in general, it is difficult to see if this constitutional edict is really serious and how taxpayers can ever challenge taxes on grounds of not getting benefits from the governments in return for paying taxes.¹⁷¹ It is as a result noted elsewhere that the insertion of “benefits received” as one of the “limitations” in the Ethiopian Constitution is nothing more than a sentimental and rhetorical indulgence in the Constitution with little practical value on the ground.¹⁷²

¹⁶⁸ See Kornhauser, *The Rhetoric of the Anti-Progressive Income Tax Movement*, p. 491; see also Bird, *Tax Policy and Economic Development*, p. 5

¹⁶⁹ See Due and Friedlaender, *Government Finance*, pp. 233-234

¹⁷⁰ See Bird, *Tax Policy and Economic Development*, p. 5

¹⁷¹ See Taddese Lencho, *The Ethiopian Tax System: Excesses and Gaps*, p. 347

¹⁷² See *ibid*

Benefits-received has virtually no practical importance as tax norm in the area of income taxation in Ethiopia. Neither the preambles nor the substantive provisions of the Ethiopian income tax law mention benefits as tax policy norms, and rightly so. As in some other countries, the benefits principle informs the levying of some specific taxes (not income taxes) and many of the charges and user-fees imposed by various governmental bodies in Ethiopia. In the theory of charges and user-fees, “benefits received” are placed as one of the conditions for levying these charges upon charges.¹⁷³

Some of the taxes of Ethiopia (some extant and others extinct) have been informed by the benefits theory of taxation. Of the extinct taxes, we may cite the education and health taxes of Ethiopia which were in force between 1947 and 1970s.¹⁷⁴ The preamble of the 1947 Education Tax Law should be mentioned in this regard as it cites benefits received from education as a justification for levying the tax in the following words:

Whereas ... education for all is an asset and a benefit to the nation, and are convinced of the necessity of providing for ... means to achieve this end.¹⁷⁵

The fuel taxes of Ethiopia today (levied on petroleum and lubricants) are justified by the benefits petroleum consumers derive from the construction and maintenance of highways and roads in Ethiopia. Through successive revision of Ethiopian excise tax regimes, the Ethiopian excise tax system has acquired a more generic character, but we can trace the history of some of the excise taxes to earlier times where specific tax policies were more clearly formulated. One of the products which has consistently become a target for excise taxation has been petroleum which, due to its association with highways, has been considered a convenient surrogate for collecting

¹⁷³ See The Federal Government of Ethiopia Financial Administration Proclamation No. 648/2009

¹⁷⁴ See Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, pp. 114-115

¹⁷⁵ See Education Tax Proclamation No. 94/ 1947, preamble

revenues from those who stand to benefit from the construction and maintenance of highways by the government.¹⁷⁶

In any case, it can be seen that benefits principle is recognized as tax policy norm in Ethiopia although the place of that is marginal and insignificant in the overall scheme of taxation in Ethiopia.

V. Summation: The Challenges of Tax Policies and Principles in Ethiopia

The attempts to articulate the tax policies of Ethiopia cannot drown out the persistent concerns over whether these policies exist in a positive sense and whether they hold out any practical meaning at all. It is difficult to brush aside these persistent concerns. The issues surrounding the landscape of tax policy in Ethiopia are many and varied, but three principal concerns emerge as the chief issues of Ethiopian tax policy. They are the issues of “uncertainty,” “hierarchy” or “trade-offs” and the huge gaps between what the tax policies prescribe and the practice on the ground.

Uncertainty about the precise nature of tax policies in Ethiopia is probably the biggest obstacle to the articulation of tax policies in Ethiopia. While public officials have been known to speak about the tax policies of Ethiopia with some air of confidence, it is not clear if these public pronouncements are afterthoughts, borne of a desire to persuade the public of specific actions of the government, or well-thought-out formulations of what was articulated in government policy circles, such as the Council of Ministers or the Ministry of Finance and Economic Development. The reluctance so far of the Ethiopian Government to formulate tax policy (apart from fiscal

¹⁷⁶ See Due and Friedlaender, *Government Finance*, p. 397

policy or other economic policies) has only contributed to the ambiguities surrounding Ethiopian tax policies. The current Ethiopian Government has shown its penchant for formulating and issuing various public policies, but, has fallen short of doing the same for taxation in Ethiopia. Whether justified or not, this reticence of the Government has played its part in the deepening of uncertainty surrounding Ethiopian tax policy. In the face of this reticence, articulation of Ethiopian tax policy remains a collection of extrapolations, second-guesses and conjectures.

The second challenge about Ethiopian tax policy flows from the first: how to handle the inevitable trade-offs among the multiple goals of taxation, granted that the goals can be formulated with some degree of certainty. While some inherent hierarchies can be discovered with close examination of the various principles and goals of taxation, these hierarchies are nothing more than hunches. Much of the landscape of hierarchies among the multiple goals of taxation in Ethiopia remains indefinite except in two fortunate cases.

In one case, as quoted previously, the Government of Ethiopia has made it clear that “in the context of Ethiopia,” stimulating economic development and attracting investment (in general economic growth) remain the key tax policy objectives of the Government. The extension of tax incentives to certain investments can only come at the expense of both horizontal and vertical equity, but the Government has fixed its priorities on attracting some forms of investment at the expense of tax equity.

Another instance in which the hierarchies of tax policies are defined is by way of the laws of Ethiopia. In the hierarchy of laws in Ethiopia, constitutional policies and principles override other policies and principles formulated in other laws, including the general policy documents of

the Government. Thus, to the extent some tax policies and principles can be extrapolated directly from the Ethiopian Constitution, we are thereby confident that those policies and principles traceable to the Ethiopian Constitution assume supremacy over those policies and principles which are expressed in other sources of tax policy in Ethiopia. Apart from these two exceptions, uncertainty stalks the issue of tax policy hierarchies in Ethiopia.

The third challenge of the landscape of tax policy in Ethiopia is the gaps between what the policies and principles espouse and the actual tax administration and enforcement on the ground. This, it is surmised, is a direct product of the uncertainty regarding the nature and precise meaning of tax policies and principles in Ethiopia as well as of hierarchies among the multiple goals and principles of taxation in Ethiopia.

All these problems are compounded by the lack of engagement (academic or otherwise) in the formulation as well as critique of Ethiopia's tax policies and principles as in elsewhere. The tax policy literature in other countries (particularly that of the developed world) is awash with both types of engagement: formulation and criticisms of actual tax policies. The bout between opposing camps regarding the equitability or efficiency, etc. of income taxes vis-à-vis consumption taxes, just to take one example, as well the countless academic criticisms of actual tax policies of various countries, is the stuff of which tax policy is made of. This kind of exercise is almost unknown in Ethiopia. Apart from some faint references to tax policy during tax reform debates, the landscape of tax policy in Ethiopia is strikingly and perhaps blindingly barren. All these realities about Ethiopia contribute to and exacerbate the existing uncertainty surrounding Ethiopian tax policies.

CHAPTER THREE
THE INCOME TAX: DESIGN AND STRUCTURE

I. Design of Alternative Tax Bases

a. Introduction

Tax reforms and experiments in taxation both in theory and practice have over the years yielded a number of models of income taxation, with varying degrees of acceptability and practicality in different parts of the world. Some models of income taxation have dominated the practice of income taxation in the world while others have never been able to cross over into the real world to consummate the platonic love of economic and tax theorists. It is difficult to provide a classification that does justice to all forms of income taxation throughout the world, but at least five models of income taxation can be (and have been) identified so far; they are:

1. The Comprehensive income tax model
2. The Dual income tax model;
3. The Semi-dual/Unstructured income tax model;
4. The Flat Tax Model; and
5. The Expenditure/Direct Consumption Tax Model

All but one (expenditure tax model) has been tested and realized in actual income tax practice, with varying degrees of success. We will give a brief account of each of these models below, with detailed accounts of some of the most influential models of income tax later in this chapter.

b. The Comprehensive Income Tax Model

The comprehensive income tax model has been the most influential model of income taxation in many parts of the world, particularly of the developed income tax systems. A majority of the OECD countries are said to have followed this model in principle at least.¹ The comprehensive income tax model is derived from or associated with the theoretical work of some influential economists and legal scholars who proposed an “ideal” definition of income that, to them, meets the requirements of both vertical and horizontal equity.² As its name suggests, the goal of a comprehensive income tax system is to tax all or almost all of cash income less deductions according to the same rate schedule.³ Of course, a cursory examination of actual income tax systems will easily confirm that a comprehensive income tax model is too good to be true in actual income tax systems, and it is therefore no surprise that many of the income tax systems whose income tax structures are modeled upon the ideals of comprehensive income tax structures have fallen far short of the ideal.⁴

c. The Dual Income Tax Model

Another income tax model that has attracted a great deal of attention and following is the dual income tax model. The dual income tax model was developed and implemented in reaction to the distortionary impact of progressive tax rates upon some forms of income, namely income from capital.⁵ The dual income tax model combines a progressive income tax upon income from

¹ OECD, *Fundamental Reform of Personal Income Tax*, p. 73

² See *ibid*

³ *Id.*

⁴ See *id.*, p. 73; for more on comprehensive income tax model, see below.

⁵ See *id.*, pp. 71, 74-80; Sorenson, *The Nordic Dual Income Tax – In or Out?*, p. 1

labor (which includes income from business) with a proportional or flat tax rate upon income from capital. Labor income is subject to progressive (and perhaps higher) tax rate than capital income, and this is supposedly justified because of the risk and fear of out-flight of capital as a result of higher tax rate.⁶

d. Semi-Dual (Unstructured) Income Tax Models

The Semi-Dual Income Tax Model has different tax rates on different types of income, but typically, income from capital is taxed at lower rates than the labor income. The name semi-dual income tax model is a little misleading. A proper name for this type of model is “unstructured and/or diffuse” income tax model. Because it is unstructured, the permutations can go on *ad infinitum*. It is common in the literature to refer to these models of income taxation generally as “schedular” income tax systems, but this conceals the underlying diversity of every schedular income tax system. Ethiopian income tax system is a schedular income tax system, as are the dual income tax systems, but Ethiopian income tax is not a dual income tax system. The characteristic feature of semi-dual income tax model in the overall scheme of things is its unstructured approach to various sources of income. It applies progressive tax rates upon certain sources of income and flat tax rates upon others. Unless one simply divides income into those that are subject to progressive tax rates and those that are subject to flat tax rates, this structure of income taxation cannot be called “semi-dual.” The multiplicity of tax rates among

⁶ See OECD, *Fundamental Reform of Personal Income Tax*, p. 71; for details of dual income taxation, see below.

various sources of income in the unstructured income tax models means that these types of modeling should be seen separately from the dual income tax systems.

e. The Flat Tax Model

The flat tax model imposes a proportional (flat) tax rate upon all net incomes whether the income is derived from capital, labor or other income.⁷ Theoretically, all forms of income (from wages and capital) are taxed equally, and the value of any allowances (if any) before tax is levied is not dependent upon the level of income.⁸

The flat tax model has had a fortunate metamorphosis of being hatched in theoretical laboratories and developing into a viable source of revenue in actual tax systems. Having been popularized by the theoretical work of Robert E. Hall and Alvin Rubushka,⁹ the flat tax model has been tested in a number of transition countries in Eastern Europe and Russia. The first transition country to experiment with the flat tax was Estonia, followed by several other Central and Eastern European countries, including Russia.¹⁰

The basic element in the flat tax lore is to end progressive tax rates and impose instead a flat or proportional tax rate upon the tax base that is identified to be the subject of flat tax regime.¹¹ The operative word is the tax base, which, due to differences over which tax bases should become the subject of the tax, has spawned a number of flat tax systems in both the theoretical circles and practical world of taxes.

⁷ See *ibid*

⁸ See *id*, pp. 71-72

⁹ See Hall and Rubushka, *The Flat Tax*

¹⁰ See OECD, *Fundamental Reform of Personal Income Tax*, p. 85

¹¹ See *ibid*

Four flat tax systems have so far been identified, namely:¹²

- Single rate upon total income with no allowances (in other words, all income is subject to flat tax rate regardless of the amount of income);
- Single rate after basic tax allowances (e.g., after exemptions for small income amounts);
- A flat tax rate upon all payments to employees above a basic allowance and a parallel flat tax rate upon business income (of incorporated and unincorporated businesses). While the tax base of employee income tax is employee income, the base of the business income is the value added by each business. The business income tax operates pretty much like the value added tax as this is known in many countries of the world.¹³ This model of the flat tax was developed by the originators of the idea of flat taxation – Robert E. Hall and Alvin Rabushka – after whom it is sometimes named.
- A flat tax with a non-wastable tax credit – this model uses tax credit instead of allowances in order to equalize the value of tax benefit available to all income levels.

These offshoots of the flat tax model show that the flat tax can be structured to fit the preferences of various tax policies. The flat tax may be structured as to affect income or consumption. Indeed, some countries that have employed the flat tax model have introduced one that is based on personal income (Russia), or both personal and business income (Slovak Republic).¹⁴ It can also be strictly proportional (when the flat tax system allows no allowances) or gently or smoothly progressive (when the flat tax system has allowances or tax credits).¹⁵

¹² See *id.*, pp. 85-86

¹³ See also Graetz and Schenk, *Federal Income Taxation* p. 39

¹⁴ See OECD, *Fundamental Reform of Personal Income Tax*, p. 86

¹⁵ See *ibid.*, p. 86

The flat tax movement in the theoretical circles is a reaction to the perceived weaknesses and distortions of the comprehensive income tax model, as this model is implemented in some income tax systems, particularly the USA.¹⁶ The promoters of the flat tax model have praised this model on a number of tax policy principles. The promoters say that the flat tax is *simpler, fairer and more efficient*.¹⁷

The proponents of the flat tax model argue that the flat tax (or a variant of it) is simpler because of its two important properties: that it is flat and that it removes most of the allowances that have bedeviled the administration of comprehensive income tax systems.¹⁸ A flat tax rate system is surely easier to administer than a progressive one (although the complexities of a progressive income tax structure can be exaggerated). The real strength of the flat tax system on simplicity grounds rests on its promise of removing the allowances that dent the body of and lurk in the comprehensive income tax models, the culprits that are responsible for much of the outcry over the complexity of modern income tax systems.

The proponents of the flat tax system have also argued that the flat tax is fairer. Their argument in this regard rests on debunking the rhetoric that the comprehensive income tax model, with its flag ship the progressive income tax, is fair. They claim that the flat tax is fairer than the comprehensive income tax systems which have turned out to be windfalls to the high income groups that have both the wherewithal and the expertise to take advantage of the many loopholes that lurk in the body of comprehensive income tax systems. The supporters of the flat tax model claim that these “subsidies to the rich” will end with the introduction of flat tax systems.

¹⁶ See Hall and Rabushka, *The Flat Tax*, pp. 5-19

¹⁷ OECD, *Fundamental Reform of Personal Income Tax*, p. 86

¹⁸ See OECD, *Fundamental Reform of Personal Income Tax*, pp. 86-87; see also Grotz and Schenk, *Federal Income Taxation*, p. 39-40

The supporters of the flat tax model have also argued that flat tax systems are more efficient, which over and above being virtues in themselves, also yield incidental dividends in the area of fairness. The argument is that lowering tax rates through a flat tax system stimulates the economy and leads to increased employment, with a positive effect upon distribution of income and wealth.¹⁹ It is also important to note that the flat tax systems can have allowances which may have equity maximizing consequences.²⁰

Without doubt, the strongest argument in favor of the flat tax system is efficiency. As suggested above, the lower tax rate of the flat tax proposal will have positive impacts upon the supply of labor and the availability of savings, thus reducing the distortions of the tax system upon the economy.²¹ Since all income (theoretically) is subject to the same tax rate, the flat tax is neutral to the type of activities one chooses to engage. As a result, taxpayers can engage in any kind of activity without their decisions being induced by either tax gains or losses.

The problem of the flat tax is that it is going to be a hard sell for those countries that have become so sentimentally attached to tax incentives for the perceived political and economic gains of tax incentives. The flat tax urges countries to eliminate all these incentives and literally flatten the world for everyone. How far countries in the developing world in particular are willing to let go off this attachment and addiction to tax incentives is to be seen.

¹⁹ See OECD, *Fundamental Reform of Personal Income Tax*, pp. 87-88

²⁰ See *id.*, p. 87

²¹ See *id.*, p. 89

f. Expenditure (Direct Consumption) Tax Model

The expenditure tax model of taxation has attracted quite a bit of following in the theoretical circles, but has never successfully travelled beyond the laboratory into the real world.²² The expenditure tax targets one constituent of income, namely consumption, leaving the saving to the time when individuals spend the saving for consumption.²³ The tax base of the expenditure tax is consumption, which is the arithmetic difference between income and savings, just as income is the sum of consumption and savings in Simons' classic definition.

The supporters of the expenditure tax model – eager to prove its practicality – have touted that consumption tax can be applied with the existing infrastructure of the individual income, with some adjustments.²⁴ Much has been written about the supposed superiority of the direct consumption tax over the income tax.²⁵ The real missing-link in the expenditure tax lore is that the expenditure tax has never been implemented in its direct sense except in one country – Sri Lanka (Ceylon), where it stayed on for a brief period to have any reason in resting confidence in its practicality.²⁶ To be sure, the expenditure tax has insinuated itself into most tax systems of the world in its indirect form – through the VAT, other forms of sales taxes, excise taxes and customs duties,²⁷ but that is not the reason why the expenditure tax has become such a darling of the academic theorists.

²² See *id.*, p. 91; Fisher, *The Double Taxation of Savings*; Rawls, *The Theory of Justice*, p. 246; see also Due and Friedlaender, *Government Finance*, pp. 366-367

²³ See Due and Friedlaender, *Government Finance*, pp. 349-350

²⁴ See Andrews, "A Consumption-Type or Cash Flow Personal Income Tax;" Warren, "Comments: Fairness and a Consumption-Type or Cash Flow Personal Income Tax."

²⁵ Irving Fisher, "The Double Taxation of Savings;" see also OECD, *Fundamental Reform of Personal Income Tax*, pp. 91-92

²⁶ See Due and Friedlaender, *Government Finance*, p. 367 and Graetz and Schenk, *Federal Income Taxation*, p. 39

²⁷ It is not really for these forms of taxes that its supporters however push for tax reforms.

Like the flat tax and the dual income tax models, the expenditure tax grew largely in reaction to the problems of comprehensive income taxes as they are implemented by countries. The sponsors of expenditure tax model have tried to end the reign of income taxes by deploying all sorts of persuasion in the book, but so far with little success.

The supporters of expenditure tax have argued, for example, that the expenditure tax is a simpler and more effective way of taxation than income taxation.²⁸ It is simpler than the income tax, say its supporters, because it is easier to measure the tax base than it is to measure the base for the comprehensive income tax base.²⁹ It is doubtful whether that is really the case, but the proponents of the expenditure tax model argue that all that it takes for the expenditure tax to be brought on the ground is to figure out the cash flow to an individual and deduct the savings from that cash flow, whereas the comprehensive income tax model requires the measurement of income from both labor and capital on an accrual basis.³⁰

The fairness argument in favor of the expenditure tax rests on the supposed comparative advantage of the expenditure tax over the income tax. The income tax has been excoriated by its critics for being harsh on savings, as savings are subject to income tax at least twice, once when the savings are made and second and perhaps more times as the savings generate returns.³¹ This feature of the income tax is seen not only as unfair but also inefficient, as it induces present consumption at the expense of savings, hurting saving accounts, which are considered vital to future economic growth and investment.

²⁸ See OECD, *Fundamental Reform of Personal Income Tax*, p. 91

²⁹ *Ibid*

³⁰ See *ibid*

³¹ See *ibid*; see Fisher, "The Double Taxation of Savings," pp. 16-33 ; the apparent superiority of the direct consumption tax (expenditure tax) arises from the fact that it tends to measure ability according to consumption, which is considered to be more consistent over a life time than an income tax; see Graetz and Schenk, *Federal Income Taxation*, p. 39

In spite of the wide following the expenditure tax has garnered in theoretical circles, the expenditure tax model faces formidable hurdles in actual tax policy – one reason why no country has so far taken the first plunge for this tax. There are serious transitional issues for any country to pass from the current world of income taxation into the world of expenditure taxation.³² Until these transitional hurdles are overcome, it is unlikely for the expenditure tax to take adequate hold on the imagination of governments. But the most formidable barrier to the admission of the expenditure tax in actual tax administrations is custom – in taxation, as in many aspects of life, countries are more comfortable with the old devil they have known than the new angel that has just announced its arrival.

II. The Concept of Income

a. The Economic Meaning of Income: the Schanz-Haig-Simons Comprehensive Income Tax Base and Its Critics

Ever since income taxes assumed prominence as sources of revenues, many economists and a few lawyers have attempted to fix the meaning of “income” for tax purposes.³³ Through their definitions, many economists in particular have sought to exert influence over the scope of income taxation in various tax systems. Several rival versions of the concept of “income” have emerged over the years, but no definition has had a hold on the actual income tax policy as that of the Schanz-Haig-Simons (otherwise known as the SHS model).

³² For transition problems, see Due and Friedlaender, *Government Finance*, pp. 370-371

³³ See Haig, “The Concept of Income – Economic and Legal Aspects,” pp. 1-28

The oft-quoted definition, at least in the literature of comprehensive income taxation, is that of Henry C. Simons, who, building upon the work of his predecessors Georg Schanz and Robert Haig, defined income as:

The algebraic sum of: (1) the market value of rights exercised in consumption; and (2) the change in the value of the store of property rights between the beginning and end of the period in question.³⁴

As Simons himself admitted, other writers proffered definitions of income along the same wavelength as his, except that he provided a definition that, in his words, was more refined and clearer than theirs.³⁵ Simons himself gave credit to the contributions of Georg Schanz and Robert Haig, and although his definition is often cited as a prototype, this version of “income” is known as Schanz-Haig-Simons (or SHS) definition of Income or the Comprehensive [Income] Tax Base (CTB).³⁶

Henry Simons saw his task as one of finding the most objective and neutral definition and of setting himself apart from those who sought to limit the reach of the income tax on the pretext of multiplicity of reasons: because the gain had no identifiable source, or because it was not recurrent or periodic or it seemed the growth of capital rather than as a separation from it.³⁷

Henry Simons thought that the task of “describing, delimiting and defining” the concept of

³⁴ See Simons, *Personal Income Taxation*, p. 50

³⁵ See *id.*, pp. 61-62

³⁶ Some writers ignore the German writer – Georg Schanz – and simply refer to this as the Haig-Simons definition of income, although Henry Simons himself admired and gave credit to the precision with which Georg Schanz constructed the notion of “income”; see Simons, *Personal Income Taxation*, p. 60-61; Bittker, *Comprehensive Income Taxation: A Response*, p. 1033

³⁷ See Simons, *Personal Income Taxation*, Chapter III, pp. 59-100; an example of a definition that requires “recurrence” in the definition of income is that of Carl Plehn, who defined income as “essentially wealth available for recurrent consumption, recurrently (or periodically) received.” Carl Plehn (1924), cited in Graetz and Schenk, *Federal Income Taxation*, p. 96

“income” must meet the rigorous requirement of having to fulfill the historical objective and appeal of income taxes. He began his classic work with the following words:

The development of income taxes may be viewed as a response to increasingly insistent and articulate demand for a more equitable apportionment of tax burdens.³⁸

The demand for a more equitable distribution of tax burdens led Henry Simons to the conclusion that the definition of income must be such that it is objective enough or can be objectivized to reach all sorts of economic gain.

Simons thought that his definition meets the task of equitably apportioning tax burdens because it considered “gain” as the lodestar of measurement. In his own words, “gain is the true *sin qua non*” of the concept of income.³⁹ As Simons imagined it, the comprehensive income tax base would extend the reach of the income tax to all the bases of economic gain, regardless of the source or the circumstances of the gain (e.g, gifts and bequests are considered income), or whether the income is realized in cash or in-kind (thus, so-called imputed incomes are considered income), or whether it is the result of an activity or the realization of capital (thus capital gains are considered income).⁴⁰

Simons was not oblivious to the criticisms his expansive definition might invite and indeed addressed some of the question marks that were likely to be raised against his definition.⁴¹ It is important to recall that Simons developed his concept of income against the background of long-running disputes over what receipts would qualify as income or otherwise. By the time of his writing, the definition of income had been haunted by persistent doubts over whether gain

³⁸ Simons, *Personal Income Taxation*, p. 41

³⁹ *Id.*, p. 84

⁴⁰ See *id.*, Chapters V – IX, pp. 110-204

⁴¹ See *id.*, Chapters IV – VIII.

from non-recurrent sources can be considered “income,” whether the growth of capital is to be considered simply a growth of capital or whether the growth of capital can be separated from the capital, etc. Simons argued that alternative definitions of “income” by his opponents (like Neumann, Vocke, Lexis and Held) suffered from too much preoccupation with practicality and at times derided such efforts as a little more than extensions of an accountant’s rule of thumb.⁴² For those that are most concerned about equity in taxation, Simons’ definition appears the most sensible. Indeed, much of the academic and tax policy debate ever since has been between those that have urged abandoning the “chimera” that Simons built for income tax systems and those that have urged policy makers to live up to the ideals of the comprehensive income tax model. The supporters of the SHS concept of income are drawn to it primarily because of its promise of equity. Indeed, the SHS model of “income” has had such an enduring influence partly because it was able to travel from the enclosure of theoretical circles to the world of practical tax policy. One of the biggest endorsers of the SHS line was the Canadian Royal Commission (otherwise known as Carter Commission) on Taxation. The Carter Commission endorsed the SHS model because of the SHS’ “explicitly ethical” stance on income taxation.⁴³ The Commission, treading a familiar SHS line, defined income thus as “... *the sum of the market value of goods and services consumed or given away in the taxation year by the tax unit, plus the annual charge in the market value of the assets held by the unit.*”⁴⁴ The appeal of the SHS model lies, as the Canadian Commission pointed out, in the fact that all net gains are “included in the tax base regardless of

⁴² In one passage, Simons wryly wrote that the doctrine of “realization” in the definition of income was an attempt to elevate the accountant’s rule of thumb into logical necessities; see Henry Simons, *Personal Income Taxation*, p. 81

⁴³ See Head, “Henry Simons, Revisited,” p. 196

⁴⁴ *Id.*, p. 202

source, form, or use.”⁴⁵ The SHS model of income has also garnered a number of ardent supporters in the academia and theoretical circles. One of the most prominent supporters of the SHS concept of income, Richard A. Musgrave, provided a typical defense for the SHS model:

The defense of the accretion plus consumption [SHS] concept as an index of equality must rest on its superiority as an equity concept, not as a tool of economic theory.⁴⁶

Although the SHS concept of income looked simple as a construct, and clearly appealed to many on account of its superior claims on our sense of fairness, its translation in actual income tax systems proved daunting even for the most equipped of income tax administrations in the world. Many income tax systems were apparently modeled after the SHS concept of income, but as many found it convenient to flout its premises by leaving out what (to critics) are large tracts of income from the income tax base for variety of reasons (administrative feasibility and considerations of other public policy goals).

The existence of many loopholes, preferences and incentives in actual income tax systems provoked some to abandon the pretense of the comprehensive income tax base and embrace more plausible conceptions of income. One of these critics of the comprehensive income tax base was Boris Bittker, who in his withering article “A ‘Comprehensive Tax Base’ as a Goal of Income Tax Reform,” examined the various sections of the U.S. Income Tax Code and found that the actual code was far removed from the ideals of the comprehensive income tax base.⁴⁷ He concluded that “a systematic and rigorous application of the “no preference” or CTB [comprehensive tax base] approach would require many more sweeping changes in the existing tax structure,” changes which “would be quite unacceptable ... to many of those who are

⁴⁵ Ibid

⁴⁶ Musgrave, “In Defense of an Income Tax,” p. 48

⁴⁷ See Bittker, “A ‘Comprehensive Tax Base’ as a Goal of Income Tax Reform,” p. 934

attracted, in the abstract, by the idea of CTB.”⁴⁸ Boris Bittker accused the supporters of the CTB of uncritically endorsing the CTB line. The faithful of the CTB, however, remained unfazed by the impracticality of the CTB as a goal of actual income tax policy.⁴⁹ The debate about the income tax is, of course, much wider than just between those who believe the CTB can be realized and those who do not. It is also between those who believe the income tax is still is viable tax policy objective and those who believe otherwise.⁵⁰

b. The Concept of “Income” in Different Legal Traditions

Although many economists and a few legal scholars write so authoritatively as if their opinions dictated the state of affairs on the ground, the history of income taxation has demonstrated that while economists propose many things, it is the law that disposes in the end. The legal definition as well as scope of “income” does not necessarily conform to the concept of “income” laid down by economists. Many income tax systems have in general followed contours of “income” which depart in significant senses from the so-called ideal notion of “income” established by economists. There are many reasons for this, but one important factor that has played a role in the scope of “income” in laws is that different income tax traditions have developed their own perhaps “quirky” understanding of what constitutes “income” and what does not. Comparative tax scholars have identified three such traditions, which have at once colored and shaped how various tax systems view the concept of “income”:⁵¹

⁴⁸ Ibid

⁴⁹ For responses to Professor Bittker’s criticism of the CTB, and his reply, please see Musgrave, “In Defense of An Income Concept,” pp. 44-62; and Bittker, “Comprehensive Income Taxation: A Response,” pp. 1032-1043.

⁵⁰ See Pechman, “Why We Should Stick with the Income Tax,” pp. 9-19; see also Hall & Rabushka, *The Flat Tax*

⁵¹ See Thuronyi, *Comparative Tax Law*, pp. 235-240; Cooper, Krever & Vann’s *Income Taxation*, pp. 44-48; Tiley, *Revenue Law*, pp. 137-139

- a) The Accretion Concept of Income;
- b) The Source Concept of Income; and
- c) The Trust Concept of Income

i. The Accretion Concept of Income

The accretion concept of “income” is closely associated with the global income tax system of the United States of America, where the idea of a “comprehensive income tax” model has influenced the writing of income taxation in general.⁵² The principal theoretical architects of this notion were, as pointed out above, the Americans Robert Haig and Henry Simons, and the German economist Georg Schanz, but it is important to remember that the courts were already disposed towards the expansive meaning of income.⁵³

The accretion concept of “income” maintains “income” to be “any realized accession to wealth,”⁵⁴ thus setting a stage for capturing a broad spectrum of items or receipts as income. The U.S. Tax Code, in its definition of “gross income” in Section 61, sets the tone for the broadest definition of “income” there is, when it defines “gross income” as “all income from whatever source derived” and provides a non-exhaustive list of items included in gross income.⁵⁵ The U.S. Courts have used this broad brushstroke to extend the notion of “income” into areas or zones not considered as “income” in conventional terms.⁵⁶ At first, in *Eisner v. Macomber*,⁵⁷ one of

⁵² Thuronyi, *Comparative Tax Law*, p. 235; see also Bittker, “A ‘Comprehensive Tax Base’ as a Goal Income Tax Reform,”

⁵³ Thuronyi, *Comparative Tax Law*, p. 235, foot note 16

⁵⁴ *Id.*, p. 235

⁵⁵ See Graetz and Schenk, *Federal Income Taxation*, p. 97

⁵⁶ See Thuronyi, *Comparative Tax Law*, pp. 235-236

⁵⁷ *Eisner v. Macomber*, 252 US 189 (1920), cited in Postlewaite, *Problems and Materials in Federal Income Taxation*, p. 39

the first cases to deal with the meaning of income, the U.S. Supreme Court created lots of uncertainties by defining income as “gain derived from labor, from capital, or from both combined.” Since *Eisner* appeared to restrict income to specific sources, it was not clear if certain types of income, such as prizes, awards, scholarships, treasure trove, constituted income, since these were the products of neither labor nor capital. It was thus left to another case, *Commissioner v. Glenshaw Glass Co.*,⁵⁸ for the Supreme Court to clarify its position. In *Glenshaw Glass*, the taxpayers relied upon the restrictive language of *Eisner* and argued that punitive damages were not income, but the Supreme Court disagreed with them and adopted the accretion concept of income by defining income as “undeniable accession to wealth, clearly realized, and over which the taxpayers have complete dominion.”⁵⁹

U.S. Courts and in general global income tax structures, such as Australia, unconstrained by schedular structures, have been more than willing to extend the reach of the income taxes to items not designated in the income tax laws. However, it will be erroneous to assume that courts in the U.S., Australia and other global income tax systems have accepted the SHS concept of income wholesale. Courts have introduced many qualifications to the idea of accretion, such as the idea that income must be realized somehow, thus excluding items like imputed income, which is considered as income under the SHS model.⁶⁰

It is quite common for income tax laws to use the SHS language in defining “income,” with the hope and desire to capture all sorts of income, although in actual fact, the reach of the income taxes may be confined to a few conventional sources. The definition of “income” in the Ethiopian income tax law echoes the SHS line when it defines it as “every sort of economic benefit ... from

⁵⁸ 348 U.S. 426 (1955), cited in Postlewaite, Problems and Materials in Federal Income Taxation, p. 40

⁵⁹ Cited in Postlewaite, Problems and Materials in Federal Income Taxation, p. 40; see also Thuronyi, Comparative Tax Law, p. 236, footnote 17

⁶⁰ See Federal Tax 2000, pp. 405-406; see also Cooper, Krever & Vann’s Income Taxation, pp. 47-51

whatever source derived...,”⁶¹ but as shall be seen in Chapter Four, this is clearly not the case at least in Ethiopian case.

ii. The Source Concept of Income

As its name implies, the source concept of “income” ties the concept of “income to a permanent source which is capable of yielding a “periodic fruit.”⁶² As the accretion concept of “income” is closely related to the global income tax system of the U.S.A., the source concept is closely related to the schedular income tax system of the UK – where the doctrine of source defined the scope and reach of the income tax system over the years.⁶³ However, although it was closely allied to the schedular income tax system of the U.K., its influence extended far beyond the traditional schedular income tax systems as to influence otherwise global income tax systems of Canada and Australia (largely because of the close historical ties between these nations and the U.K.).⁶⁴ The idea of “source” as a defining factor in the notion of “income” is a legacy, according to some, of income tax systems which were fashioned at a time when agriculture held sway as a means of livelihood.⁶⁵ This agrarian outlook was said to have shaped the idea that a source – such as land – should be there to yield an annual value which became “income.”⁶⁶

The source concept viewed “income” narrowly and excluded such items like windfall gains, personal injury awards, gifts and capital gains, items which have now fallen under the much

⁶¹ Income Tax Proclamation No. 286/2002, Article 2(10)

⁶² See Thuronyi, *Comparative Tax Law*, p. 236, foot note 18

⁶³ See Tiley, *Revenue Law*, pp. 131-132; see also, Olofoweyeku, Kirkbride and Butler, *Revenue Law*, p. 74

⁶⁴ See Thuronyi, *Comparative Tax Law*, p. 236; see also Cooper, Krever & Vann’s *Income Taxation*, pp. 44-46

⁶⁵ See Thuronyi, *Comparative Tax Law*, p. 236, citing Kevin Holmes, *The Concept of Income* 175 (2001)

⁶⁶ See *ibid*

expanded notion of “income” in income tax systems of many countries.⁶⁷ The narrow understanding of “income” in source terms was said to be a factor in holding back countries like the U.K., Canada and Australia from imposing tax upon items like capital gains.⁶⁸ Nonetheless, all these countries were later able to break free from their “source” tradition of income taxation in their income tax reforms. All of these countries have now extended their income taxation to items which were thought not to have sources.⁶⁹

iii. The Trust Concept of Income

Unlike the accretion and source concepts of income, the trust concept of income was not a product of the internal growth of income tax laws themselves but an offshoot of “trust law,” which in practice helped shape how some income tax systems viewed the notion of “income.”⁷⁰ In its impact, the trust concept of income had an impact similar to that of the source concept. In trust law, the need to separate the revenue from capital for the purpose of allocating the “revenue” to the beneficiaries of trust and put the capital under the administration of the trustee/s resulted in the development of elaborate rules to distinguish what constitutes “income” for allocation among beneficiaries and “capital” to be placed or to continue to be placed under the administration of trustee/s.⁷¹

In effect, if not in origin, the trust concept of “income” coincided with that of the source concept of “income.” Both the source and the trust conceptions of “income” led to the exclusion of an

⁶⁷ See *ibid*

⁶⁸ See *id*, p. 237; see also Cooper, Krever & Vann’s *Income Taxation*, pp. 44-46

⁶⁹ See Thuronyi, *Comparative Tax Law*, p. 237; see also Tiley, *Revenue Law*, pp. 138-139

⁷⁰ See Thuronyi, *Comparative Tax Law*, p. 238; see also Cooper, Krever & Vann’s *Income Taxation*, p. 46

⁷¹ See Thuronyi, *Comparative Tax Law*, p. 238

item called “capital.” These two notions have helped in shaping the idea that “capital gains” are not “income” but “capital.”⁷²

There are, however, nuanced and subtle differences between source and trust concepts of income. These differences have been noted in the treatment of capital gains in the context of business activities.⁷³ In continental legal systems, where the source concept has defined the course of income tax history, capital gains in the context of businesses have been the subject of income taxation because these systems defined the sources to be “business” while in the commonwealth jurisdictions, the influence of trust concept of “income” led to the exclusion of capital gains even when these gains were obtained in the context of business.⁷⁴

iv. Recent Convergences in the Notion of Income

Income tax structures are not necessarily constrained by historical understandings of what items constitute “income” and what items do not. Recent developments in commonwealth and continental legal systems have overturned the historical strictures of the notions of “source” and “trust” and resulted in the expansion of the meaning of “income” beyond what the “source” and “trust” concepts would have permitted.

In income tax traditions shaped by source and trust concepts, legislatures have introduced statutes to impose income taxes upon items which were once excluded under both trust and sources concepts of “income.”⁷⁵ Although the Continental legal systems did not at one point view “capital gains” from private property as a result of the influence of the source concept of “income,” most continental European countries have introduced separate statutes to tax all

⁷² See *id.*, p. 239

⁷³ See *ibid.*

⁷⁴ See *ibid.*

⁷⁵ See *ibid.*

capital gains.⁷⁶ The U.K., which was under the heavy influence of the “trust” concept of “income,” introduced separate statutes to impose taxes upon capital gains.⁷⁷ These developments show that the distinctions between “accretion,” “source” and “trust” conceptions of income are no longer relevant to many income tax systems, which seems to indicate the ascendancy of the accretion concept of income throughout the world. Although many income tax systems of the world would like to flatter themselves with the expansive definition of the comprehensive income tax base, the reality on the ground is far from the ideal of the comprehensive income tax model.

c. The Schanz-Haig-Simons’ (SHS) Comprehensive Income Tax Base and some Departures in Actual Income Tax Systems

Although many income tax systems claim to touch as much ground as the SHS model of income taxation suggests, the reality is that no actual income tax system has come close to meeting that ideal – a source of many a frustration to those that are drawn to the SHS model of income taxation. The overwhelming consensus is that “the base of the personal income tax falls far short of the SHS notion of income.”⁷⁸

If the SHS concept of income has had its way, it would have meant that the income tax base would cover not only wages and salaries, business income, capital income, rents, royalties, but also fringe benefits and all kinds of in-kind benefits as well as imputed rent from consumer durables, income transfers, pension income and gifts and bequests.⁷⁹ The SHS model has served both as touchstone for an ideal income tax and a reminder that it is perhaps never attainable in

⁷⁶ See *id.*, p. 240

⁷⁷ See *id.*, p. 239; see also Tiley, “The United Kingdom,” pp. 154-155 and Tiley, *Revenue Law*, p. 138

⁷⁸ Stotsky, “The Base of the Personal Income Tax,” p. 121

⁷⁹ *Id.*, p. 256

actual income tax systems. The income tax systems that are supposedly built on the foundations of the SHS model of income taxation have drawn criticism from those who have argued that the income tax laws represent a poor shadow of the ideal. Over the years, critics have drawn a large catalogue of departures from the SHS model. We shall review some of these departures below.

i. Gifts and Bequests

Gifts and bequests are considered as income under SHS definition of “income,” but many income tax systems have excluded them from the ambit of income taxation.⁸⁰ Some countries have a separate tax on gifts and bequests (e.g., the USA) while most simply ignore these sources of income.⁸¹ The special treatment, if not outright exclusion of gifts and bequests, is borne out of their irregular and windfall character and the special relationships which give rise to the generation of these sources of income.⁸² There are also serious practical challenges to taxing all gifts, and prudence has compelled many countries to omit them from the base of income taxation.⁸³

ii. Fringe Benefits

Fringe benefits have presented a number of challenges to actual income tax systems.⁸⁴ Many income tax systems have tried to extend the tentacles of income taxation to fringe benefits.⁸⁵ But there is a lot of dissatisfaction surrounding the special treatment of fringe benefits as many countries exclude fringe benefits from income taxation.⁸⁶ The approaches predictably vary

⁸⁰ See *id.*, pp. 260-261

⁸¹ See Federal Tax Course, pp. 2703-2730

⁸² See Due and Friedlaender, *Government Finance*, p. 260

⁸³ See Due and Friedlaender, *Government Finance*, p. 261

⁸⁴ See Lathrope, *Global Issues in Income Taxation*, pp. 18-42

⁸⁵ See Ault and Arnold, *Comparative Income Taxation*, pp. 201-202

⁸⁶ See Stotsky, “The Base of the Personal Income Tax,” p. 122

across nations, which in themselves contribute to some exclusion of fringe benefits from the base of income taxation.⁸⁷

Some countries have sought to tax fringe benefits by way of employers (e.g., Australia, through fringe benefits tax (FBT)).⁸⁸ Others deny deduction of fringe benefits at the employers' level.⁸⁹ Many countries have tried to impose tax on employees for the fringe benefits the latter receive.⁹⁰ Even when fringe benefits are taxed to employees as beneficiaries, however, they are often undervalued (fringe benefits are rarely valued at equivalent value).⁹¹ However treated, it is now agreed that the special treatment of fringe benefits "results in significant erosion of the comprehensive income tax base."⁹² Experience has shown that higher income employees tend to receive more in fringe benefits than the lower income employees, and many have seen this as a subsidy to high income groups, thus violating the principles of vertical equity.⁹³

iii. Imputed Income

Imputed income consists of the economic benefit one derives from the use of self-produced goods or the provision of services to oneself. The comprehensive income tax model regards "imputed income" as much an income as income received in the form of flow of cash from sale of goods or provision of services. As the British economist Alfred Marshall put it: "a woman who makes her own clothes or a man who digs in his own garden, or repairs his own house, is earning income just as would the dressmaker, gardener or carpenter who might be hired to do

⁸⁷ see *ibid*

⁸⁸ See *ibid*; see also Lathrope, *Global Issues in Income Taxation*, pp. 32-34

⁸⁹ Stotsky, "The Base of the Personal Income Tax," p. 122

⁹⁰ See Chapter Five below for the treatment of fringe benefits in some African countries

⁹¹ See Stotsky, "The Base of the Personal Income Tax," p. 122

⁹² See *ibid*

⁹³ See *ibid*

the work.”⁹⁴ Imputed income comes in variety of forms, but the largest component is imputed rent from the use of owner-occupied homes.⁹⁵ Henry Simons thought that excluding imputed income was tantamount to penalizing “specialization” of those who choose to hire the services of others instead of doing it themselves.⁹⁶ Few would dispute the existence of economic benefits in these cases. The problem is how to measure the extent of that economic benefit.

Many tax systems have been forced to leave imputed income out largely because of administrative difficulties of measuring the value of the “imputed” income and in part “from the political unpopularity that would be associated with any attempt to tax” “non-monetary form of income.”⁹⁷ With respect to one kind of imputed income, namely owner-occupied housing, it is held that this exclusion has the positive impact of encouraging socially desirable activity of homeownership.⁹⁸ Nonetheless, it is largely acknowledged as one of the significant loopholes of actual income tax systems, as this exclusion leads to inequities and inefficiencies of various kinds in actual income tax systems.⁹⁹

iv. Income Transfers

Income transfers are those cash and in-kind benefits that some members of society receive from the welfare programs of governments.¹⁰⁰ Income transfers today constitute important sources of

⁹⁴ Alfred Marshall, *Economics of Industry* (1901), p. 51, cited in Haig, “The Concept of Income,” p. 3

⁹⁵ See Stotsky, “The Base of the Personal Income Tax,” p. 122; see also Due and Friedlaender, *Government Finance*, pp. 258-260

⁹⁶ See Simons, *Personal Income Taxation*, p. 110

⁹⁷ See Stotsky, “The Base of the Personal Income Tax,” p. 122

⁹⁸ See *ibid*

⁹⁹ See *ibid*

¹⁰⁰ See Musgrave, “In Defense of an Income Tax,” p. 54; income transfers are government assistance programs to help the poor and social security schemes for retired persons, unemployed and include various forms of health benefits; see also Pechman, “Why We Should Stick with the Income Tax,” pp. 11-12

income for many people, particularly in the welfare conscious systems of the developed world.¹⁰¹ Income transfers may take a variety of forms in different countries, but the most important ones are social security, old-age benefits, and various types of health benefits, including insurance. Income transfers meet the classic definition of income but are often excluded from the income tax base for a variety of reasons. One theory maintains that income transfers should be excluded because they represent payments for previous taxes paid (namely social security taxes).¹⁰² Social security contributions in particular are usually made out of the pre-income tax base (e.g., of employees) and they should therefore be excluded when they are paid out to beneficiaries.¹⁰³ This theory does not apply to those countries in which social security taxes are excluded from taxable income.¹⁰⁴ For these countries, the exclusion of social security taxes from the income tax base has more to do with public policies intended to encourage saving for old age and times of unemployment.

v. Special Treatments or Exclusions of Capital Income

Income from capital has presented income tax systems with a special set of problems, forcing some countries to exempt income from capital altogether and others to concede a special treatment in the taxation of income from capital. One form of income from capital – capital gains – has in particular divided opinions over whether it is income in the first place and if so, how it is to be taxed.¹⁰⁵ The SHS model of income squarely placed capital gains within the ambit of income, conceding only some ground over when income taxes should be imposed on gains

¹⁰¹ Stotsky, “The Base of the Personal Income Tax,” p. 122

¹⁰² Ibid; see also Due and Friedlaender, *Government Finance*, pp. 283-284

¹⁰³ See Stotsky, “The Base of the Personal Income Tax,” p. 122

¹⁰⁴ Ibid

¹⁰⁵ See Due and Friedlaender, *Government Finance*, pp. 262-272

(realization).¹⁰⁶ Some traditional conceptions over whether income from capital is a growth of capital or income had hobbled many income tax systems in this regard, although later statutory developments have overcome this problem.¹⁰⁷

Many countries today impose income taxes upon capital gains, but the peculiarities of capital gains (e.g., their irregular nature and higher than normal susceptibility to inflation) have forced a number of concessions from actual income tax systems as to separate the treatment of capital gains from other sources of income. The special treatment of capital gains is today accepted as one departure from the SHS income model and one reason why many otherwise global income tax systems have been forced to introduce some elements of “schedularity” into their income tax structures (see below).

Aside from the special treatment of capital gains, other types of income from capital may be accorded special tax treatments in different countries, and the special treatments may range from lower tax rates to total exemptions. These kinds of special treatments for capital income are sometimes justified by the public policies of countries to encourage the inflow of capital (particularly for developing countries) and the concomitant fear of capital flight if incomes from capital are taxed heavily or even at the same rate as income from labor.¹⁰⁸ Whatever the rationales may be, any special treatments for capital income constitute one of the most significant departures from the ideal of comprehensive income taxation.

¹⁰⁶ See Simons, *Personal Income Taxation*, p. 151

¹⁰⁷ The metaphor of “the growth of the size of the tree rather than fruit produced by the tree” prevented these countries from looking beyond the metaphor to reach capital gains as income; see Due and Friedlaender, *Government Finance* op cit., p. 263

¹⁰⁸ See Stotsky, “The Base of the Personal Income Tax,” p. 122; as Richard M. Bird once noted “the rationale for special treatment of income from capital rests not on principle but on considerations of policy and administration”; see Bird, *Tax Policy and Economic Development*, p. 91

vi. Special Preferences in Exemptions, Exclusions and Deductions

What the critics of the SHS call “erosion” of the comprehensive income tax base often occurs not at the income level but at the level of various reliefs and deductions that are afforded to specific types of income or expenses associated with specific types of income. The width of taxable income varies from one source of income to another under various income tax systems.¹⁰⁹ For some sources of income, full deductions are accorded for all direct and indirect expenses associated with the generation of that income, while for others, no deductions are allowed at all. It is, for example, often the case that expenses incurred in connection with employment income are not deductible from employment gross income, for the simple expedience of using withholding by employers as final taxes. To be sure, in lieu of the denial of deductions for employment-related expenses, some countries use certain proxies to compensate for the denial of deductions (e.g., standard deductions) and exclusions of certain types of income (e.g., exclusion of transportation allowances), but these consolations do not refute the argument that the comprehensive income tax base has been eroded.¹¹⁰

Certain non-business expenses are also allowed deductions under certain conditions, for example, when the expenses are incurred for charitable causes.¹¹¹ Some income tax systems also

¹⁰⁹ See Stotsky, “The Base of the Personal Income Tax,” p. 122

¹¹⁰ Ethiopian income tax law denies deduction of “employment related” expenses but seeks to compensate for this by excluding certain cash allowances, like transportation allowance, travelling allowance and hardship allowance: see Income Tax Regulations 78/2002, Article 3; see also Stotsky, “The Base of the Personal Income Tax,” pp. 122-123

¹¹¹ See Stotsky, “The Base of the Personal Income Tax,” p. 123; see also Due and Friedlaender, Government Finance, p. 293

go out of their way to allow deductions for otherwise personal expenses like medical expenses as well as for dependents.¹¹² While some of these deductions are justified by appeals to tax equity, it is now understood that all these adjustments, deductions and reliefs inevitably affect the personal income tax base, contributing to its further erosion and departure from the ideal laid down by SHS model.¹¹³

vii. The Choice of Taxable Unit

The taxable unit defines the individual or group of individuals whose income (and expenses) must be taken into account in a personal income tax.¹¹⁴ The choice of taxable units would have been easy if individuals earn and spend income by and for them alone. The fact of the matter is that human beings are social animals when it comes to contributing into the “income pool” as they are in drawing from it. The social fact of “spending and earning cooperation” raises a fundamental challenge for income tax systems of choosing a taxable unit that is, at once, fair and administratively feasible.

Personal income tax systems have identified various taxable units over the years: taxing each individual separately regardless of marital status, taking couples as taxable units, having couples or separate filing by couples as options or using families as taxable units.¹¹⁵ On whichever of these options the choice of a country falls, it is now recognized that the choice of a taxable unit affects the income tax base quite considerably, thus affecting the equitability of a personal

¹¹² See Stotsky, “The Base of the Personal Income Tax,” p. 123; see also Due and Friedlaender, *Government Finance*, pp. 289-290, 290-291,

¹¹³ See Stotsky, “The Base of the Personal Income Tax,” p. 123; see also Thuronyi, *Comparative Tax Law*, p. 244 and Due and Friedlaender, *Government Finance*, pp. 272-278

¹¹⁴ See Due and Friedlaender, *Government Finance*, pp. 284-290; see also Thuronyi, *Comparative Tax Law*, pp. 243-244

¹¹⁵ See Stotsky, “The Base of the Personal Income Tax,” p. 124; see also Due and Friedlaender, *Government Finance*, pp. 284-287; countries like the U.S., Portugal and Switzerland regard married couples as taxable units, while France and Luxembourg, and a number of former French colonies treat the family as a unit under the so-called “family quotient system”; see Thuronyi, *Comparative Tax Law*, p. 243

income tax system, not to speak of efficiency.¹¹⁶ It is also known that the choice of a taxable unit affects the departure from or the proximity of the income base to that defined by the SHS model. The choice of a taxable unit is closely related with the idea that individuals with equal income should pay equal taxes (horizontal equity) and those with unequal income should pay unequal taxes (vertical equity).¹¹⁷ But many income tax systems have recognized that individuals are seldom alone in society, and their abilities to pay tax are often associated with their status as married or members of certain families. Some income tax systems have recognized that the status of being married affects ability to pay considerably, thus choosing married couple as a taxable unit, while others (e.g., France and many Francophone African countries) have gone beyond married couples and considered a family as the “proper” taxable unit.¹¹⁸ Some countries continue to view individuals as separate taxable unit and base income tax liability solely on the basis of the individual’s income regardless of her marital status or family affiliations.¹¹⁹ The shifts in modes of living, such as the choice of a greater number of individuals in the western world to live alone, have also affected the public policies of countries in this regard.¹²⁰ Whatever it is, it has become increasingly clear that the choice of a taxable unit is one of the factors that affects income tax base and ultimately determines the departure from or proximity of the income base to that of the ideal SHS model. The use of exemptions in consideration of the taxable unit and the progressive rates that are usually applied to income have led to substantial differences in tax liabilities among the various methods of taxable units chosen.¹²¹

¹¹⁶ See Stotsky, “The Base of the Personal Income Tax,” pp. 124-126

¹¹⁷ See *id.*, p. 125

¹¹⁸ See *id.*, pp. 125-126; see also Due and Friedlaender, *Government Finance*, pp. 286-287

¹¹⁹ See Due and Friedlaender, *Government Finance*, pp. 284-285; Due and Friedlaender give the example of Canada; see *ibid.*, p. 284

¹²⁰ See Stotsky, “The Base of the Personal Income Tax,” p. 126

¹²¹ See Due and Friedlaender, *Government Finance*, p. 284

III. The Structures of Income Tax Systems: A Comparative Overview

a. Global and Schedular Income Tax Structures in General

On a theoretical plane, two models of income tax structures have existed in the world – the global and schedular income tax structures.¹²² These are, of course, theoretical models and do not necessarily reflect the actual practice of income tax systems throughout the world. In reality, there is so much inter-penetration of the two systems in actual income tax systems, with the so-called global income tax systems partaking from the schedular income tax systems and vice versa.¹²³ What we describe here is prototypes of the two models of income taxation in the world. In its purest form, global income taxation requires aggregation of all incomes of individual or any other “taxable unit” without any exceptions, and applies a single progressive income tax rate upon the taxable income.¹²⁴ A global income tax model, again in its purest form, allows deductions for all expenses regardless of the source of income.¹²⁵ The difference between total income from all diverse sources and total expenses from all activities makes up the taxable income, upon which the progressive income tax is then imposed.¹²⁶ This format of income taxation is consistent with, and in fact, derived from the SHS model of income, in which, no distinction shall be made between various sources of income in any shape or form.

As it requires an aggregation of the income of an individual from all sources, a global income tax structure is found mainly in developed income tax systems of the world, although some

¹²² See Ault and Arnold, pp. 197-198; Thuronyi, *Comparative Tax Law*, p. 241; see also Stotsky, “The Base of the Personal Income Tax,” p. 121

¹²³ See Ault and Arnold, *Comparative Income Taxation*, p. 198; Thuronyi, *Comparative Tax Law*, p. 241

¹²⁴ See Ault and Arnold, *Comparative Income Taxation*, p. 197; see also Janet Stotsky, “The Base of the Personal Income Tax,” p. 121

¹²⁵ See Ault and Arnold, *Comparative Income Taxation*, p. 197

¹²⁶ See *ibid*

countries of the developing world are increasingly moving towards a global income tax prototype.¹²⁷ The advantages of a global income tax structure are many. One advantage, often touted for a global income tax structure by its proponents, is that the global income tax structure is more amenable to achieving the goals of vertical (and horizontal) equity than schedular income tax structures.¹²⁸ A global income tax structure is able to pierce the thicket of sources of income and apportion income tax liability on the basis of the aggregate income derived by individuals and overcomes the problems of fixing tax liability on the basis of sources – which are not important considerations in ensuring tax equity.¹²⁹ Individuals who earn income from multiple sources and individuals who earn income from a single source are more likely to bear identical or at least comparable burdens of income tax liability under a global income tax structure than a schedular income tax structure.

Besides, while many countries are apprehensive about the administrative burdens of a global income tax system, the proponents of a global income tax structure have argued that a global income tax structure is administratively simpler for taxpayers who obtain income from multiple sources, as these individuals are required to file a single tax return (usually at the end of the tax year) instead of having to comply with multiple income taxes under typical schedular income tax

¹²⁷ See Stotsky, “The Base of the Personal Income Tax” *ibid.*, p. 121; it must, however, be noted that the global income tax structure is by no means the dominant structure even among the developed tax systems; out the twelve industrialized countries compared in Ault’s *Comparative Income Taxation*, only three belong truly to the global income tax camp (U.S.A., Canada and Australia); all the other major industrialized countries continue to employ a schedular system of income taxation (UK, France, Germany, Japan and Scandinavian countries); see Gest, “France,” p. 50; Schon, “Germany,” p. 71; Nakazato, Ramseyer and Nishikori, “Japan,” p. 98; Raad, “The Netherlands,” p. 115; Melz, “Sweden,” p. 133; Tiley, “The United Kingdom,” p. 153; see also OECD Model Tax Convention and Key Country Features, pp. 387-648

¹²⁸ See Stotsky, “The Base of the Personal Income Tax,” p. 121; see also Ault and Arnold, *Comparative Income Taxation*, p. 197

¹²⁹ See Stotsky, “The Base of the Personal Income Tax,” p. 121

structures.¹³⁰ It is also argued that global income tax systems are less susceptible to tax planning, providing thereby less temptation for lots of administrative expenses spent in trying to place income under one heading rather than another.¹³¹

Schedular income tax systems stand in direct theoretical opposition to the underlying notion of the global income tax structures. Schedular income tax systems partition income into specific sources of income and impose separate income tax rules and rates upon these individual sources of income.¹³² The extreme forms of schedular income tax structures treat each source of income as if it were different, and completely disregard the fact that the individual or the taxable unit in general is one person deriving income from multiple sources. Each separate source (which may be labeled and identified under a “schedule,” or a “box,” or a “category” or a “part” in different income tax systems), has its internal rules of income tax computation and separate income tax brackets and tax rates. The separate rules determine the amounts to be included as income in each category and amounts to be excluded from that category as well as determining whether certain expenses are deductible and to what extent.¹³³

Schedular income tax structure can be as diverse as the number of countries following schedular income tax structures, but, as a general matter, schedular income tax structures share the following common characteristics:

¹³⁰ See *ibid*

¹³¹ Ault and Arnold, *Comparative Income Taxation*, p. 197

¹³² See *ibid*

¹³³ To take examples from Ethiopian income tax law; Schedule “A” of Ethiopian income tax law has separate and self-contained rules regarding the types of income from employment that are taxable and the types that are excluded from tax; it also includes provisions for defining income tax brackets, tax rates, assessment as well as collection of tax on schedule A income; see Income Tax Proclamation No. 286/2002, Articles 10-13; 65; Income Tax Regulations No. 78/2002, Articles 3 and 4; see Chapter Four below

- i) Amounts included in income (and at times excluded from income) and deductions are determined separately;¹³⁴
- ii) Any amount, not included in any schedule, box, category or part, generally remains un-taxable unless there is a separate schedule with a catch-all phrase that seeks to capture all other “undesigned” income;¹³⁵
- iii) Deduction of expenses for certain sources or categories of income is either prohibited or extremely limited;¹³⁶
- iv) A loss incurred in connection with one category of income is often not allowed to be offset against any other category of income;¹³⁷
- v) The income brackets and tax rates are developed for each category of income, and sometimes these brackets and tax rates may not even be comparable with one another;¹³⁸and
- vi) The assessment and collection measures are often different for each source of income.¹³⁹

Schedular income tax structures possess several merits to commend them. The strongest suit of a schedular income tax structure, with all its imperfections, is its administrative simplicity.¹⁴⁰ A

¹³⁴ See Ault and Arnold, *Comparative Income Taxation*, p. 197

¹³⁵ See *ibid*; the old income tax laws of Ethiopia had a catchall phrase that was broad enough to capture all other (unspecified) types of income; but these catchall phrases were removed from recent income tax reforms of Ethiopia; see Chapter Eight below

¹³⁶ Income from investment is often subject to final withholding taxes thereby foreclosing any possibility of deduction of expenses incurred in connection with investment; see Ault and Arnold, *Comparative Income Taxation*, p. 197

¹³⁷ *Ibid*

¹³⁸ For example, the income brackets and tax rates in Ethiopia for the four major schedules of Ethiopian income tax were very different prior to the income tax reforms of 2002, see Chapter Four below

¹³⁹ Some sources are subject to final withholding taxes while others are assessed through a combination of self-assessment and withholding taxation schemes; see Ault and Arnold, *Comparative Income Taxation*, p. 197

¹⁴⁰ See Stotsky, “The Base of the Personal Income Tax,” p. 121

schedular income tax structure enables tax authorities to capture what they can at identifiable sources and obviates the need for filing of tax returns for a greater number of taxpayers. The tax authorities can direct their energies to the conspicuous streams of income and collect as much revenues from these streams as they can manage. The use in particular of withholding as a final tax (e.g., against employment income) absolves weak tax administrations from having to worry about processing individual tax returns, which can consume huge tax administration resources particularly if expenses are made deductible. Those income streams that are not easily amenable to withholding taxation may still make it necessary for tax authorities to monitor and process individual tax returns, but the number of taxpayers subject to tax return filing have already been considerably reduced for the tax authorities to concentrate their administrative energies upon the very few that are subject to the regime of self-assessment. Schedular income tax structures can also be regarded as a plus for those taxpayers whose incomes are subject to withholding tax regimes as they don't have to worry about their income tax liabilities. They have the withholding agents (e.g., employers) to handle their tax liabilities on their behalf.

The structural arrangements of schedular income tax systems have given rise to a number of objections against schedular formats of income taxation. Critics charge that differential tax rates in schedular income tax systems expose schedular systems to various forms of tax planning. Those that seek "to manipulate the character of amounts" and ultimately minimize or even eliminate tax burdens can take advantage of schedular income tax structures.¹⁴¹

Although countries generally choose schedular income tax structures on account of their ease of administration (compared at least to the global income tax structures), critics allege that schedular income tax structures give rise to some complexities in the classification of different

¹⁴¹ See Ault and Arnold, *Comparative Income Taxation*, p. 197

types of income and might become a source of considerable headache for tax administration.¹⁴² Paradoxically, schedular income tax structures may end up running into the very problems they were designed to avoid, namely, complexity in characterization and administration.¹⁴³

The most serious handicap of schedular income tax structures, however, is that they make it extremely difficult for tax authorities “to implement progressive taxation of individuals in accordance with the ability-to-pay principle” of taxation¹⁴⁴ This is the inevitable consequence of separate taxation of specific income tax sources. As tax burden is determined on the basis of the sources rather than the individuals deriving income, it is difficult to reconcile the administrative requirement of separate taxation on the one hand and the equity demands of having to measure the income of the individual rather than sources.¹⁴⁵ There is no necessary link between the source of income (which is the basis for distribution of tax burdens in schedular income tax structures) and ability-to-pay, and this, critics complain, violates the principles of tax equity.

Both global and schedular income tax structures, in their pure forms, represent theoretical models of the opposite ends of a spectrum. The purity of the theoretical models is not to be found in actual income tax systems. Driven as they are more by pragmatic considerations as opposed to theoretical niceties, actual income tax systems are more likely to partake from the features of both income tax models. In reality, so-called global income tax systems have borrowed some elements of the schedular structures while many schedular income tax systems of the world have moved increasingly towards the global income tax structures.¹⁴⁶ The global

¹⁴² See Ault and Arnold, *Comparative Income Taxation*, p. 197; see also Burns and Krever, “Individual Income Tax,” p. 497

¹⁴³ For complexities associated with the schedular income tax system of Ethiopia, see chapters Five to Eight below

¹⁴⁴ See Ault and Arnold, *Comparative Income Taxation*, p. 197

¹⁴⁵ See *id.*, pp. 197-198

¹⁴⁶ See *id.*, p. 198; Thuronyi, *Comparative Tax Law*, p. 241

income tax structures of the USA, Canada and Australia (**see below**) are underpinned by some schedular elements, while the otherwise schedular income tax structures of many European countries, including the UK, have incorporated some global elements in their income tax systems.¹⁴⁷ Victor Thuronyi summarized the trend very well when he wrote:

... the distinction between schedular elements superimposed on a global tax and a schedular tax that has become partially global is hard to draw. As a structural matter, ... schedular elements can be built on top of a pure global income tax. Or they might take the form of a reverse evolution from a global tax.¹⁴⁸

In truth, therefore, the world is not divided into two pure forms of income tax models, as the theoretical models would have us believe, but into perhaps two hybrid forms of income tax structures, whose boundaries have become more and more blurred as countries integrate in response to global pressures.¹⁴⁹ The two hybrid forms of income taxation are:

- i) Global Income Tax Structures with superimposed schedular elements; and
- ii) Schedular Income Tax Structures with streaks of a global income tax variety.

Apart from these developments of interpenetration, there is one model of the schedular income tax structures that has generated lots of interest and attention in recent years – the dual income tax model of the Scandinavian/Nordic countries. In its own sense, the dual income tax model of taxation represents both streaks of structural organization. It has streaks of the global variety because it insists on bringing together as many sources as possible under one category, and it

¹⁴⁷ See Ault and Arnold, *Comparative Income Taxation*, p. 198; see also Thuronyi, *Comparative Tax Law*, 242

¹⁴⁸ Thuronyi, *Comparative Tax Law*, p. 241

¹⁴⁹ See Lathrope, *Global Issues in Income Taxation*, p. 4

also has schedular features in the sense that it still separates clusters of income into two categories or schedules: income from labor and business on the one hand and income from capital on the other (**see below**).

These developments represent global trends in income tax structures, but it is important to note that there are many income tax systems that continue to use the pure schedular income tax variety, unaffected by the convergence of nations around certain income tax models. Ethiopia can be taken as the best example of this, as its income tax laws continue to enforce income taxation on the basis of sources or categories of income, although there are some embryonic elements of a global income tax variety in some of the provisions of Ethiopian income tax laws.¹⁵⁰

We shall herein below deal with selected countries representing the global and schedular income tax systems from the developed world, and then deal with the dual income tax system as a model and give examples of specific countries with the hope that some lessons can be drawn from these income tax systems. Income tax models have their origins in the income tax systems of the developed world as well as theoretical discussions in that world. It may thus be maintained that surveying the prototypical models of the developed world will be sufficient for drawing lessons from comparative experience. But it can equally be maintained that this process perpetuates a stereotypical notion that the winds of change must always blow from north to south. An exercise that represents the income tax systems of the developed world can also be easily ridiculed as disadvantaging poorly organized income tax structures like that of Ethiopia by drawing unfair comparisons with better organized income tax structures of the developed world. A comparative review of income tax structures of other countries has therefore incorporated the income tax

¹⁵⁰ See Chapter Four below

structures of selected African countries with which Ethiopia obviously shares many political, historical and continental affinities.

b. Global Income Tax Structures: Country Examples

i. USA

The U.S. income tax system is probably the archetype of global income tax structures in the world.¹⁵¹ Although the extent of its influence is unclear, the U.S. income tax model has influenced in the development and structure of income tax systems of many Latin American countries, Canada, Indonesia and Japan.¹⁵² The U.S. income tax law defines income “broadly to include all accession to wealth, with a few well-defined exclusions.”¹⁵³ The recognized sources of income include wages, salary, business income and investment income (viz., dividends, interest, rental income) but are not limited to those.¹⁵⁴ All sources of income (with the exception of capital gains and in some cases dividends) are aggregated and taxed at the same rates.¹⁵⁵

Overall, the U.S. income tax structure exhibits the following characteristics – features not necessarily shared by the tax systems influenced by the U.S.:¹⁵⁶

- i) a global definition of income;
- ii) a comprehensive system for taxing capital gains;¹⁵⁷
- iii) a classical corporate tax system;

¹⁵¹ Repetti, “The United States,” p. 178

¹⁵² Thuronyi, *Comparative Tax Law*, p. 28

¹⁵³ Repetti, “The United States,” p. 178; the known exclusions are gifts, bequests, and proceeds from life insurance policies, scholarships, and a broad range of fringe benefits; *ibid*

¹⁵⁴ See OECD Model Tax Convention and Key Tax Features, p. 643

¹⁵⁵ *Ibid*

¹⁵⁶ Thuronyi, *Comparative Tax Law*, p. 28-29

¹⁵⁷ Capital gains are subject to preferential tax rates even in an otherwise seemingly global tax systems of the US; see Thuronyi, *Comparative Tax Law*, p. 28

- iv) a single law for corporate and individual income taxes;
- v) a worldwide jurisdictional approach based on nationality and residence;
- vi) a highly developed system of rules on virtually all areas of income taxation; and
- vii) a high percentage of self-assessed income tax returns per head of population.

If U.S. income tax system were ever truly global in reach in the first place, a number of developments have eroded the global credentials of U.S. income tax structure as to give it some veneer of schedularity.¹⁵⁸ One of these schedular veneers is the restriction on the deductibility of certain expenses to similar categories of income.¹⁵⁹ For example, losses from so-called “passive activities” are only deductible from income generated from passive activities.¹⁶⁰ Similarly, expenses incurred in connection with investment activities are deductible only from income generated from those investment activities.¹⁶¹ Perhaps the most significant encroachment of schedular structures upon the global superstructure of the U.S. income tax system is the preferential treatment for capital gains, including the restrictions imposed on the deductibility of capital losses.¹⁶² With all its preferences and loopholes, however, the U.S. income tax structure remains global in its overall approach.

ii. Canada

Canada, like the U.S., has a global income tax structure.¹⁶³ But Canada, unlike the U.S. came under the influence of and inherited some schedular elements from the UK income tax

¹⁵⁸ See Repetti, “The United States,” p. 180

¹⁵⁹ Ibid

¹⁶⁰ See *ibid*; passive activity is defined rather tamerly as a profit-seeking activity to which the taxpayer does not devote a significant amount of time; *ibid*

¹⁶¹ See Repetti, “The United States,” p. 180

¹⁶² See *ibid*; at the moment only up to 3000 of capital losses can be deducted from ordinary income; *ibid*

¹⁶³ Arnold, “Canada,” p. 29

system.¹⁶⁴ One of these elements is the “source” concept of income, a doctrine in which it is assumed that income which does not have a source is not considered to be income in the legal sense (**see above**).¹⁶⁵ The idea that income must have source to be chargeable with tax made it at first difficult for the Canadian income tax system to recognize “windfall profits” and “capital gains” as income, and it took the issuance of specific tax statutes to impose taxes on capital gains.¹⁶⁶

The Canadian income tax system shows strong signs of a schedular structure also because it requires calculation of income from various sources separately as well as allocating reasonable deduction to each respective source.¹⁶⁷ For example, the income tax rules of Canada severely limit deduction of expenses with respect to income from employment.¹⁶⁸ Of course, the global feature of the income tax system is finally restored in the sense that, once income and losses from the various sources are computed, incomes from the various sources are aggregated to obtain the taxpayer’s taxable income.¹⁶⁹

In general, the Canadian income tax system recognizes four categories of income: employment income, business income, property income and capital gains.¹⁷⁰ Income from employment, business and property income are taxed at full rates, except for dividends, which are taxed at reduced rates due to the availability of an imputation tax credit system.¹⁷¹ Capital gains are taxed

¹⁶⁴ Id, p. 30

¹⁶⁵ Id, p. 29

¹⁶⁶ Id, pp. 29-31

¹⁶⁷ Id, p. 31; see also OECD Model Tax Convention and Key Tax Features, pp. 416-417

¹⁶⁸ Arnold, “Canada,” p. 31

¹⁶⁹ Ibid

¹⁷⁰ See OECD Model Tax Convention and Key Tax Features, p. 417; property income includes passive income, such as rent, interest, royalties and dividends; *ibid*, p. 417

¹⁷¹ Ibid

at reduced rates as the Canadian income tax rules require only 50% of the capital gains to be included in income.¹⁷²

iii. Australia

Australian income tax is also global in approach.¹⁷³ Under Australian law, income includes “all ordinary and statutory income.”¹⁷⁴ Because of Australia’s historical ties with the UK, one would have assumed the Australian income tax system to closely follow the patterns of the UK income tax structure, but Australia (like the USA) has charted its own global income tax structure independently of the influence of the UK schedular income tax system.

Nonetheless, some schedular approaches of the UK income tax system have crept into the Australian income tax system.¹⁷⁵ For example, the “source” concept of the UK income tax mindset has influenced income tax developments in Australia.¹⁷⁶ The development of the trust concept in both countries at one time also led to the exclusion of “capital gains” from the ambit of the income tax system of both countries.¹⁷⁷

Still, the global elements of the Australian income tax structure are predominant over its schedular underpinnings, with the result that all items are included as income and all losses (with the exception of capital losses) are allowed to be offset against income.¹⁷⁸

¹⁷² Ibid

¹⁷³ Vann, “Australia,” p. 6

¹⁷⁴ OECD Model Tax Convention and Key Tax Features, p. 391

¹⁷⁵ Vann, “Australia,” pp. 6-7

¹⁷⁶ Id, p. 6

¹⁷⁷ Id, p. 7; the tax reform in Australia in 1980 led to the introduction of capital gains tax and fringe benefits tax; see *ibid*

¹⁷⁸ Id, pp. 7-8

c. Schedular Income Tax Structures: Country Examples

i. Unstructured Income Tax Structures: Examples from the Developed World

1. UK

The UK often provides a perfect paradigmatic contrast in the developed countries to the global income tax models.¹⁷⁹ The UK income tax system today is synonymous with the schedular structure of income taxation, but, since it happened so long ago, it is difficult to believe that at first the UK went with a global structure of income taxation until in 1803, when it seemed it permanently shifted to the schedular structure.¹⁸⁰ The UK developed a colonial model law in 1922 in which different types of income were divided into schedules and separate rules of computation and assessment were established for each schedule.¹⁸¹ Many of the colonies of the UK inherited this model law although as many have since then departed from the schedular definition of income.¹⁸²

The income tax system of the UK itself is presently based on the division of income into sources, which are expressed in schedules (sometimes subdivided into “cases”).¹⁸³ This compartmentalization of income has generally meant that income must fall within one of the schedules to become taxable.¹⁸⁴ Like many other income tax systems, the UK has a long list of so-called “statutorily declared non-taxable incomes,” but the doctrine of “source” (**see above**) and the application of the schedular system act as additional limitations on the taxability of all

¹⁷⁹ Ault and Arnold, *Comparative Income Taxation*, p. 199

¹⁸⁰ See Thuronyi, *Comparative Tax Law*, 2003, p. 26

¹⁸¹ *Id.*, pp. 26-27

¹⁸² *Id.*, p. 27

¹⁸³ Ault and Arnold, *Comparative Income Taxation*, pp. 199-200

¹⁸⁴ *Ibid.*; see also Tiley, *Revenue Law*, pp. 138-139

income in the UK.¹⁸⁵ The doctrine of “source” requires that “the source of income must be an identifiable activity and that activity must be recognized as falling within one of the schedules.”¹⁸⁶ The upshot of these doctrines is that “income in any tax year will not be taxable unless it can be traced to a source identified in a schedule.”¹⁸⁷

The income tax schedules of the UK have evolved over the years (have in fact come a long way since the first introduction in 1802).¹⁸⁸ Some schedules cover a wide variety of income (e.g., the schedule regarding profits of trade) while others are intended for a narrow stream of income (e.g., schedule regarding income from foreign securities).¹⁸⁹

The schedules represent the lens through which one needs to view the treatment of specific sources of income in the UK. The schedules are theoretically structured in such a way that one source of income is or ought to be distinct from another source of income (e.g., income from business is or ought to be distinct from income from employment, because these two types of income fall under separate schedules).¹⁹⁰ This has given rise to the doctrine of “mutual exclusivity” of the schedules.¹⁹¹ Once income is characterized as falling under one of the schedules, it is thereby excluded from falling under the other schedules.¹⁹² Upon characterization, income from a certain source is subjected to the rules of computation of each schedule of the income tax.¹⁹³

¹⁸⁵ Olowofoyeku, Kirkbride and Butler, Revenue Law, p. 72; the statutory declared non-taxable incomes change from time to time but they include certain social security benefits, War Widows pension, redundancy payments, education scholarship and foreign services allowances for civil servants; see Olowofoyeku, Kirkbride and Butler, Revenue Law, p. 72

¹⁸⁶ Id, p. 74

¹⁸⁷ Id, p. 72

¹⁸⁸ Ault and Arnold, Comparative Income Taxation, p. 200

¹⁸⁹ Ibid

¹⁹⁰ Ibid

¹⁹¹ Olowofoyeku, Kirkbride and Butler, Revenue Law, p. 73

¹⁹² Ibid

¹⁹³ Ibid

As a result of recent income tax reforms, the UK income tax structure is no longer arranged in the form of schedular (although it remains schedular) “in terms of a list of heads of charge” (whatever that means!).¹⁹⁴ According to one recognized authority on the UK income tax system, John Tiley, these are mere “matters of form” and do not “change the meaning.”¹⁹⁵ However, these continual refinements and reforms may eventually threaten the long reign of the schedular income tax structure in the UK.¹⁹⁶

In general, under the UK income tax system of today, of the multiple schedules of the UK, the so-called Schedule E charges three heads of income, namely “income from employment” (Part 2), “pension income” (Part 9), and “social security income” (Part 10).¹⁹⁷

Another Income Tax Act, of 2005, which is intended for so-called “trading income” lists at least three separate schedules, namely:¹⁹⁸

- i) Trading income (Part 2, formerly under Schedule D Cases I and II);
- ii) Property income (Part 3), formerly under Schedule A;
- iii) Savings and investment income (part 4), formerly under Schedule D, cases II and Schedule F, and
- iv) Miscellaneous income (Part 5), (includes former schedule D case VI)

Still another Income Tax Act, issued in 2007, lists several types of income as chargeable under separate schedules or parts, namely:¹⁹⁹

- i. Charitable trusts (Part 10);
- ii. Accrued income profits (Part 12); and

¹⁹⁴ Tiley, “The United Kingdom,” p. 154

¹⁹⁵ *Ibid*

¹⁹⁶ See Olowofoyeku, Kirkbride and Butler, *Revenue Law*, p. 72

¹⁹⁷ See Tiley, “The United Kingdom,” p. 154

¹⁹⁸ *Ibid*

¹⁹⁹ *Ibid*

- iii. Tax avoidance (Part 13).
- iv. Two other heads of charge with open-ended charges.²⁰⁰

It must be noted at the end that although the UK income tax system is internally organized in the form of schedules and cases within schedules, there is an aggregation of income from all sources, reflecting the journey the UK income tax system is making towards a global income tax.²⁰¹ The refinements of the computation methods in each of the schedules have also served to harmonize all the schedules so that the schedular system will not result in the “mere collection of taxes essentially distinct.”²⁰²

2. Germany

Germany is another country whose schedular income tax structure has exerted a strong influence in a number of countries.²⁰³ Taxation in Germany is based on categories, and the “differences between the categories have increased over time.”²⁰⁴ One of these differences is that capital income is accorded special treatment, in the sense that “only 50% of dividends and capital gains on shares are included in the income tax base.”²⁰⁵ As of 2009, Germany has also introduced a rule which imposes a final withholding tax of 25% upon income derived from financial assets.²⁰⁶ Germany is also coming increasingly under the influence of the dual income tax movement as a number of proposals have been considered to adopt the dual income tax

²⁰⁰ See *ibid*

²⁰¹ Olowofoyeku, Kirkbride and Butler, *Revenue Law*, p. 73

²⁰² Lord Macnaghten in *London County Council v. A.G.*, cited in Olowofoyeku, Kirkbride and Butler, *Revenue Law*, p. 73, foot note 23

²⁰³ See Thuronyi, *Comparative Tax Law*, pp. 9, 32, 36, and 38; Victor Thuronyi, who attempted to identify the major families of taxation in the world, even boldly suggested that the three most important tax systems to study for comparative purposes are Germany, U.K., and the U.S.A.; see Thuronyi, *Comparative Tax Law*, p. 9; see also Schon, “Germany,” p. 72; OECD *Model Tax Convention and Key Tax Features*

²⁰⁴ Schon, “Germany,” p. 72

²⁰⁵ *Ibid*

²⁰⁶ *Ibid*

system in Germany.²⁰⁷ There are at least seven categories (schedules) of income tax under the Germany income tax system, namely:²⁰⁸

- i) Income from agriculture and forestry;
- ii) Income from trade or business enterprises;
- iii) Income from professional and certain other independent personal services;
- iv) Income from dependent personal services (wages and salaries) – income from employment;
- v) Income from capital investments (interest and dividends);
- vi) Rent and royalty income; and
- vii) Income from certain other sources specifically defined in the ITA, such as from speculative transactions

The German income tax system has some elements of the global income tax variety in the sense that the net results of the computation of income from each category are aggregated for purposes of applying progressive income tax rates.²⁰⁹

3. Japan

Japanese income tax system is also schedular in orientation.²¹⁰ The Japanese income tax system divides income into ten categories for purposes of taxation:²¹¹ i) interest income; ii) dividend income; iii) real estate income; iv) business income; v) employment or earned income; vi)

²⁰⁷ Ibid

²⁰⁸ Ibid; see also OECD Model Tax Convention and Key Tax Features, p. 463

²⁰⁹ OECD Model Tax Convention and Key Tax Features, p. 463

²¹⁰ Nakazato, Ramseyer & Nishikori, “Japan,” p. 99

²¹¹ OECD Model Tax Convention and Key Tax Features, p. 517; Nakazato, Ramseyer & Nishikori, “Japan,” p. 99

retirement income; vii) timber income; viii) capital gains; ix) occasional income and x) miscellaneous income.²¹²

These categories are identified such that the taxable income from each category is calculated separately after allowable deduction under each category.²¹³ Then the Japanese income tax system groups or aggregates these categories of income into three general categories: i) retirement income; ii) timber income; and iii) ordinary income.²¹⁴ Retirement income and timber income are assessed separately and taxed at progressive rates.²¹⁵ All types income from the remaining categories (namely interest income, dividend income, real estate income, business income, capital gains, occasional income and miscellaneous income) are aggregated into so-called “ordinary income” and taxed at progressive rates after deduction of personal allowances.²¹⁶ Interest income and capital gains from stock transactions and capital gains from real property are taxed separately.²¹⁷

The Japanese income tax system relies very heavily on withholding schemes of taxation, which “obviates the need for self assessment and filing a tax return.”²¹⁸ The need for self-assessment is eliminated for wage earners through a scheme that allows wage earners to “make appropriate adjustments to their withholding at the end of the year.”²¹⁹ Income other than wage income is also collected through withholding schemes (e.g., interest on deposits).²²⁰

²¹² See OECD Model Tax Convention and Key Tax Features, p. 517

²¹³ Ibid

²¹⁴ Ibid

²¹⁵ Ibid

²¹⁶ Ibid

²¹⁷ Ibid

²¹⁸ Nakazato, Ramseyer & Nishikori, “Japan,” p. 99

²¹⁹ Ibid

²²⁰ Ibid

The divisions of income into ten categories at times resulted in favorable treatment of certain types of incomes compared to others. For example, the category “occasional income” is said to have received relatively more favorable treatment than the category “miscellaneous income.”²²¹ This feature of Japanese income tax is said to be responsible for numerous tax planning activities, as individuals seek to take advantage of differences among schedules by “changing the character of income from one category to another through sophisticated financial products and other technologies.”²²² The most important aspect of the schedular income tax system of Japan is the rule that limits the deductibility of losses in one category to that category alone.²²³ The different categories of income are critical in computation of taxable income in Japan. However, the Japanese income tax system has some global tendencies as the taxable incomes from each category are in the end to be aggregated and chargeable with a single progressive tax rate structure after general tax credits are made available.²²⁴

ii. Dual Income Tax Structures: General Features and Country Examples

The Nordic or Scandinavian countries have a distinct privilege of innovating and popularizing a variant of a schedular income tax structure, known as the “Dual Income Tax System,” also known as the “Nordic Tax System.”²²⁵ This model creates a moiety of sorts, dividing the structure of the whole income tax system between two sources of income: labor and capital.²²⁶

²²¹ Id, p.100

²²² Ibid

²²³ See *ibid*

²²⁴ See Ishi, *The Japanese Tax System*, p. 75

²²⁵ See Sorenson, *The Nordic Dual Income Tax – In or Out?*, p. 5; Boadway, *Income Tax Reform for a Globalized World*, p. 29; Richard Bird and Eric Zolt have noted that several European countries (outside Scandinavia) have already adopted what appears to be a dual income tax structure, without

All the Nordic countries have followed this model of income taxation, following the lead of Denmark, which inaugurated this system of income taxation in 1987, followed by Sweden (1991), Norway (1992) and Finland (1993)(see **Table 3.1 below**).²²⁷ While there are differences in approaches even among the Nordic countries, the basic features of the “dual” income tax structures have been summarized as: ²²⁸

- a) A separate reporting by individuals of capital and non-capital income;
- b) An expansive definition for capital income as to include income from all sources other than labor, and include such sources like interest, dividends, capital gains and profits from personal business, among others;
- c) A definition of non-capital income as to include both income from employment and self-employment, thus lumping income from employment and self-employment, sources normally treated separately under traditional schedular income tax structures;
- d) The existence of separate tax rate schedules for income from capital and income from non-capital (labor) sources and the application of progressive income tax rates upon labor income with deductions for expenses and adjustments for personal circumstances, and an application of flat tax rates and denial of deductions for expenses for income from capital;

acknowledging to be having one; see Bird and Zolt, *Dual Income Taxation and Developing Countries*, p. 189

²²⁶ Boadway, *Income Tax Reform for a Globalized World*, p. 29

²²⁷ Genser, *The Dual Income Tax*, p. 12; see also Bird and Zolt, *Dual Income Taxation and Developing Countries*, pp. 180-181

²²⁸ Boadway, *Income Tax Reform for a Globalized World*, pp. 30-31

- e) The existence of a corporate income tax structure, which, though separately and distinctly administered, is integrated with the personal income tax structure through credits.²²⁹

Apart from these, it is also generally true that the flat tax rate on capital income is usually pegged against the lowest marginal tax rate on non-capital income and the tax burden upon capital is usually lower than the tax upon non-capital income.²³⁰

The supporters of the dual income tax structures have touted dual structures on a number of levels and have viewed these structures as a viable alternative to the comprehensive income tax model.²³¹ The first advantage of dual income tax structures is that they broaden the base of the income tax system over capital and avoid most of the distortions associated with multiple tax structures based on individual sources of income.²³² Since most sources of income from capital are channeled through financial institutions one way or another, dual income tax structures also enable countries to use withholding taxes to raise income taxes from capital.²³³ This rationale is often a powerful argument for developing tax systems in particular as there are several limitations to implementing the administrative requirements of a global income tax system.

The existence of separate corporate income taxes along with personal income taxes in both global and schedular income taxes have often been blamed for distortions of one kind or

²²⁹ Ibid; the degree of integration of corporate and individual income varies among Nordic countries; see Bird and Zolt, *Dual Income Taxation and Developing Countries*, pp. 185-196

²³⁰ Boadway, *Income Tax Reform for a Globalized World*, pp. 30 and 31; this is said to increase the risk of tax arbitrage, providing some individuals (particularly those that own closely held companies) with strong incentive to characterize labor income as capital income; see Bird and Zolt, *Dual Income Taxation and Developing Countries*, p. 187

²³¹ See Genser, *The Dual Income Tax*, p. 277

²³² Boadway, *Income Tax Reform for a Globalized World*, p. 31

²³³ Ibid

another, and it is argued that dual income tax systems eliminate these distortions when the tax rates upon capital and upon corporate income are the same and when integration rules are incorporated in the income tax rules.²³⁴ Dual income tax structures are especially recommended for federal fiscal systems as they make it easier for federal systems to assign portions of the income tax to sub-national governments and the central governments. In a federal context, dual income tax structures make it easier to assign the less mobile source of income (i.e., income from labor) to sub-national governments while central governments retain the administration over income from capital.²³⁵

While dual income tax structures have been praised by their supporters for their simplicity, they are not without their critics.²³⁶ Critics charge that dual income tax systems violate principles of tax equity by applying differential tax rates upon labor income (subject, as pointed out before, to progressive taxes) and capital income (subject to proportional or flat taxes).²³⁷ Critics of dual income tax systems are not also impressed by the advent of this structure because dual income tax structures do not show any improvement with regard to the dilemmas posed by some types of income which are difficult to measure.²³⁸ Dual income tax systems suffer from the same problems and trappings of the global as well as (other) schedular income tax structures, namely the inability to measure and quantify some types of income.²³⁹

Lastly, although dual income tax systems are hailed for their simplicity of approaches, they still require distinguishing labor income from capital income, which is not easy to do, particularly

²³⁴ Ibid

²³⁵ Id, p. 37

²³⁶ Id, p. 32

²³⁷ Ibid

²³⁸ Id, p. 33

²³⁹ Ibid

when we are up against small business owners.²⁴⁰ Some Nordic countries have tried to overcome this problem by adopting a device of income—splitting, but these devices have been less than satisfactory in practice.²⁴¹

Table 3.1: Dual Income Tax Structures of Four Nordic Countries (2004)

	Denmark	Sweden	Norway	Finland
Introduction	1987	1991	1992	1993
Rate on capital income	28% for dividend income below threshold, or 43% else	30	28	29
Rate on earned income	1-59	5-56	28-47	2-52
Withholding on dividends	28	30	0	0
Withholding on interest	0	30	28	29
PIT on capital gains	28	30	28	29

Source: Bernd Genser: The Dual Income Tax, p. 278-279

As in all income tax families, there are significant variations within the dual income tax family. We shall review the special features of the dual income tax structures of some Scandinavian countries below.

²⁴⁰ Id, p. 34

²⁴¹ Id, p. 35

1. Finland

Finnish income tax system represents the best prototype of the dual income tax structures among all the Nordic countries. Finnish income tax system divides income into two broad categories: income from capital and earned income.²⁴² The category of “earned income” includes income from employment generally (salaries, director’s fees, pension income etc.), and business income.²⁴³ Finnish income tax system recognizes that a part of business income is a capital income and allows up to 20% of business income as a “capital income” with the rest going into the earned income pool.²⁴⁴ The category “capital income” includes typical investment incomes like interest, dividends and capital gains.²⁴⁵ An exception is made for interest from bank deposits, which is subject to a final withholding tax in Finland.²⁴⁶ The basic difference between the treatment of “earned income” vis-à-vis “capital income” is that the former is subject to progressive tax rates while the latter is subject to a flat tax rate.²⁴⁷

2. Norway

Norway is also a principal exponent of the dual income tax system. It classifies income into two general categories: general income and personal income.²⁴⁸ The category “general income” comprises all categories of taxable income, namely income from employment, business and capital.²⁴⁹ The net income from this category, after deduction of allowances, expenses and

²⁴² OECD Model Tax Convention and Key Tax Features, p. 443

²⁴³ See *ibid*; see also Pakarinen, “Finland, Individual Taxation,” Sec. 1.1.3

²⁴⁴ See OECD Model Tax Convention and Key Tax Features, p. 444

²⁴⁵ *Ibid*

²⁴⁶ *Ibid*

²⁴⁷ See *id*, p. 443

²⁴⁸ Norstebo & Gjerde, Norway – Individual Taxation, Section 1.1.3

²⁴⁹ *Ibid*

certain losses, is subject to a flat tax rate of 28%.²⁵⁰ The category “personal income” is a gross income tax base and covers mainly income from employment and pensions.²⁵¹ This tax base is subject to social security contributions and an additional tax at progressive rates.²⁵² The Norwegian income tax system splits the income of the self-employed for purposes of applying the tax rates on the income of the self-employed that is considered as income from labor (which is subject to progressive tax rates) and on income that is considered as income from capital (subject to flat tax rates).²⁵³

3. Sweden

The Swedish income tax system calculates income tax on the basis of three sources (income from employment, from business and capital), but it is still a dual income tax structure as income from employment and business is added together as “earned income” and tax computed on the aggregate of the “earned income.”²⁵⁴ Within the “earned income” category, Swedish income tax rules create some distinctions about the deductibility of some expenses. For example, expenses related to employment are not deductible unless they exceed a certain threshold.²⁵⁵ Losses resulting from employment are not deductible from business income and vice versa, and can only be carried forward to offset future income from the same source.²⁵⁶

The second schedule (thus giving the Swedish income tax its dual structure) is “income from capital” upon which a flat tax rate of 30% is imposed.²⁵⁷ Under Swedish income tax law, capital

²⁵⁰ Ibid

²⁵¹ Ibid

²⁵² Ibid

²⁵³ Id, Section 3.2

²⁵⁴ Melz, “Sweden,” p. 133; see also OECD Model Tax Convention and Key Tax Features, p. 607

²⁵⁵ Melz, “Sweden,” p. 133

²⁵⁶ Id, p. 134

²⁵⁷ Ibid

income includes interest, dividends, capital gains on realization of all types of assets and foreign debt.²⁵⁸ All income from capital is aggregated and subject to a flat tax rate of 30%.²⁵⁹ In general, all expenses in connection with capital income are deductible in full from capital income.²⁶⁰ Sweden has taken precautions to prevent tax planning opportunities by setting the capital income tax rate at an equivalent level with corporate and municipal tax rates.²⁶¹ Nonetheless, due to the differences between the tax rate on capital income and on earned income, tax planning opportunities remain.²⁶²

Although the two main schedules of Swedish income tax system (earned income and capital income) are kept apart for computation of tax liabilities, some intersections are permitted at times. For example, up to a certain percentage of capital losses is allowed to offset earned income.²⁶³

4. Dual Income Tax Structures in other (Non-Nordic) Countries

Several other countries outside the Scandinavian region have considered or adopted dual income tax structures.²⁶⁴ Several countries have dual income tax systems without admitting to having one. Several countries have final withholding taxes on interest and dividends at rates below the top marginal rates under the personal income tax system. In the EU, these countries

²⁵⁸ Ibid

²⁵⁹ Ibid

²⁶⁰ Ibid

²⁶¹ Ibid

²⁶² Ibid

²⁶³ Id, pp. 134-135

²⁶⁴ Bird and Zolt, *Dual Income Taxation and Developing Countries*, p. 189

include Austria, Belgium, Italy, Portugal, the Czech Republic, Lithuania and Poland.²⁶⁵ The U.S. Treasury proposed a dual income tax system in 1992.²⁶⁶

The Netherlands adopted a variant of the Dual Income Tax System in 2001 – the OECD characterized it as “semi-dual.”²⁶⁷ The Netherlands’ approach provides for three separate “boxes” of income: i) taxable income from work and homeownership; ii) taxable income from a substantial business interest; and (iii) taxable income from savings and investment.²⁶⁸ Each box has its own tax rate and methods of computing income and the law quarantines losses so that losses from each box may not offset income from any other box.²⁶⁹ The Netherlands imposes progressive income tax rates, flat and presumptive income tax rate respectively for box 1, box 2 and box 3.²⁷⁰ Net assets in the last box are assumed to yield a return of 4% and subjected to an income tax rate of 30%. This is the equivalent of a wealth tax of 1.2%.²⁷¹ Whether taxpayers earned 1% or 10% on their portfolio assets does not matter; they are presumed to have earned 4%.

iii. Income Tax Structures of Selected African Countries

1. Introduction

Africa is one of the least integrated parts of the world, legally, economically and even politically speaking. However, Africa is not short of aspirations of integration and unity. The most visible gesture of this aspiration of integration in Africa has been the establishment of the Organization

²⁶⁵ Bird and Zolt, *Dual Income Taxation and Developing Countries*, p. 189, foot note 69

²⁶⁶ Bird and Zolt, *Dual Income Taxation and Developing Countries*, p. 189

²⁶⁷ Genser, *The Dual Income Tax*, p. 283

²⁶⁸ *Ibid*; see also OECD *Model Tax Convention and Key Tax Features*, pp. 549-550

²⁶⁹ Bird and Zolt, *Dual Income Taxation*, p. 13

²⁷⁰ Bird and Zolt, *Dual Income Taxation*, pp. 13-14

²⁷¹ Bird and Zolt, *Dual Income Taxation*, p.14

of African Unity (OAU) in 1963, the predecessor of the current African Union (AU). Over the years, a number of African countries have aspired to integrate their legal and economic systems, with varying degrees of success. Some of the notable recent examples include the Common Market for East and Southern African States (COMESA), which comprises of nations from east, north and southern Africa,²⁷² and in the area of legal integration, OHADA, which seeks to harmonize the business law systems of mainly Francophone African countries.²⁷³ The most ambitious of them all is the announcement by members of three major regional economic groupings – the South African Development Community (SADC), the Common Market for Eastern and Southern Africa Customs Union (COMESA) and the East African Community – to create the African Free Trade Zone (AFTZ) with the aim of establishing a single free trade zone connecting 26 African countries by 2019.²⁷⁴ While full economic and legal integration has a long way to go, one thing is certain: African countries are moving towards integration with greater urgency than ever before.

If African countries are un-integrated in their overall economies and socio-political systems, they are even more un-integrated in their taxation systems. African tax systems are more likely to have affinities with the tax systems of the United States and European countries than with one another. Ethiopia, which prides itself on not being colonized by the European powers,

²⁷² Current members of COMESA are Burundi, the Comoros, Congo (Dem. Rep.), Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe. Of the member countries, the Comoros, Congo (Dem. Rep.), Eritrea, Ethiopia, Libya, Seychelles, Swaziland and Uganda are yet to join the COMESA Free Trade Area launched at the end of October 2000; see Namubiru, *Uganda – Business and Investment*, Section 8

²⁷³ OHADA, which stands for “*Organisation pour l’Harmonisation du Droit des Affaires en Afrique*” was originally created by fourteen African countries and later on expanded to include more countries. Some of the members of OHADA include Benin, Burkina Faso, Cameroon, the Central African Republic (CAR), Cote d’Ivoire, Mali and Senegal; see Martor, Pilkington, Sellers and Thouvenot, *Business Law in Africa*, pp. 4-5

²⁷⁴ Hattingh, *South Africa – Business and Investment*, Section 8.1.2

nonetheless looked to Europe and sometimes the United States in modeling its legal system, including its tax system. The winds of influence on the modern Ethiopian legal system blew not from its proximate African neighbors but from the developed and major colonial powers of Europe.

Although the situation is changing as a result of the globalization of influence in recent times, the survey of countries sampled in this study confirms the suspicion that African income tax systems bespeak of a genealogy that is not African at all. If African countries are not integrated at all, it is legitimate to question whether it is at all necessary to enter African income tax systems in the comparison. It may even be said cynically that once we understand the structures of the UK income tax system, it is not at all necessary to hanker after the income structures of former colonies of the UK: Kenya, Uganda and South Africa.²⁷⁵ The same can be said for former colonies of France: Cameroon and Senegal. There is no question that these countries' income tax systems are heavily influenced by the income tax systems of their former colonial power, and skeptics are partly right to argue that once one has examined one system, one has examined and known all.

A survey of some African income tax systems is undertaken not with the conviction that these systems reveal unique structures of income taxation but with the assumption that all countries have some unique features from which one or two lessons can be drawn. The first lesson that is expected to be drawn from these samples is that developing income tax systems are by no means homogenous – which hopefully will put a lie to the uncritical claim that developing income tax systems should be structured in a certain way. The second lesson that should be drawn is that

²⁷⁵ Victor Thuronyi, who tried to identify the major tax families of the world, even went to the extent of declaring that the tax systems that are really worth studying to understand the rest of the world's tax system are: USA, UK, and Germany, and perhaps France as a substitute, see Thuronyi, *Comparative Tax Law*, pp. 9, 24

although African income tax systems started in a modest, strictly schedular way, they are increasingly moving towards the integration of most sources of income for purposes of taxation. The third lesson that can be drawn from this exercise is that even when income tax structures are schedular, they are not structured alike. There are alternatives along the whole spectrum of schedularization of income tax systems, and it might be instructive to take account of these options along the spectrum in order to re-imagine an income tax system like that of Ethiopia.

A quick note on the selection criteria of the seven African countries sampled here. The countries selected represent a broad spectrum of modern African society. Three are selected from former colonies of the UK: Kenya, Uganda and South Africa; two from former colonies of France: Senegal and Cameroon; and two from North African Arab countries: Egypt and Morocco. As a sample, this is quite representative of the demographics and history of Africa today. The former colonies of the UK (Kenya, Uganda, and South Africa) belong to the Commonwealth family, whose members more or less inherited the British colonial model law of 1922.²⁷⁶ The former colonies of France (Senegal and Cameroon)²⁷⁷ belong, not surprisingly, to the French family, inheriting certain structures from the French income tax system.²⁷⁸ Although Egypt and Morocco had different colonial affiliations, their association with the North African region and pan Arab movements, is something to take into account.

A word of caution in the selection of countries is in order here. Income tax systems are in general dynamic, subject as they are to varying winds of influence at different times in history. The divergences among countries of supposedly common historical heritage is a testament to

²⁷⁶ See Thuronyi, *Comparative Tax Law*, pp. 25-26

²⁷⁷ Cameroon fell under colonial administrations of Germany, and later when the Germans were defeated, France took over the administration of Eastern Cameroon and Britain the Northern and Southern Cameroons until Cameroon gained full independence in 1960 and 1961; see a *Political and Economic Dictionary of Africa*, s.v. "Cameroon, Republic of," p. 101

²⁷⁸ See Thuronyi, *Comparative Tax Law*, pp. 29-30

the fact that countries engage in their own independent reforms of one kind or another, unencumbered by historical baggage. The winds of influence flow from multiple directions, or at least history is not a spectacle in which the winds flow from one direction all the time. If the colonial powers had greater influence on the earlier evolution of income taxation, they were supplanted by far stronger forces at later stages. Miranda Stewart, who examined the influence of external forces on the landscape of tax reform in developing countries during the post WWII period, suggested in one of her articles that international financial institutions (e.g., the IMF and the World Bank) exerted decisive influence on the changing landscape of taxation in many parts of Africa.²⁷⁹

2. The Income Tax Structures of Three English Speaking African Countries: the Cases of South Africa, Kenya and Uganda

South Africa

The Republic of South of Africa has the biggest economy in Africa, with per capital income of \$ 2780 according to 2003 World Bank estimates.²⁸⁰ South Africa, perhaps not surprisingly, has distinguished itself as the country that has gotten closest to the global or comprehensive income tax model. The South African Income Tax Act defines “income” in the broadest terms as “all kinds of income possibly derived by individuals.”²⁸¹ The South African Income Tax Act identifies the broadest range of income sources and subsumes these under four major categories, namely:

²⁷⁹ See Stewart: *Global Trajectories of Tax Reform*, pp. 154-164

²⁸⁰ *A Political and Economic Dictionary of Africa*, s. vv. “South Africa, Republic of,” p. 481

²⁸¹ The actual definition runs “the amount remaining of the gross income of any person for any year or period of assessment after deducting therefrom any amounts exempt from normal tax under Part I of Chapter II;” see also Hattingh, *South Africa – Individual Taxation*, Section 1.2.1

- i) Employment income, which includes salaries, benefits-in-kind, pension income, and other forms of income associated with employments, such as stock options and termination payments;²⁸²
- ii) Business and professional income, which includes business income, professional income, partnership income, so-called other income (e.g., income from pastoral, agricultural or other farming activities);
- iii) Investment income, including dividends, interest, royalties, and income from immovable property; and
- iv) Other income, which includes proceeds from life insurance, income from lottery prizes, betting or gambling and capital gains.

The South African income tax system is also distinguished for employing withholding income taxation quite sparingly. The South African income tax law requires withholding of income tax by employers from any remuneration paid or payable to employees through the so-called PAYE scheme and that of dividends paid to non-residents.²⁸³ Unlike many of the income tax structures sampled in this study, South Africa does not require withholding of income tax against interest, dividends and royalties.²⁸⁴

Kenya

Kenyan Income Tax Act requires the aggregation of income of individuals from all sources identified in the Income Tax Act, namely business income, employment income, income from

²⁸² Hattingh, South Africa – Individual Taxation, Sections 1.3.1 – 1.3.4

²⁸³ Id, Section 1.10.3 and Section 6.3.1.3

²⁸⁴ Id, Section 1.9.2

property, dividend and interest income, farming income and pension income.²⁸⁵ At the bottom, however, the Kenyan income tax is underpinned by a schedular structure of income taxation. The computation of income and tax is done source by source, which introduces strong schedular elements into the tax system in spite of the concessions of aggregation of income at the end.²⁸⁶ Separate computation is prepared for each category of income identified in the Kenyan Income Tax Act, and any expenses incurred in respect of each source or category is deducted in principle from that source of income only.²⁸⁷

At times, the convenience of withholding taxation takes precedence over the need for aggregation. Certain types of income are subject to withholding taxes, which are considered final. Withholding taxes upon dividends and interest are considered final, which means that these are not aggregable with the income from other sources.²⁸⁸ Kenya treats tax withheld from employment income by employers as final if the individual's income consists solely of employment income.²⁸⁹

Uganda

Uganda has also moved increasingly towards the ideal of aggregating income from all sources for purposes of computing income tax liability of individuals.²⁹⁰ Ugandan Income Tax Act

²⁸⁵ Omondi, Kenya – Individual Taxation, Section 1.2.1; see also Article 3(2) of Kenyan Income Tax Act Cap. 470, Article 3(2) available at www.eac.int/customs/index.php?option=com_docman&task...last accessed on August 06, 2012

²⁸⁶ Omondi, Kenya – Individual Taxation, Section 1.2.1

²⁸⁷ Ibid

²⁸⁸ Id, Section 1.10.2

²⁸⁹ This became operational as of 2011; see Omondi, Kenya – Individual Taxation, Section 1.10.2

²⁹⁰ Namubiru, Uganda – Individual Taxation, Section 1.2.1; see also Ugandan Income Tax Act, Cap. 340, Article 17, which defines gross income as “total amount of a) business income; b) employment income; and c) property income, derived during the year by the person, other than income exempt from tax”; available at ww.opm.go.ug/assets/media/resources/.../INCOME%20TAX%20ACT.p...last accessed August 21, 2012

requires computation of tax on the basis of the total or aggregate income of individuals before the progressive income tax rate is applied.²⁹¹ Perhaps even more than the Kenyan income tax, however, the Ugandan income tax system retains significant features of schedular income tax systems. Unlike the Kenyan Income Tax law, for example, Ugandan income tax has a separate schedule and tax rate structure for rental income.²⁹² While income from business, employment and property (the three major categories identified as sources of income in Uganda) should be aggregated in principle for purposes of computation of the income tax, rental income is to be treated separately, subject to a separate rate structure under the Ugandan income tax system.²⁹³ Uganda also retains many forms of final withholding taxes upon certain investment income sources, namely dividends and interest.²⁹⁴ Like Kenya, Uganda does not require employees to file self-assessment tax returns if their income consists exclusively of employment income.²⁹⁵

For more see Table 3.2 below

3. The Income Tax Structures of Two Francophone African Countries: Cameroon and Senegal

Cameroon

From the Francophone countries, Cameroon has come to increasingly represent the movement towards “globalization” of individual income tax systems in Africa. Cameroon, which until 2004 applied a schedular income tax structure popular among the Francophone countries (i.e., the

²⁹¹ Namubiru, Uganda – Individual Taxation, Section 1.2.1

²⁹² Ibid; see Ugandan Income Tax Act, Cap. 340, Article 5; see also Ugandan Income Tax Act, Cap. 340, Articles 5 and 6, and Third Schedule, Part VI

²⁹³ Namubiru, Uganda – Individual Taxation, Section 1.2.1 and 1.9.1 ; see Ugandan Income Tax Act, Cap. 340, Article 5

²⁹⁴ Namubiru, Uganda – Individual Taxation, Section 1.9.2

²⁹⁵ Namubiru, Uganda – Individual Taxation, Section 1.10.2

application of proportional tax upon each category of income first and then the application of progressive surtax upon the total net of income), introduced a personal income tax system which is distinguished by its requirement of applying one progressive income tax rate upon the aggregate of income from all the six categories identified in the Cameroonian Income Tax Law.²⁹⁶ The six categories of income are:²⁹⁷

1. **Income from employment**, which includes wages, salaries, pensions and life insurance;
2. **Income from movable property** (*revenus de capitaux mobiliers*), which includes income from shares, bonds, debentures, income from debt claims and capital gains realized on the transfer of shares, bonds and the like;
3. **Real estate income** (*revenus fonciers*), which includes rental income and capital gains from developed and undeveloped property, and dividends distributed to members of civil enterprises dealing with property but opting out of the corporate income tax;
4. **Income from artisanal, industrial and commercial activities**, which includes profits realized by mines and quarry agents, persons renting mines in exchange for royalties, the income of non-salaried commercial agents;
5. **Income from agriculture**, which includes the income of individual farmers and share-croppers; and

²⁹⁶ Almeida, Cameroon – Individual Taxation, Section 1.2.1

²⁹⁷ Ibid

6. **Income from non-commercial professional activities** (*benefices des professions non commerciales et assimilées*), which includes income generated by liberal professionals and non-trading agents, non-salary income of sportsmen and artists, and all income from activities not falling under any other income category (e.g., royalties from literary and artistic work, and royalties from the use of trademarks, licenses and production formulae)

Senegal

The other Francophone country sampled in this study – Senegal²⁹⁸– has retained much of its Francophone heritage in income taxation. Senegalese income tax system is underpinned by a foundation of a schedular income tax system in the sense that each category of income identified in the Senegalese income tax system is first subjected to a proportional income tax rate.²⁹⁹ The categories identified as separate under the Senegalese income tax system are employment income, business and professional income and investment income.³⁰⁰ The taxable income in each category is the difference between gross income from that category less expenses incurred in the course of acquiring or preserving the relevant income. The computation of taxable income is done in accordance with each category’s rules.³⁰¹ All these elements of the Senegalese income tax system imply strong features of a schedular income tax system. The Senegalese income tax system is also a composite of a global income tax system in some senses. The global progressive

²⁹⁸ Senegal was a French colony until independence in 1960; see a Political and Economic Dictionary of Africa, s. vv. “Senegal, Republic of,” p. 457

²⁹⁹ Barry, Senegal – Individual Taxation, Section 1.2.1

³⁰⁰ Id, see Sections 1.3 – 1.6

³⁰¹ Id, Section 1.2.1

tax rates apply upon the aggregate of incomes from all categories once the taxable net income from each category is determined.³⁰²

4. The Income Tax Structures of two North African Arab Countries: Morocco and Egypt:

Morocco

Morocco's income tax system retains some strong elements of schedular income tax structures. Morocco's income tax system identifies five different categories (or schedules) for the income tax (i.e., business income, wages and salaries, agricultural income, income and profit from rent and income and profit from movable capital) and requires a separate computation of net income for each category. Expenses incurred in one category are not deductible from income from a different category.³⁰³ At least one form of investment income – dividends – is subject to a final withholding tax of 10%.³⁰⁴ Interest income is also subject to a final withholding tax under certain circumstances.³⁰⁵ However, Morocco's income tax system evinces at least some elements of a global income tax structure in the sense that at the end of the day tax is imposed upon the total net income of the individual from all sources or categories identified under Morocco's income tax laws.³⁰⁶

³⁰² Id, Sections 1.2.1 and 1.9.1.1

³⁰³ Benchekroun, Morocco – Individual Taxation, Section 1.2.1

³⁰⁴ Id, Section 1.5

³⁰⁵ Ibid

³⁰⁶ Id, Section 1.2.1

Egypt

Egyptian income tax system retains the schedular income tax system for purposes of computing net income in each category of income identified under the Egyptian income tax laws.³⁰⁷

Egyptian income tax system has identified four broad categories of income for purposes of taxation, namely employment income, business income, non-commercial income and income from real estate assets.³⁰⁸ Under Egyptian income tax laws, non-commercial income includes income of professionals who are registered as active members of a professional association, income of individuals who write and translate books, income of members of teaching staff of the universities from the sale of books initially printed for distribution to students and income of members of artists from painting, sculpting and engraving activities.³⁰⁹

While the net income from each category is calculated separately according to the rules laid down for each category, Egyptian income tax system shows strong elements of a global income tax system in the sense that at the end of the day the aggregate of the four categories is subject to progressive tax rates which range from 0 to 25%.³¹⁰

³⁰⁷ Ibid

³⁰⁸ Ibid

³⁰⁹ Id, Section 1.2.2.3

³¹⁰ Hamzaoui, Egypt – Individual Taxation, Section 1.9.1.1

Table 3.2: Income Tax Structures of Seven African Countries

Country	Gross Income and Categories of Income	Computation	Categories of Income Identified	Final withholding taxes
Kenya	Find definition. Business income; employment income, income from property; dividend and interest income; farming income and pension income	Income computed source by source; in other words, separate computation is prepared for each source and any expenses incurred are deducted in principle from that source only (e.g., business expenses not deductible from rental income)		Dividends; interest
Uganda	Gross income is the total amount of a) business income; b) employment; Business income; employment income and	Computation by source; and rental income is taxed under a separate schedule and is not included in gross income		Dividends and interest

	property income			
South Africa	Gross income includes all kinds of income possibly derived by individuals	Differentiation among various sources income made for purposes of deducting expenses, attribution or income-splitting and some administrative aspects applicable to some source of income	Employment income; Business and professional income; Investment income; and other income	Dividends paid to non-residents
Senegal		Individuals subject to double layer of taxation. Each category of income is subject to special tax rules for the purposes of determining the tax base. A specific tax rate applies on net taxable income for each category. And the taxable net income for	Employment income; Business and professional income; Investment income	Dividends; Interest

		each category is then aggregate and subject to progressive tax rates.		
Cameroon	As of January 2004 on total annual individual income	Personal income tax levied on the taxpayer's total net annual income after deducting a lump sum amount of F.CFA 500, 000. The total net income is the sum of the taxpayer's net income from each of the six income categories. The net income from each category is the gross income less expenses incurred in generating the income in question.	Six categories: <ol style="list-style-type: none"> 1. Wages, salaries, pensions and life annuities; 2. Income from movable capital; 3. Real estate income; 4. Income from artisanal, industrial and commercial activities; 5. Income from agriculture; 6. Income from non-commercial professional activities; 	
Morocco	Total income of the individual	Net income for each category is calculated	Business income; Wages and salaries; Agricultural income;	

	from business income, wages and salaries, agricultural income, income and profit from rent and income from movable capital	separately	Income and profit from rent and Income and profit from movable capital	
Egypt	Total net annual income derived in Egypt	Net amounts from each category computed separately	Four categories: 1. Employment income; 2. Business income; 3. Non-commercial income 4. Income from real estate assets	

Country	Non-final withholding taxes	Global elements (if any)	Remarks
Kenya	Royalties; Insurance commissions; Contractual fees	Kenyan income tax law requires aggregation of net income from almost all sources after separate computation of income	Individuals whose income consists exclusively of employment

		from the different schedules.	income are not required to submit self-assessment returns
Uganda	Management or professional fees; All payments by government institutions	Ugandan income tax system requires aggregation of individual income from all sources except income from rental of property and income subject to final withholding taxes	Individual whose sole income consists exclusively of employment income need not submit self-assessment income tax returns
South Africa	None	South African income tax system is global in many respects	South Africa does not employ withholding schemes on dividends, interest and royalties paid to residents and instead includes them in their individual income
Senegal	In Senegal, the individual income tax applies in two steps: A proportional tax on each	Both schedular and global features	Senegal is a Francophone country and its income tax

	category of income and then a progressive tax rate on the aggregate income		structure follows the double layered income taxation of Francophone countries in general
Cameroon	Dividends; Interest; Royalties; Income from immovable property	Global in features	Cameroon replaced its French income tax structure by its current global income tax structure in 2004. Prior to 2004, Cameroon applied a proportional tax on each category of income and a graduated surtax on total income.
Morocco	Dividends	Global in aggregation and schedular in computation of net income from each category	
Egypt		Egyptian income tax has global outlooks in the sense that progressive	

		tax rates apply upon the aggregate of the four categories, but it remains schedular in the computation of net income from each category	
--	--	---	--

Source: Summarized from, Country Surveys, IBFD, Amsterdam

5. Some Concluding Remarks on Income Tax Structures in Africa

The survey of seven African income tax structures at the moment shows the incredible diversity of income tax structures even within the schedular income tax systems. None of the countries that supposedly should have exhibited common income tax features has any common structures, although certain sources of income tend to recur in all of the income tax structures.

Even countries that were close historically and politically (e.g., Kenya and Uganda) have evolved income tax structures that are unique to each country. That is presumably because tax reforms in general and income tax reforms in particular follow routes that are not preordained by historical or political relationships. Since African countries are some of the least integrated in the world, it is not at all surprising if we meet with incredible diversities across nations in Africa. Many of the countries are members of either regional or continental economic and political groupings, but these aspirations of integration have not yet reached a point at which the income tax structures of African Countries have developed structures that are similar on fundamental issues.

However, while the differences are significant, the similar tendencies are also noticeable. Many of the countries have taken significant steps to integrate income tax sources for an application of

taxation on the aggregate. In this regard, South Africa has gone farther than any of these countries as to place itself in the camp of global income tax structures. Other countries have also taken steps towards the “globalization” of their income tax systems.

It can also be seen that schedular income tax systems are by no means homogenous. Even among countries that are found in similar economic circumstances, some countries have taken steps to superimpose global income tax structures over the underlying schedular income tax systems. These structural qualities of African income tax systems put a lie to the widely held belief that developing countries could do nothing more than collecting income taxes at the easiest points possible and not worry for the moment about the inequities of such income tax structures.

In this survey, we have only looked at the income tax structures, and we have made assumptions that the income tax structures are being implemented according to the rules laid down in the income tax laws of these countries. We know that the income tax structures as they are implemented on the ground diverge quite significantly from the income tax rules in the books. However, having the right kind of rules is the first important step to change, regardless of whether it materializes immediately or not. At the minimum, the existence of the legal framework will provide an impetus for a change on the ground.

A notable development of many of the income tax structures sampled in this study is the increasing move towards the aggregation of the total income of individuals for purposes of computation of the income tax. While many of the income tax structures still retain significant features of a schedular income tax system, the fact of the matter is that these income tax structures have also reorganized and restructured the income tax structures so as to compute

income tax on the basis of the aggregate income of an individual rather than on the basis of the income derived from each source.

There are still some significant relics of the schedular income tax structures in many of the countries sampled for this study. These relics are:

- i) The employment of withholding schemes as final taxes on specific investment income sources, such as dividends, interest and royalties;
- ii) The retention the schedular income tax structure (at least in modified forms) for purposes of computation of net income from each of the categories or sources identified as targets for income tax purposes; in other words, all of the income tax systems sampled in this study require the netting of expenses against only the income of each category.

CHAPTER FOUR

GENERAL INTRODUCTION TO THE ETHIOPIAN TAX INCOME TAX SYSTEM

I. Introduction

The “Ethiopian income tax system” is a loose assortment of a number of income taxes related rather tenuously by the common term “income.” At present, the Ethiopian income tax system is comprised of four separate income tax regimes, with their own distinct legal and administrative frameworks:

- i) The main income tax system, consisting of four separate schedules;
- ii) The agricultural income tax systems, which are constitutionally thoroughly decentralized to the Regional Governments at the moment;
- iii) The mining income tax system, regulating taxation of income from the extraction of minerals, except petroleum;
- iv) The petroleum income tax system, regulating taxation of income from the extraction of petroleum;

With the exception of agricultural income tax systems, which are currently the exclusive preserve of the Regional Governments, all the other income tax systems are administered at both the Federal and Regional levels, although the same income base is rarely subject to overlapping jurisdictions. The Constitutional distribution of revenue powers over income taxes is such that the same source of income is sometimes allocated to the Federal Government and the Regional Governments based on criteria like the identity of an employer or the organization

of a business. Jurisdiction over personal income taxes (on employment income) on federal employees is, for example, assigned by the Ethiopian Constitution to the Federal Government, as jurisdiction to tax over the employment income of Regional government employees and all employees of the private sector is allocated to Regional Governments.¹ Jurisdiction over the income of businesses is allocated on the basis of the nature of the business organizations. Taxation of the income of sole proprietor businesses is the exclusive preserve of the Regional Governments; taxation of the income of businesses organized as companies is the concurrent jurisdiction of the Federal and Regional Governments; taxation of state-owned enterprises is the jurisdiction of the Federal Government if the Federal Government owns those enterprises and of the Regional Governments if Regional Governments own the enterprises.² This formula of revenue power distribution is followed in the Constitution in all other sources of income (**see Table 4.1 below**).

Table 4.1: The Constitutional Assignment of Major Income Tax Sources

Major Categories of income	Source of income	Jurisdiction
Taxation of income from employment (Schedule “A”)	Taxation of income from employment	
	Federal Government Employees	Federal Government

¹ See The Constitution of Ethiopia, Articles 96 (2), 97 (1); see also Taddese Lencho, *The Ethiopian Tax System: Excesses and Gaps*, p. 330

² See The Constitution of Ethiopia, Article 96 (3), 97 (4) and (7)

	Employees of international organizations	Federal Government
	Employees of Regional Government	Regional Governments
	Employees of Private Enterprises	Regional Governments
Taxation of Income from Rental of Buildings (Schedule "B")		
	Buildings owned by the Federal Government	
	Buildings owned by the Regional Governments	
	Buildings held by private enterprises and individuals	
Taxation of Business Income (Schedule "C")		
	Business profits of companies	Concurrent
	Business profits of sole proprietorships	Regional Governments
Taxation of "Miscellaneous Income" (Schedule "D")		

	Income from Technical Services rendered abroad	Federal Government
	Income from games of chance	Federal Government
	Dividends	Concurrent
	Interest on bank deposits	Federal Government
	Capital gains	
	From transfer of shares	Concurrent
	From transfer of buildings	Regional Governments ³
Taxation of income from agricultural activities	Land use fees and income from agricultural activities	Regional Government
Taxation of income mining activities	Income from large-scale mining activities	Federal Government
	Income from small-scale mining activities	Regional Governments

Source: The Constitution of Ethiopia, Articles 96-98

The Federal Government (of Ethiopia) has issued a number of income tax laws on all but one source of income taxation in Ethiopia – i.e., income from agricultural activities.⁴ Owing to the preponderance of the Federal Government in income tax legislation, federal income tax legislations tend to cover income source grounds that are reserved by the Ethiopian Constitution

³ Except when buildings are owned by the Federal Government in which case the Federal Government gets to levy the tax

⁴ See Mining Income Tax Proclamation No. 53/1993 (as amended by Mining Income Tax (Amendment) Proclamation No. 23/1996); Petroleum Income Tax 296/1986; Income Tax Proclamation No. 286/2002

to the Regional Governments and as such have informally served as “common law” of income taxation for many Regional Governments in Ethiopia.⁵ Many of the Regional Governments have formally issued their income tax legislations over sources over which they have jurisdiction, but the Regions have carefully toed the lines already drawn by the Federal Government with the result that Regional Government income tax laws are at times indistinguishable in content from Federal income tax laws. Thus while the Constitution can potentially result in the explosion of various income tax systems in Ethiopia, the income tax system at present exhibits incredible unity, as whatever the Federal Government proposes is likely to be echoed and disposed by the Regional Governments, which are heavily dependent upon the former.

The dominance of the Federal Government in income tax legislation should have boded well for projecting a unified and organized income tax system. But the Ethiopian income tax system is anything but unified and organized. Apart from its strictly schedular approach to income taxation, a number of factors have conspired to create a highly disorganized landscape of income taxation in Ethiopia. Even the main income tax system of Ethiopia does not exhibit the level of unity and organization that is normally expected from a single piece of legislation. The piecemeal revision and accretion of individual income tax legislations with little thought for the impact of amendments upon the whole body of the income tax system and the proliferation of subsidiary pieces of income tax legislations and rules whose legal status is sometimes contested have all contributed to an income tax system that is, to put it mildly, shabbily organized.⁶

In terms of major heads of income, the Ethiopian income tax system is at the moment composed of four major bodies of income tax laws:

⁵ See Taddese Lencho, *Income Tax Assignment under the Ethiopian Constitution*, pp. 43-45

⁶ See Taddese Lencho, *The Ethiopian Tax System: Excesses and Gaps*, pp. 354-356

- a. Agricultural Income Taxes
- b. Petroleum income Taxes
- c. Mining Income Taxes; and
- d. The Main Income Tax System

Petroleum and mining income tax laws exhibit substantial affinities with each other in content, in administration, etc., a fact that justifies their treatment together. We shall give an overview of these income tax regimes below.

a. Agricultural Income Taxes

With the exception of the brief period between 1967 and 1975, agricultural income taxes have constituted autonomous income tax regimes throughout the modern history of taxation in Ethiopia.⁷ In a country dominated by agricultural production, this is hardly surprising. The agricultural sector has been the mainstay of the Ethiopian economy, with more than 80% of the population living directly off agriculture in one form or another. Paradoxically, in no time during the modern history of taxation has agricultural income been the main source of taxation for the Governments of Ethiopia.⁸

Owing to the political sensitivities of the agricultural sector in Ethiopia, successive Ethiopian Governments have stipulated special rules of assessment and collection of tax on income of farmers and farming communities. The income brackets and tax rates have also been different and in many instances lower than the income brackets and tax rates of the main income tax

⁷ Between 1967 and 1975, agricultural income taxation was briefly incorporated into the main income tax system of Ethiopia, forming at the time Schedule “D” of the Income Tax; see Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, p. 120.

⁸ See Eshetu Chole, *Towards a History of the Fiscal Policy of the Pre-Revolutionary Ethiopian State*, p. 67

system. In times when Ethiopia had unitary forms of governments, one agricultural income tax law, amended from time to time, served as a legislative basis for taxation of agricultural income throughout the country. With the adoption of a federal form of government in 1991, the jurisdiction over agricultural income taxes has gone to the Regional Governments.⁹ This is quite unlike many other sources of income, which are often administered at both the Federal and Regional Government levels.

Decentralization of agricultural income tax system in Ethiopia has resulted in wide diversity in the modes of taxation in recent times. Many of the Regions initially followed the progressive agricultural income tax system inherited from the agricultural income tax system in place since 1976 (when Ethiopia was a unitary state). Some Regions have in recent times reverted to a cruder form of agricultural income taxation based on the size of land holding rather than the amount of annual agricultural production. For example, the Oromia Regional State (the largest and most populous region in Ethiopia) initially adopted a progressive agricultural income tax system, but replaced this practice with an agricultural income tax system based on the size of landholding, rather than the amount of agricultural produce.¹⁰ The tax base of agricultural income taxation in Benishangul-Gumuz and Gambella is the annual agricultural produce (and therefore predictably varies from year to year), while in Regions like Tigray and Harari, the tax is fixed on the basis of the size of land holding.¹¹ In some regions, the tax burden varies with the specialty produce of the area, its location or the kind of production.¹² For example, in Southern

⁹ See The Constitution of Ethiopia, Art. 97(3)

¹⁰ See Deso Chemed, Taxation of Agricultural Income and Rural Land Use Payment, note 34, pp. 37-48; see Oromia National Regional Government Rural Land Use Payment and Agricultural Income Tax Amendment Proclamation No. 99/2005

¹¹ See The Federal Budget Grant Distribution Formula, pp. 20-21

¹² See id, p. 21

Nations, Nationalities and Peoples Region (SNNPR), higher rates of agricultural income tax are imposed on holders of land used for *chat* or coffee production,¹³ taking obviously into consideration the higher market value of these commercial crops. In any case, the agricultural income tax systems of Ethiopia are thoroughly decentralized in Ethiopia, with all the inevitable diversities in modes of agricultural income taxation in various regions of the Ethiopian federation.

b. Petroleum and Mining Income Tax Regimes

Income from petroleum became a subject of income taxation long before any sign of a petroleum discovery in Ethiopia. In 1986, the Ethiopian Government at the time introduced a special income tax for companies involved in petroleum exploration and extraction not really anticipating any revenue from the sector at the time (there were none) but with the hope of luring mainly foreign companies into petroleum exploration in Ethiopia. The petroleum income tax law of 1986 (as amended) as such is replete with concessions of one kind or another for companies willing to invest, explore and extract petroleum in any part of Ethiopia. Nearly three decades later, the prospect of finding petroleum in Ethiopia seems as distant as ever – the well-meaning concessions of the 1986 petroleum income tax law notwithstanding.

The mining income tax law was surprisingly introduced later than petroleum income tax – in 1993 – but the mining income tax law of 1993 bears every resemblance in substance to the petroleum income tax law of 1993, except that the mining income tax law of 1993 applies to the exploration and extraction of all kinds of minerals save that of petroleum.¹⁴ Unlike the

¹³ See *ibid*

¹⁴ See Mining Income Tax Proclamation No. 53/1993; Mining Proclamation 52/1993

petroleum income tax law, the mining income tax has had some practical significance at both the Federal and Regional levels. The Federal Government has the constitutional mandate to administer mining income tax over large-scale mining activities (mainly companies) and the Regional Governments administer the tax over small-scale mining activities, including mining at artisanal levels.

Like the agricultural income tax laws, both petroleum income tax and mining income tax laws are *sui generis* income tax laws, with little to partake from the main income tax law of Ethiopia. They have their own definitions (and special definitions as that) of taxable income, gross income, revenue expenditure, depreciation, reinvestment deduction and permitted losses.¹⁵ For example, the mining income tax law permits depreciation allowance at a straight-line deduction over the useful life of all capital expenditures and pre-production costs for four consecutive years.¹⁶ The mining income tax law also allows deduction of reinvestment income (5% of the gross income of the mining company) if the company wishes to reinvest its profits, and more importantly, there are rules for deduction of financial losses and physical losses, in the former case allowing the mining company a carry-forward of its losses for ten consecutive accounting years.¹⁷

c. The Main Income Tax System

The main income tax system is labeled “main” because it covers most other sources of income in Ethiopia and constitutes the major source of revenue in the area of income taxes in general. The

¹⁵ See Mining Income Tax Proclamation No. 53/1993 (as amended by Mining Income Tax (Amendment) Proclamation No. 23/1996), Articles 4, 7, 8, 9 and 10

¹⁶ See Mining Income Tax Proclamation No. 53/1993 (as amended by Mining Income Tax (Amendment) Proclamation No. 23/1996), Article 8

¹⁷ See *id.*, Article 10 and compare that with Article 28 of the Income Tax Proclamation No. 286/2002

chief legislative authority for the main income tax system at present is the Income Tax Proclamation of 2002 (as subsequently amended). The Income Tax Proclamation is flanked by one Income Tax Regulation (issued in the same year – 2002), a number of subsequent amendments, countless directives, circulars, letters, and income tax forms issued from time to time by the Council of Ministers, the Ministry of Finance and Economic Development and Ethiopian Revenues and Customs Authority (ERCA), among others.

The Income Tax Proclamation of 2002 stipulates most of the substantive and procedural rules pertaining to the income taxation of the four Schedules. At a distance, the main income tax law of Ethiopia may look like a unified law of income taxation, but upon closer reading, it is really a collection of “income taxes” – as much as a dozen separate income taxes, indeed, if we count the miscellaneous sources of income subject to withholding under Schedule “D”.

Officially, the main income tax system of Ethiopia consists of four Schedules:

Schedule “A” – income from employment (employment income tax);

Schedule “B” – income from rental of buildings (rental income tax);

Schedule “C” – income from business (business profit tax);

Schedule “D” – miscellaneous income (other income) – royalties, income from technical services rendered abroad, income from games of chance, income from dividends, income from interest on a bank deposit, income from casual rental of property, income from

transfer of investment property (capital gains on transfer of shares and of buildings held in business), and income from windfall profits.¹⁸

If we count individual sources rather than the official schedules, we will notice that the main income tax system alone is comprised of more than a dozen income taxes conveniently collected in one piece of major income tax legislation. Individuals (and perhaps associations of persons)¹⁹ are subject to progressive income tax rate structures if their incomes fall either under Schedule “A”, Schedule “B” or Schedule “C”. Individuals who derive income from sources falling under Schedule “D” are subject to flat and final withholding income taxation in most cases, with the exception of capital gains on transfers of shares and buildings, which are subject to self-assessment taxation.

The main income tax system of Ethiopia embeds the taxation of the income of companies (or corporations) in the income tax proclamation. Companies, as in many other countries of the world, are subject to a separate income tax in Ethiopia, and shareholders are subject to a withholding taxation when companies distribute dividends to them. Companies are subject to a flat tax rate (currently 30%), but the rules (in respect of, for example, computation of gross and taxable income, deductions and assessment) that apply to taxation of companies are by and large the rules that apply to individuals. Ethiopia does not have separate income tax regimes for companies.

¹⁸ All but one of the miscellaneous sources were incorporated in the Income Tax Proclamation No. 286/2002; the item “windfall profits” was added by an amendment in 2010; see Income Tax (Amendment) Proclamation No. 693/2010

¹⁹ The status of “associations of persons,” such as business partnerships, is not explicitly regulated by the income tax laws of Ethiopia, although there are embryonic hints to the effect that these associations would be treated as transparent entities as in many other income tax systems; for the comparative treatment of partnerships in income taxation, see Ault and Arnold, *Comparative Income Taxation*, pp. 418-428

We must also remember that some of the schedules of Ethiopian income tax (Schedules B and C) have categories of taxpayers, classified for purposes of book-keeping obligations on the basis of the annual volume of turnovers and the organization of businesses. Taxpayers whose annual volume of turnovers exceeds half a million Birr and all companies (regardless of turnovers) are classified as Category A; taxpayers whose annual volume of turnovers is in excess of hundred thousand Birr but less than half a million Birr are classified as Category B taxpayers, and taxpayers whose annual volume of turnovers is less than hundred thousand Birr are classified as Category C taxpayers.²⁰ Category A and Category B taxpayers have income tax book-keeping obligations while Category C taxpayers are currently subject to a presumptive income tax regime called standard assessment.²¹

To sum up, if we count all the individual sources, categories as well as the companies that are subject to separate tax rates, we will realize that the Ethiopian income tax system is a collection of a number of income taxes rather than an “Income Tax” in a capital and strict sense of that expression. What confers a system upon it is not the application of some common and general rules upon all sources of income but reference to a common legal text, which is at the moment the Income Tax Proclamation of 2002(as amended).

²⁰ See Income Tax Regulations No. 78/2002, Article 18

²¹ See Income Tax Proclamation No. 286/2002, Article 66; Income Tax Regulations No. 78/2002, Article 19

II. The Concept of Income in the Ethiopian Income Tax System: the Comprehensiveness of the Notion of Income and Its Limitations

a. The Legal Notion of Income

In the definition of “income” for income tax purposes, Ethiopian income tax law appears at first to endorse the accretion notion of income. In Article 2(10), “income” is defined very broadly as:

... every sort of economic benefit including nonrecurring gains in cash or in-kind, from whatever source derived and in whatever form paid credited or received.

If we juxtapose this definition with that of the classic accretion concept of income (for example, that of Robert Haig “*income is the money value of the net accretion to one’s economic power between two points of time*”), we will realize that there is not much to pick between the definition of “income” in the Ethiopian income tax law and that of model definitions of income based on the concept of accretion. The semantic construction of the definition of income in the Income Tax Proclamation is broad enough to capture all “economic benefits” in the classic sense of the accretion concept of income.

First, the definition is broad enough to capture all “economic benefits.” Although the phrase “economic benefits” is nowhere defined either in the Income Tax Proclamation itself or in other pieces of legislation in Ethiopia, the intention is clearly to capture all “economic benefits,” to the extent possible. What Henry Simons called “the essential connotation of income,” namely “gain to someone during a specified period and measured according to objective market standards”²² is captured in a different language in the definition of income in the Income Tax Proclamation.

²² See Simons, *Personal Income Taxation*, p. 51

Second, the definition sets aside the requirement of “source” as a key to the notion of “income.” In view of the historical affiliation of Ethiopian income tax system with that of the UK, where the doctrine of source played an important role in setting limits to the income tax, the language of the definition of income in the Proclamation may strike us as a departure from the shackles of source. Of course, it may even be argued that the Ethiopian Income Tax Proclamation uses “from whatever source,” which may be read as simply saying the source of income is irrelevant as long as there is a source. What the phrase “from whatever source” may mean is a matter of pure speculation as there are no cases in which courts, as in the UK and other countries, asserted that notion of “source” is important to the definition of “income.”

Third, the notion of income according to the pure language of the definition of “income” does not appear to stand on ceremonies of “recurrence in gains.” The phrase in the definition “including non-recurring gains in cash or in-kind” is intended to include all gains or economic benefits regardless of whether these gains are recurrent or non-recurrent. We can infer from the strong phrase that it would be of little consequence whether the economic benefits are a one-in-life time gains (e.g., income from gambling or even capital gains) or flow from the usual sources of income like employment or business activities.

Fourth, the phrase in the definition “in what ever form derived, credited or paid” seems to imply that Ethiopian income tax law considers as income not just receipts in cash but also “imputed income,” and “income received in kind.” If we don’t know much about the contents of the Ethiopian income tax system in law and practice, we are inclined to accept this comprehensive meaning of income. Of course, we quickly realize that this is simply too good to be true in Ethiopian context.

b. Limitations on the “Comprehensiveness” of the Notion of Income

The existence of a sweeping, all-embracing definition of income in the Ethiopian income tax law could potentially have paved the way for Ethiopian courts to extend the reach of the income tax to sources and forms of income that were not explicitly mentioned in the schedules, as was the case, for example, in the United States, where the concept of accretion was developed by courts to capture “unconventional” sources of income.²³ Such a definition will, however, remain valid only if we operate behind the veil of ignorance and imagine the reach of the Ethiopian income tax system in the abstract. And it is not long before we shed this veil of ignorance and dismiss the sweeping definition of income as a chimera.

The comprehensive definition of income in the Income Tax Proclamation has never been a reliable gauge of the actual income tax base of the Ethiopian income tax system. This is for a number of reasons.

In no time in the modern history of Ethiopian income taxation have the tax authorities and courts in Ethiopia invoked this comprehensive definition to capture sources of income not already explicitly or implicitly mentioned in the individual income tax schedules. Instead, the tax authorities, and by extension, the courts in Ethiopia chose to tread the narrow line of the schedules and ensured that the reach of the income tax was restricted to the usual suspects – the sources explicitly mentioned in one of the schedules of Ethiopian income tax.

²³ The U.S. Supreme Court adopted the “accretion” concept of income in *Commissioner v. Glenshaw Glass Co.*, in which it defined income as “undeniable accessions to wealth, clearly realized, and over which ... taxpayers have complete dominion.” see *Commissioner v. Glenshaw Glass Co.*, 252 U.S. 189, 207 (1920), cited in Postlewaite, Problems and Materials in Federal Income Taxation, p. 236 ; see also Thuronyi, Comparative Tax Law 235

There aren't many cases in which courts pronounced their positions on income sources not explicitly covered by schedules, but at least one case provides a perfect illustration of the conservative positions taken by courts as well as the tax authorities. In ***Shell Ethiopia Ltd. v. IRA***,²⁴ the Inland Revenue Authority (IRA) attempted to impose income tax upon an interest accruing upon a provident fund set up for the benefits of employees of Shell Ethiopia. IRA argued that Shell Ethiopia should have reported the interest accruing on the provident fund and withheld tax as the interest constituted income under Ethiopian income tax law.²⁵ Shell Ethiopia Ltd. concurred with the IRA that the interest theoretically fit in the definition but denied any obligation to withhold tax on the said interest. The Supreme Court at the time cited the definition of income in the law and agreed that it was income.

Although all parties were in agreement as to the fact that the interest accruing on a provident fund was income, the necessity of fitting the interest in one of the schedules brought the whole reasoning to a screeching halt. The IRA felt the need to fit in the interest in one of the schedules of Ethiopian income tax law and argued strenuously that the interest paid on a provident fund was an income from employment as much as the salaries paid by Shell Ethiopia to its employees. The Supreme Court disagreed and found that the interest paid on the provident fund was interest for the loan extended to Shell Ethiopia by its employees and did not arise from the performance of employment services by employees. In effect, the decision of the Supreme Court threw the ball back to the tax authorities to show that this was a taxable source no matter what

²⁴ ***Shell Ethiopia Ltd. v. Inland Revenue Administration***, Civ/App/File/No. 763/78, in Amharic, unpublished

²⁵ The definition of "income" has changed very little over the years. The 1961 Income Tax Proclamation, for example, defined income as "every sort of revenue, from whatever source derived and in whatever form paid, credited or received, which has its origin within Ethiopia, irrespective of whether it is paid, credited or received within or without Ethiopia;" see a Proclamation to Provide for Payment of Income Tax No. 173/1961, Article 3(e) (now repealed)

the expansive definition of income implied. The Authorities were unable to prove that this was a recognized source of income according to the existing schedules and failed in their bid to capture income in accordance with the definition of income.

The trajectory of income tax reforms of Ethiopia provides another evidence of how narrowly incomes were defined in the Ethiopian income tax system, despite what the generality of the definition of income implied. Whenever the Governments of Ethiopia felt the need to expand the reach of the income tax to sources that were not explicitly covered in the existing schedules, they introduced specific tax bills that covered new sources of income.²⁶ In no case did the tax authorities attempt to expand the reach of the income tax through judicial extension of the reach of the income tax. Many specific sources of income that have now become such an accepted component of the income tax system – dividends, lottery income, royalties, income from casual rental of property, interest, capital gains, and most recently windfall profits – did not become chargeable with income tax until the Ethiopian legislatures introduced income tax amendments to incorporate these new sources of income. Income from dividends, lottery winnings, royalties, casual rental of property did not become chargeable with income tax until an amendment was introduced to the income tax in 1978.²⁷ Capital gains did not become chargeable until the Government of Ethiopia introduced an income tax amendment in 1994.²⁸ Windfall profits were not even known as sources until the Government realized that its abrupt devaluation of currency

²⁶ The 1978 Income Tax Amendment was an exception in this regard, but its attempt to capture all sorts of income went unnoticed. The 1978 Income Tax Amendment Proclamation expanded the traditional reach of Schedule “C” of the Income Tax (which was mostly intended for income from business activities) by turning it into a catch-all-basket of all income not mentioned in any of the other schedules and laws of Ethiopian income tax system. The use of catch-all-basket to capture unmentioned sources did not take root in the practice of income taxation; the catch-all-basket provisions have disappeared in subsequent income tax reforms of Ethiopia; see Income Tax Amendment Proclamation No. 155/1978,

²⁷ See Income Tax Amendment Proclamation No. 155/1978

²⁸ See Payment of Tax on Gains from Capital Proclamation No. 108/1994

provided a financial bonanza to financial institutions.²⁹ As the Shell Ethiopia case illustrates, the tax authorities would probably have not succeeded in persuading courts to recognize new sources of income in many of these other cases.

To sum up, although the definition of income in the Ethiopian income tax law appears to endorse the comprehensive income tax base model, the definition has never been used in Ethiopian tax history to extend even an inch beyond what the schedules have explicitly identified. In general, a schematic analysis of the structure and substance of the Ethiopian income tax system reveals that the general definition of income is undermined by three basic limitations of the Ethiopian income tax system, namely:

- i. Structural Limitations:
- ii. Practical Limitations:
- iii. Legal Limitations.

We shall review the impact of these limitations upon the scope of the main income tax system of Ethiopia.

i. Structural Limitations

It has already been suggested that the structure of the schedules plays a more decisive role than the generality of the definition of income in Article 2(10) of the Income Tax Proclamation. As shown above, this feature of the Ethiopian income tax system became clear in the Shell Ethiopia case, in which the tax authorities (having been unable to persuade the Supreme Court that the interest accruing from provident funds constituted income from employment) were forced to let go of the interest tax free largely because they were unable to attach this form of income to any

²⁹ See Income Tax (Amendment) Proclamation No. 693/2010,

of the schedules then operating. The tax authorities appear to realize the pointlessness of invoking the general definition of income in Article 2(10) except to use it as a corroboration of an argument that is already strongly supported by one of the schedules of the Ethiopian Income Tax System. Appeals to the general definition can still play rhetorical functions but they are not decisive. The tax authorities must overcome the more important onus of having to show an affiliation of a specific source of income with one of the schedules, and in particular of proving that the income has arisen either from employment (A), or rental of buildings (B), or business activities (C) or any of the miscellaneous sources listed down in Schedule “D” or from activities that are governed by autonomous income tax regimes (mining, petroleum and agriculture).

The tax authorities appear to be aware of the role of the definition of “income” in Article 2(10), and in all cases in which they have cited Article 2(10), they have complemented that citation with specific charging provisions. The Authorities have used Article 2(10) in a number of guidance letters and circulars along with specific charging provisions. In one case involving the issue of taxation of payments to higher education instructors for preparation of instructional modules, the ERCA used Article 2(10) as a rhetorical prop and then argued that payments for preparation of instructional materials fell under Schedule “A” and are thus chargeable with tax under Schedule “A” rules.³⁰ Similarly, in response to the practice in Addis Ababa City Council of relieving housing allowance payments from income tax withholding, the Revenue Bureau of Addis Ababa City Administration resorted to Article 2(10) definition and argued that housing allowances paid to City Council members are considered as “income” within the language of

³⁰ See Ethiopian Revenues and Customs Authority, Letter Written to Ethiopian Revenues and Customs Authority, Jimma Branch, 24 Megabit 2001 E.C., in Amharic, unpublished

Article 2(10) and were not exempted by any of the “exemption” provisions of Schedule “A” and should therefore be chargeable with income tax under Schedule “A.”³¹

ii. Practical Limitations

Ethiopian income tax laws may boast a long arm of the income tax but the practical limitations of the Ethiopian income tax administration have held back this long arm even in the best of times. Even in cases where the schedules have categorically included a specific source of income as income, the practical realities of Ethiopian income tax administration have prevented the Ethiopian income tax from reaching some of the mentioned sources of income. A case in point is the many employment fringe benefits that some employees receive in the course of their employment (company cars, housing, etc) (**see Chapter Five below**). The tax authorities have repeatedly admitted that the income tax administration is effective only against one source of income: cash income from employment.³² There are many in Ethiopia who derive a significant income (sometimes a hefty income) from activities that are difficult to detect (e.g., agents and intermediaries who negotiate various types of contracts and perform other activities).³³ Those members of society who do business informally are generally beyond the radar of the Ethiopian tax administration. Some of the schedules of Ethiopian income tax are not effective sources of revenue for the Government owing to massive tax evasion and avoidance.

³¹ See Memo from Revenue Laws Work Process Team to Office of the Executive, Addis Ababa City Administration, 08/10/01, in Amharic, unpublished.

³² See *Demoztagnoch Ka Nagadewoch Yeteshale Taks Yikaflalu*, Addis Zemen, Sene 3, 2004 E.C., 71st year, No. 273; *Ikonomiwu Yemiyamenachewin Gabi Bagbabu Masabsab Yigabal*, Addis Zemen, Sene 2, 2004 E.C., 71st year, No. 272, in Amharic; Conference Emphasizes Building Tax Administration Capacity, *The Ethiopian Herald*, 9 June 2012, Vol. LXVIII No. 233

³³ These traders are aptly called “Air-to-Air” traders in colloquial language

iii. Legal limitations

Successive concessions, exemptions and exclusions granted by the various income tax laws of Ethiopia have taken a huge chunk out of the already narrow income tax base of the Ethiopian income tax system. What separates these exemptions and exclusions from the previous contractions of the tax base is that the lawmaker is fully aware of their exclusion and therefore they represent explicit exceptions to the comprehensive definition of income. The numberless loopholes that dent the body of the Ethiopia income tax might take pages to catalogue. Their existence proves at least that the definition is once again a pointless flourish in the language of the comprehensive income tax base.

Successive Ethiopian Governments have used income tax exemptions for variety of public policy objectives.³⁴ The most prominent exemptions are provided for in the investment incentive laws of Ethiopia, which typically extend income tax holidays (of varying periods) to priority investments.³⁵ The Income Tax Proclamation and the Regulations issued under it also provide a long list of income tax exemptions – (e.g., contributions by employers to pension and provident funds, various types of allowances paid for transportation, travelling and to cover medical treatments).³⁶ The list of these exemptions and exclusions from income expands from time to time as the Ministry of Finance and Economic Development is empowered by law to extend tax exemptions.³⁷

³⁴ See Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, pp. 149-154

³⁵ See Investment Proclamation No. 769/2012; Export Trade Duty Incentive Schemes Proclamation No. 768/2012

³⁶ Income Tax Proclamation No. 286/2002, Article 13; Income Tax Regulations No. 78/2002, Article 3

³⁷ The Minister of Finance has used this power of exemption in a number of cases; one such exemption is to Cuban expatriates who came to work in the Ethiopian Ministry of Health under a special agreement between the Governments of Ethiopia and Cuba; see Ministry of Finance and Economic Development,

On the deduction side, there are many provisions in the Income tax laws which count as so-called “tax expenditures” or subsidies and thus erode the comprehensiveness of the definition of income in Article 2(10). The main income tax law, for example, grants deductions for reinvestment of income in other companies subject to certain conditions.³⁸ The Income Tax Regulations allow deductions for “donations and gifts” for charitable causes under certain conditions.³⁹

All these limitations severely undermine the generality of the definition of income in the Ethiopian income tax system. Although the language of the definition of income in Article 2(10) is evidently borrowed from the lexicon of comprehensive income tax base, the truth is that the Ethiopian income tax system is closer in spirit to those income tax traditions where the doctrine of “source” has shaped the course of the income tax system. Whereas courts and traditions operated as limitations on the reach of the income tax systems of some countries, the structural, practical and legal limitations of the Ethiopian income tax system have produced a result somewhat similar to the developments of the doctrines of source in schedular income tax systems of other countries.

III. General Features of Ethiopian Income Tax Schedules: the Mutual Exclusivity of the Schedules and Sources

Mature income tax systems like the UK have developed a number of doctrines around the meaning and implications of the schedular system of taxation upon the various sources of

Letter to Ministry of Revenues and Addis Ababa Finance and Economic Development Bureau, 15/09/98 E.C., in Amharic, unpublished

³⁸ See Income Tax Proclamation No. 286/2002, Article 27

³⁹ See Income Tax Regulations No. 78/ 2002, Article 11.

income.⁴⁰ A number of judicial doctrines have emerged regarding the meaning of terms like “source” in relation to the operation of the schedules and how courts should view cases in which the source of income is not either known or conventional or in cases in which the operation of the schedules results in overt discrimination among the various sources of income.⁴¹ Statutory refinements over a number of years have also resulted in ensuring substantial uniformity in the treatment of various sources of incomes falling under different schedules.

While these statutory and judicial doctrines (e.g., in the UK) are not directly transferable to the income tax system of Ethiopia, the doctrines surrounding schedular income tax systems can serve as useful props in understanding the impact of the schedular system of taxation upon the whole organization and operation of the income tax system in Ethiopia. We have already seen above how the doctrine of “source” informs the Ethiopian income tax system despite its ambition for a comprehensive income tax base in the definition of “income.” We shall now explore one other doctrine of a schedular income tax system – the doctrine of mutual exclusivity – and analyze whether it is relevant to the Ethiopian income tax system and what that means for the various sources of income falling under the separate schedules of Ethiopian income tax laws.

The doctrine of “mutual exclusivity” posits that once an income is attributed to one of the schedules (through interpretation), it is thereby excluded from all the other schedules of the income tax.⁴² In the archetypal schedular income tax system of the UK, the doctrine of “mutual exclusivity” is propounded by courts, which, through individual cases, assumed that the operation of the schedular system of income taxation operated on the premise of mutual

⁴⁰ See Tiley, Revenue Law, pp. 133-137; Olowofoyeku, Kirkbride and Butler,, Revenue Law, pp. 72-75

⁴¹ See Tiley, Revenue Law, pp. 138-139

⁴² Olowofoyeku, Kirkbride and Butler, Revenue Law, pp. 73

exclusivity of individual schedules.⁴³ In relation to the UK schedular income tax system, the doctrine is stated quite clearly by Lord Radcliff:

Before you can assess a profit to tax you must be sure that you have properly identified its source or other description according to the correct Schedule; but once you have done that, it is obligatory that it should be charged, if at all, under that Schedule and strictly in accordance with the Rules that are there laid down for assessments under it. It is a necessary consequence of this conception that the sources of profit in the different Schedules are mutually exclusive.⁴⁴

An examination of all the known income tax laws of Ethiopia and numerous tax cases decided over the years by courts in Ethiopia has not yielded any positive results with respect to the question of whether the doctrine of mutual exclusivity is even known in the Ethiopian income tax system. In spite of the silence of Ethiopian laws and of courts in this regard, however, it may be asserted that the mutual exclusivity of the schedules is one of the cardinal principles of Ethiopian income tax system. To be sure, neither the income tax laws nor courts have ever given a stamp of recognition to this doctrine, but so pervasive and so rooted this doctrine is in the very structure of the Ethiopian income tax system that it is impossible to get away from it.

The income tax laws of Ethiopia devote quite a substantial number of provisions to defining the domains of each individual schedule vis-à-vis that of the other schedules. The income tax laws of Ethiopia are peppered with provisions that define, delineate and mark the domains of individual schedules. Almost all of the schedules of the main income tax system begin with provisions that somehow either describe or define the scope of the income tax bases assigned to each schedule as well as the sources that are properly considered to be sources chargeable with tax under each of the schedules.

⁴³ Id, pp. 73-74

⁴⁴ In *Mitchell and Edon v. Ross* [1961] 3 All ER 49, 55; 40 TC 11, cited in Tiley, Revenue Law, pp. 136

The provisions of “mutual exclusivity” confer one of the most fundamental properties upon the Ethiopian income tax system – that the schedules are for all purposes and intents distinct domains of income taxation despite all appearances to the contrary. The rules of “mutual exclusivity” are not mere rules of convenience for identifying various sources of income chargeable with taxation but rules that lie at the root of the reason why income taxes in both form and content are fundamentally different. None of the schedules is truly interchangeable. Each schedule stands on its own zones, which are distinct and different from one another as anything is. It will be seen in subsequent chapters that this doctrine determines not just the approaches to income taxation of various sources of income but also affects the equitability as well as administrability of the Ethiopian income tax system.

The doctrine of “mutual exclusivity” is a general descriptor of the Ethiopian income tax system, manifested in a number of rules of the income tax rules that determine the source and fix the income tax liability of individuals and business organizations in Ethiopia. These differences can be highlighted in six general rules of the income tax system of Ethiopia:

- a. Separate Income Tax Bases
- b. Separate Income Brackets and Tax Rate Structures;
- c. Computation of taxable incomes;
- d. Income tax preferences;
- e. Modes of assessment; and
- f. Rules of Income aggregation

We shall analyze the operation of the doctrine of “mutual exclusivity” in respect of the six major points of differences among the schedules of Ethiopian income tax system.

a. Separate Income Tax Bases

Nothing perhaps epitomizes the doctrine of “mutual exclusivity” as the separate tax bases of individual schedules of Ethiopian income tax. In intent, if not in practice, the schedules assume that there is such a distinct source called “income from employment” as opposed to “income from rental of buildings” or “income from businesses,” etc. The income tax laws of Ethiopia devote quite a number of rules to delineating the boundaries of the tax base of each of the schedules and sources of income chargeable with income tax in Ethiopia. The definitions for “employee,” “contractor,” “business” as well as the definitions for such specific sources of income like “royalties,” and “dividends” are there to demarcate one schedule from another. Where there are no definitions, there are descriptions that help in separating one tax base from the other.

Since the differences among the schedules of Ethiopian income tax are at times so stark, it is a matter of utmost importance to delineate the boundaries of the separate tax bases of the Ethiopian income tax system. As shall be seen in subsequent chapters, however, the demarcation of the different tax bases that fall under separate schedules is far from satisfactory. Ambiguities in the language of definitions, and at times complete lack of definitions, and the absence of subsidiary rules that supply the details necessary for sorting out one form of tax base from another, combined with the virtual dearth of cases in this regard, have all contributed to the current state of affairs in which one tax base can be characterized as falling under one schedule as another, depending on who interprets and applies a specific provision of the law. Therefore, although cases in which the same tax base is taxed under two or more schedules are rare, cases in which a tax base exhibiting similar factual situations can be subject to disparate schedules are abundant in practice. For example, cases in which income is derived from the

same source but taxed under separate schedules are very rife with respect to Schedule “A” (income from employment) and Schedule “C”(income from business or self-employment) (**see Chapters Five and Seven below**).

b. Exclusive Income Brackets and Tax Rate Structures

The doctrine of “mutual exclusivity” of the schedules is also most powerfully expressed in the existence of separate income brackets and tax rate structures. In the past, the income brackets and tax rate structures were not even remotely interchangeable. In the 1990s, for example, a Schedule “C” taxpayer with annual income of 1300 ETB was subject to 10% tax while she would be exempted if she were a taxpayer under Schedule “A”.⁴⁵ The tax rate structures were totally different for different categories of taxpayers. The top marginal tax rate, for Schedule “A” and C taxpayers, was 40% while the top marginal tax rate for Schedule “B” taxpayers was 45%.⁴⁶

Some have argued that the income bracket and tax rate differentials were the product of piecemeal revisions of the income tax laws of Ethiopia while others believed that these differentials expressed some unarticulated legislative policy towards certain sources of income.⁴⁷ Since the tax policies of Ethiopia were seldom recorded, it is difficult to say whether one was more the reason than the other. As the tax reforms of Ethiopia came increasingly under the influence of international actors like the IMF that placed huge premiums upon the neutrality of taxes, the income bracket and tax rate differentials came under increasing scrutiny and Ethiopia

⁴⁵ See Income Tax (Amendment) Proclamation No. 107/1994

⁴⁶ See Income Tax (Amendment) Proclamation No. 62/1993

⁴⁷ See Muzondo, Courneyea, Brooks and Amina, Ethiopia: Introduction of a VAT and Presumptive Income Tax and Reform of the Income Tax, pp. 54-55

found itself under pressure to scrap income bracket and tax rate differentials for various sources of income.⁴⁸

Partly as a result of these international pressures, the Ethiopian Government conceded some ground. As part of the income tax reforms of 2002, the Ethiopian Government ended some of the obvious differentials between the various schedules of the Ethiopian income tax system.⁴⁹ The 2002 income tax laws introduced income brackets and tax rate structures that looked uniform from the outside, though still separate. The threshold for income brackets for the three schedules (A, B and C) was fixed at 1800 ETB a year (150 ETB a month for employees), and the threshold for the highest marginal tax rate was fixed at above 60,000 ETB (or 5000 ETB for employees). The marginal tax rates were also outwardly uniform, ranging from 10% to 35% for all taxpayers, except companies, which are subject to a uniform flat tax rate of 30%.

The harmonization of income brackets and tax rate structures is quite an improvement over the repealed income tax systems of Ethiopia, but some overt as well as latent disharmonies remain.

First of all, one of the schedules of the Ethiopian income tax system – Schedule “D” – is not governed by the principle of uniformity of income brackets and tax rate structures. The tax rates in Schedule “D” are as diverse as the number of sources chargeable with income tax under Schedule “D.” Schedule “D” is indeed an exhibition of disparate tax rates for various sources of income – royalties (5%), income from technical services (10%), income from games of chance (15%), income from dividends (10%), interest income from bank deposits (5%), income from casual rental of property (15%), capital gains from sale of buildings (15%), capital gains from sale

⁴⁸ See *ibid*; curiously, the critics of the differentials never pushed for the scrapping of the schedules themselves, which seem to be at the root of the income tax discrimination in Ethiopia

⁴⁹ Income Tax Proclamation No. 286/2002, see Articles 11, 15 and 19

of shares (30%), and windfall profits from devaluation of Ethiopian currency back in 2010 (75%). These tax rate differentials have never been officially defended and justified. These tax rate differentials appear to express some legislative intent about various sources of income, but these are at the moment mere conjectures.⁵⁰

There are also subtle and latent differences in income brackets and tax rate structures even among the otherwise uniform brackets and rate structures for Schedules A, B and C. These latent differences arise from the differences in accounting periods and accounting methods between Schedule “A,” on the one hand, and Schedule “B” and Schedule “C” on the other. Schedule “A” income is subject to the simple PAYE system of withholding. The simple PAYE system of withholding does not adjust for changes in monthly income over the course of a year, which, in a progressive income tax structure, can lead to differences in income tax liability, even though the annual income is the same as that of a Schedule “B” or “C” counterpart.⁵¹ A simple example can illustrate this hidden discrimination. Suppose X is an employee (Schedule “A” taxpayer) with monthly income of 2000 ETB. X got a salary raise in the middle of the tax year from 2000 ETB to 3000 ETB. Let’s assume for simplicity sake that X’s monthly salary for six months (from Hamle 1 to Tahsas 30) is 2000 ETB and after his salary raise (from Tir 1 to Sene 30) is 3000 ETB. Since X would be subject to the simple PAYE system, his total tax deduction for the first six months is 1695 ETB (taking the current income bracket and tax rates) and his

⁵⁰ Some of those who participated in the tax reforms of 2002 say that these differentials were the product of subjective attitudes towards those who are suspected of deriving income from Schedule “D” sources; for example, when the tax rate for interest on bank deposits was fixed as 5%, the low tax rate somehow reflected the economic demographics of those who save their earnings in banks as opposed to those who invest in companies and earn dividends, who are generally thought to be of higher economic status; interviews with Ato Wasihun Abate, Legal Advisor to the Minister of Finance and Economic Development, July 13, 2012; interview with Ato Girma Tafesse, ERCA, Branches Directorate, May 09, 2012

⁵¹ See van der Heeden, *The Pay-As-You-Earn Tax on Wages*, p. 567

total tax deduction for the second six months is 3090 Birr. The aggregate deductions in taxes would amount to 4785 ETB. If X were a Schedule “C” taxpayer with the same amount of income, his total tax liability would be 4680 ETB. There is a difference of 105 ETB. X would pay more because he is a Schedule “A” taxpayer. The outwardly uniform income brackets and tax rates structures might achieve uniformity among those whose incomes remain steady, but they are likely to result in differential tax burdens when incomes fluctuate. The Ethiopian income tax laws do not adjust tax burdens in view of these fluctuations, resulting in discriminatory treatments of those whose incomes change throughout a tax period.

Table 4.2: Income Tax Brackets and Tax Rate Structures for Schedule “A”

Employment Income Per Month		Income Tax Rate
Over Birr	To Birr	
0	150	Exempt
151	650	10
651	1400	15
1401	2350	20
2351	3550	25
3551	5000	30
Over 5000		35

Source: Income Tax Proclamation No. 286/2002, Article 11

Table 4.3: Income Tax Brackets and Tax Rate Structures for Schedule “B” and Schedule “C”

Taxable Income from Rental		Income Tax Rate
Over Birr	To Birr	
0	1800	Exempt
1801	7800	10
7801	16800	15
16801	28200	20
28201	42600	25
42601	60000	30
Over 60, 000.		35

Source: Income Tax Proclamation No. 286/2002, Articles 15 and 19

Table 4.4: Income Tax Rates for Schedule “D” (Miscellaneous Income)

Type Income	Tax Rate	Withholding/Non-Withholding
Royalties	5%	Final withholding
Income from technical services rendered abroad	10%	Final withholding
Income from games of chance	15%	Final withholding
Dividends distributed by companies (share Companies and Private Limited Companies)	10%	Final withholding

Interest on a bank deposit	5%	Final withholding
Income from casual rental of property	15%	Non-withholding
Capital gains on transfer of certain investment property		
Buildings held in business	15%	Non-withholding
Shares	30%	Non-withholding
Windfall profits as a result of devaluation of Birr in 2010	75%	Non-withholding

Source: Income Tax Proclamation No. 286/2002, Articles 31-37; Income Tax Amendment Proclamation No. 693/2010 and Directive No. 29/2003, A Directive to Impose Tax on Windfall Profits of Banks

c. Computation of Taxable Incomes

The rules for computation of taxable income are separate and distinct for each of the schedules of the Ethiopian income tax system. Unlike many other schedular systems of the world, the taxable incomes from all the schedules are not even allowed to meet at the end for application of a single progressive tax rate. Each of the schedules has their own internal rules of computation of taxable income.

The taxable income under Schedule “A” (employment income) is the gross salaries, wages and all other emoluments from employment excluding certain employment allowances and

exemptions.⁵² Schedule “A” income tax is collected through withholding by employers and thus excludes any deductions of employment related expenses.

Schedule “B” and Schedule “C” income tax apply after deduction of various expenses from gross incomes from each of the Schedules. But in many respects, they are as different from each other as they are from the other schedules. The rules for computation of taxable income under Schedule “B” are different from those of Schedule “C”. Schedule “B” rules recognize standard deductions for those taxpayers who do not maintain books and records; Schedule “C” rules do not have standard deduction rules. Those who do not maintain books and records under Schedule “C” are subject to the regime of standard assessment.⁵³

In principle, all expenses incurred for the generation of gross income should be deductible under both Schedules “B” and “C”, but, in practice, the separate rules of deduction have meant that some expenses, while deductible under Schedule “C”, are not necessarily deductible under Schedule “B”.⁵⁴

Schedule “D” taxable income is calculated on gross income from each of the sources chargeable with tax, except capital gains, which recognize deduction of capital costs. Schedule “D” income tax (like Schedule “A”) relies upon withholding as a final tax and denies any deduction of expenses. All of the withholding taxes are considered final, which means that there is no possibility of adjustment later with the other schedules of Ethiopian income tax.

⁵² Income Tax Proclamation No. 286/2002, see Article 10

⁵³ See *id.*, Article 66

⁵⁴ See Chapter Six below for these differences in the rules of deductible expenses between Schedule “B” and Schedule “C”.

d. Income Tax Preferences⁵⁵

The general rule of income taxation in Ethiopia is that tax preferences, whether they come in the name of exemptions or exclusions or deductions, are unique to each of the schedules and sources of income. With the possible exception of floor exemptions (up to 1800 ETB at the moment), it is difficult to name one other tax preference which is available and valid for all the schedules and sources of the Ethiopian income tax system. Even the 1800 ETB floor exemption is not available for Schedule “D” income.

Schedule “A” has a long list of preferences – which come in the form of exemptions and exclusions. Schedule “A” does not recognize any deduction for employment related expenses. Any expenses incurred in the course of employment are either presumed to be assumed by employers, or even if borne by employees, they are not recognized as deductible expenses. Perhaps as a consolation for denial of any employee expenses, Schedule “A” rules exclude a number of employment related benefits: medical allowance, transportation allowance, hardship allowance, travelling allowance and contributions by employers to pension and provident funds.⁵⁶

Schedule “B” recognizes deductions, but does not have rules for exemptions except for the generalized floor exemption at the time of writing of 1800 ETB. Schedule “C”, on the other hand, has detailed rules for exemptions and deductions.⁵⁷ A Schedule “C” taxpayer who wins an award in cash for outstanding performance in business is exempted from income tax on that award;

⁵⁵ The word “preference” is here used as a general term to designate the various exemptions, exclusions or otherwise deductions given to some taxpayers in departure from the basic concept of income, as defined in the Income Tax Proclamation itself.

⁵⁶ Income Tax Proclamation No. 286/2002, see Article 13 and Income Tax Regulations No. 78/2002, Article 3

⁵⁷ Income Tax Proclamation No. 286/2002, see Article 30

Schedule “B” taxpayer is not exempted. A Schedule “C” taxpayer who reinvests her profits in another company receives a deduction for what is known as “participation or reinvestment deduction;” a Schedule “B” taxpayer who does the same thing is not.⁵⁸ A Schedule “C” taxpayer is entitled to carryover of losses to the next three years while a Schedule “B” taxpayer who incurs losses is not entitled to loss-carryovers.⁵⁹ The differences in preferences between Schedule “B” and Schedule “C” can go on and on.

Schedule “D” taxpayers have few preferences, if any. Of all the Schedule “D” taxpayers, only those subject to capital gains taxation are entitled to a deduction of the costs of acquisition and maintenance of capital assets (buildings and shares) and of capital losses (which may be carried forward indefinitely).⁶⁰ All other sources of income chargeable with income tax under Schedule “D” are subject to tax on gross receipts. Since all of these taxes are considered final, there are no opportunities for adjustment against other sources of income.

There are few cases in which the rules of preferences among the schedules intersect. For example, the rules for deduction of depreciation costs are the same for Schedules B and C.⁶¹ But these are exceptions. In many other instances, it is safe to assume that the preferences available in one schedule are not transferable to the other schedules, confirming once again the pervasiveness of the doctrine of mutual exclusivity of the schedules in the Ethiopian income tax system.

⁵⁸ See *id.*, Article 27

⁵⁹ See *id.*, Article 28

⁶⁰ See Income Tax Proclamation No. 286/2002, Article 37(6) and Income Tax Regulations No. 78/2002, Article 15

⁶¹ Income Tax Proclamation No. 286/2002, see Article 16

e. Modes of Assessment

The differences in the rules of assessment among the schedules are not as stark as the other points of difference, but significant differences exist, contributing to the differences in income tax burdens among various categories of taxpayers. Two of the schedules – Schedules A and D – are subject to withholding taxation as the primary vehicle for collection of the taxes. Most employees whose income consists primarily of income from employment never get to worry about filing income taxes, as these are done for them by their employers. Similarly, most of those chargeable with income taxes under Schedule “D” have their tax obligations met for them by their withholding agents. Only in few instances are employees subject to the regime of self-assessment and only those earning capital gains from the sale of shares and buildings and possibly those earning income from casual rental of property⁶² are ever subject to the regime of self-assessment.

In contrast, Schedules “B” and “C” taxpayers are subject to the regime of self-assessment, which requires many of these taxpayers to maintain books and records and file their tax returns at the end of the tax year. The degree of self-assessment, of course, varies according to the categories of taxpayers under those schedules. Some of the taxpayers (Category “A” and “B”) are required to maintain adequate books and records in accordance with generally accepted accounting standards while small-sized ones (Category “C”) are subject to a presumptive tax regime, which nonetheless requires them to declare their annual turnover to the tax authorities.

The income tax accounting rules of the Ethiopian income tax are not strictly organized around schedules, but certain accounting principles are known to be the property of certain categories

⁶² The collection of tax on casual rental of property is shrouded in uncertainty; see Chapter Eight below.

of taxpayers. For example, employees are subject to cash-basis accounting as a result of the operation of the simple PAYE system. Similarly, most Schedule “D” taxpayers are subject to cash-basis accounting by the simple operation of the withholding system of tax collection. The rules of tax accounting are not as clear cut on Schedule “B” and “C” taxpayers, as there the principles of accounting depend more on the size of businesses or activities than on the schedules *per se*. Companies (whether subject to Schedule “B” or “C”) are always required to maintain books and records in accordance with accrual accounting principles while individuals may choose cash or accrual accounting rules.⁶³ There are also special accounting rules in the income tax laws which are set in motion when taxpayers are involved in certain activities. For example, a Schedule “B” or “C” taxpayer may be required to comply with the accounting principle of long-term contracts when it is involved in long-term contract transactions.⁶⁴ But there are accounting principles that are peculiar to Schedule “C” taxpayers. For example, the accounting rules for “costs of goods sold” are seldom relevant for Schedule “B” taxpayers for the simple reason that there are no goods sold in Schedule “B” activities.⁶⁵

f. The Rules of Income Aggregation

The effect of the rules of aggregation upon the equitability of the Ethiopian income tax system has already been pointed out (**see Chapter Two above**). The Ethiopian income tax system recognizes the principle or at least the need for aggregation in a progressive income tax structure, but the rules of aggregation have always been bounded by the schedules. The basic principle is stated in Article 70 of the Income Tax Proclamation:

⁶³ Income Tax Proclamation No. 286/2002, Article 58

⁶⁴ Id, see Article 62

⁶⁵ Id, Article 22

A taxpayer who derives income *subject to the same schedule* shall be assessed on the aggregate of such income (italics added).

Rules of similar import are also stated in Article 65 of the Income Tax Proclamation for employees who derive income from multiple employments.

Rules of aggregation, indeed rules requiring computation of the tax upon the taxable income from all sources, are quite common even in many otherwise schedular income tax systems (**see Chapter Three above**). These rules, however imperfectly conceived, are rooted in the principles of tax equity. If equity is the criterion by which income tax burdens are to be distributed, the computation of the income tax must be based on total or aggregate income derived by taxpayers rather than on the different sources from which income is derived. While the different sources of income may be identified separately for purposes of the convenience of tax administration, tax equity requires at the minimum that taxpayers are assessed on the basis of their total income regardless of the number and diversity of the sources of income.

The Ethiopian income tax system appears to recognize this basic insight about the relationship between the progressive income tax structure and the need to aggregate income from several sources. But it does not carry the insight far enough. It halts the requirement of aggregation on the boundaries of individual schedules, and in some cases on the boundaries of individual income sources. The schedules therefore play not just the role of identifying the various sources chargeable with income taxes in Ethiopia, but also of limiting the bounds of different rules of the income tax. For example, while employees are required (along with their employers) to aggregate income from multiple employments, if all of which fall under Schedule “A”, employees who derive income from employment (A) and rental of buildings (B) are not required to aggregate income from these two schedules. Similarly, taxpayers subject to tax under Schedule

“C” are required to aggregate income from multiple businesses falling under Schedule “C” but not if one or more of these sources fall under the other schedules.

In the case of Schedule “D”, the question of aggregation (if at all it exists) acquires a peculiar meaning. In Schedule “D”, the fact that the sources of income fall under the same schedule is not even relevant. Every “miscellaneous” source operates pretty much like an individual schedule. The rules of Schedule “D” (based as most of them are upon the application of flat tax rates upon miscellaneous sources and final withholding) obviate the need for aggregation of incomes falling under Schedule “D”. The multiplicity of the flat tax rates under Schedule “D” also make it impossible to aggregate incomes from individual sources falling under Schedule “D”.

In any case, the schedule-bound rules of aggregation in the Ethiopian income tax system provide another proof of how strictly schedularized the Ethiopian income tax system is. Even among the ranks of schedular income tax systems, the Ethiopian system is distinguished by its heavy emphasis upon the schedules.

CHAPTER FIVE
SCHEDULE “A”: EMPLOYMENT INCOME TAX

I. Introduction

Schedule “A” income tax, entitled alternatively as “Employment Income Tax,” is in practice sometimes referred to as “Wage-Earners Tax” or “Personal Income Tax.”¹ Employment income tax existed in the Ethiopian income tax system as a separate schedule since the beginning of modern income taxation in Ethiopia.² It is one of the major paradigmatic pillars of the Ethiopian income tax system, enduring major political upheavals.

The scope of Schedule “A” is defined by the scope of “employment income.” The income tax law does not define “employment income” but merely stipulates that “employment income” includes “any payments or gains in cash or in kind received from employment by an individual, including income from former employment or otherwise or from prospective employment.”³ All kinds of payments in consideration of employment are included in income, except so-called “representation allowances” paid to some employees to reimburse expenses incurred on social occasions, guest accommodation and similar events on behalf of employers.⁴

Anyone who reads the whole sections regarding “Employment Income Tax” and other provisions of the Ethiopian income tax law will, of course, immediately realize that the expansive rendition of “employment income” is simply not the case. Apart from “representation allowance” which is excluded from the scope of Schedule “A,” the income tax law immediately

¹ Income Tax Proclamation No. 286/2002, See Chapter I, Section II, Articles 10-13; see also The Federal Budget Grant Distribution Formula, pp. 17, 18

² See Taddese Lencho, *Towards Legislative History of Modern Taxes*, pp. 115-124

³ Income Tax Proclamation No. 286/2002, Art. 12(1)

⁴ *Id.*, see Art. 12(3)

follows the expansive definition with a long list of incomes exempted from income tax and what is more, gives the Council of Ministers and the Ministry of Finance in particular the power to exempt other forms of “employment income.”⁵ The Income Tax Proclamation itself grants income tax exemption to such employment-related incomes as “income received by casual employees,” “pension or provident fund contributions by employers of up to 15% of employee salary,” and “income received in compensation for personal injuries or death of a person.”⁶

Following the power granted to it in the Income Tax Proclamation, the Council of Ministers has added a catalogue of employment income excluded from employment income tax base.⁷ Exclusions of employment income like medical allowance, transport allowance, and hardship allowance, among others, owe their exemption to the Regulations issued by the Council of Ministers in 2002.⁸

Besides the Council of Ministers, the Minister of Finance (and Economic Development) wields an important power of exemptions over specific sources of employment income.⁹ The power of the Minister to exempt is not even qualified as that of the Council of Ministers – any income that is exempted by the approval of the Minister is excluded from the scope of Schedule “A” regardless of the circumstances under which the exemption is granted. The Ministry of Finance exempts specific types of employment income from time to time through directives and circular letters, which are circulated as instructions to the tax authorities for appropriate actions.¹⁰ The exclusions of the income of expatriates hired by export industries and Cuban expatriates hired

⁵ Id, see Art. 13

⁶ See *ibid*

⁷ Income Tax Regulations No. 78/2002, Article 3

⁸ Id, see 3(a-h)

⁹ Income Tax Proclamation No. 286/2002, see Art. 13(d) (iii)

¹⁰ See Ministry of Finance and Economic Development, Letter Written to Ministry of Revenues, 15/09/98 E.C., in Amharic, unpublished

by the Ministry of Health, among many others, owe their existence to exemptions granted by the Ministry of Finance.¹¹

The Income Tax Proclamation also gives due recognition to international law, as a result of which certain types of incomes or some categories of employees are exempted from the income tax. As in many income tax systems of the world, Ethiopian income tax law gives due recognition to the exemption of the income of members of the diplomatic community.¹² “In accordance with international usage or custom” and subject to the rules of reciprocity, the Income Tax Proclamation exempts the income of representatives of diplomatic and consular organizations and other persons employed by these organizations provided these representatives are nationals of a foreign state and bearers of diplomatic passports.¹³ In addition, income from employment may be exempted by the operation of bilateral tax treaties to which Ethiopia is a party.¹⁴ At the time of writing, Ethiopia has entered into “double taxation treaties” (DTTs) with more than a dozen countries¹⁵ and many of these treaties have one or two provisions pertaining to “employment income” and some grant exemptions.¹⁶

¹¹ See *ibid*; Ministry of Finance and Economic Development, Directive to Exempt the Income of Expatriate Technical Staff of Export-Oriented Industries in Ethiopia, in Amharic, unpublished, Sene 22, 1996 E.C.

¹² See the Vienna Convention on Diplomatic Relations and Optional Protocol, 18th April 1961

¹³ Income Tax Proclamation No. 286/2002, see Art. 13(c)

¹⁴ *Id*, see 13(d)(ii)

¹⁵ Ethiopia has signed double taxation treaties with more than fifteen countries at the time of writing: Italy, Egypt, India, Sudan, China, France, Kuwait, Russian Federation, Yemen, Algeria, Tunisia, Romania, Republic of South Africa, Israel, Turkey, and Czech Republic; a number of tax treaties are on the pipeline of being ratified by respective bodies.

¹⁶ The double taxation treaty between Ethiopia and the Kingdom of the Netherlands, for example, exempts the income of professors and researchers “who are present in one of the States at the invitation of any university, college, school or other similar non-profit education institution” for a period not exceeding two years; see Convention between the Federal Democratic Republic of Ethiopia and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, 2012 (pending ratification by respective parliaments)

All in all, the income tax system of Ethiopia exempts the following general categories of taxpayers and/or specific sources of income from the operation of Schedule “A”:

- a. Special categories of employees: casual employees¹⁷ and domestic servants;¹⁸
- b. Members of the Diplomatic Community: representatives of foreign governments and international organizations as well as other employees of these organizations; and other taxpayers exempted by the operation of double taxation treaties to which Ethiopia is a party; and
- c. A long list of specific sources of income from employment: compensation for injuries or death;¹⁹ pension contributions by employers of up to 15% of monthly salary of an employee;²⁰ medical allowance;²¹ transportation allowance;²² hardship allowance;²³ travelling allowances;²⁴ and government board fees.²⁵

In many ways, Schedule “A” income tax epitomizes some of the distinctive features of the schedular system of income taxation in Ethiopia. The peculiar features of Schedule “A” income tax in Ethiopia, as stipulated in the law and implemented in practice, have had tremendous implications upon the equitability and administrability of the Ethiopian income tax system. We have already analyzed the implications of lack of uniformity of income tax brackets and tax rate structures on the equitability of the income tax system of Ethiopia (**see Chapter Four above**). We have seen, for example, how the choice of a monthly accounting system for Schedule “A”

¹⁷ Income Tax Proclamation No. 286/2002, see Art. 2(12) for definition of casual employees

¹⁸ Income Tax Regulations No. 78/2002, see Art 3(g)

¹⁹ Income Tax Proclamation No. 286/2002, Art. 13(f)

²⁰ Income Tax Proclamation No. 286/2002, Art. 13(b)

²¹ Income Tax Regulations No. 78/2002, Art. 3(a)

²² Id, Art. 3(b)

²³ Id, Art. 3(c)

²⁴ Id, Art. 3(d) &(e)

²⁵ Id, Art. 3(f)

income tax, with no relief or adjustment at the end of the tax year, might unfavorably affect some employees, compared with their counterparts in Schedule “B” or Schedule “C”.

In this chapter, we will review some of the major gaps in Schedule “A” income tax rules that have had significant impacts on the equitability of the income tax laws even among employees themselves (intra-schedular equity)²⁶ as well as between employees on the one hand and those taxpayers subject to the other schedules, and how some rules of Schedule “A” income tax have created administrative problems in the enforcement of Schedule “A” income tax in Ethiopia.

This chapter will explore the equitability as well as administrability of Schedule “A” income tax in connection with three major issues currently facing the taxation of employment income in Ethiopia. The first set of issues concerns the scope of Schedule “A” vis-à-vis that of other schedules, in particular the legal and practical problems that Ethiopian tax administration faces in delimiting the scope of terms like “employment” from that of “self-employment” and the scope of “income from employment” from incomes falling under the other schedules of Ethiopian income tax. The second set of issues revolves around the impact of some Schedule “A” rules upon the equitability of Ethiopian income tax system among various categories of employees. The third set of issues involves the problem of the treatment of employment fringe benefits under Ethiopian income tax system. The upshot of these three major issues of Schedule “A” income tax is to highlight how far the income tax system of Ethiopia departs from the tenets of tax equity even in its rudimentary sense of treating equals in the same category (intra-schedular horizontal equity), let alone achieving equity among taxpayers regardless of the sources of income (inter-schedular horizontal equity).

²⁶ The expression “intra-schedular equity” is used to test how the rules of one schedule ensure tax equity among those subject to the same schedule – among employees, among renters, businesses, etc; it is contrasted with “inter-schedular equity,” which is focused on testing the impact of the schedular system upon categories of taxpayers subject to tax under the different schedules of Ethiopian income tax.

II. Problems of Delimiting the Scope of Schedule “A”

a. The Notion of “Employment” in the Ethiopian Income Tax Laws

The notion of “employment” is one of the key concepts in Schedule “A”. Although “employment” is a key concept in Schedule “A,” it is surprisingly nowhere defined in the income tax law itself or in any of the subsidiary income tax laws of Ethiopia. This in spite of the fact that the term “employment” is used more than half a dozen times in the sections dealing with employment income tax.²⁷ Nonetheless, the term “employment” receives its own definition of sorts in Article 2(12), which provides a definition for an “employee.” It is a tad curious in an income tax legislation that is more focused upon the source of income than the regulation of the parties that a definition is offered for “employee instead of “employment.” It is also no less curious that the definition for “employee” is placed in a general definition section, where, even if the definition is comprehensive, is liable to be disregarded in the application of Schedule “A”. This may sound like an unreasonable complaint against the structure and organization of the Income Tax Proclamation, but there is reason to believe that the location of the definition has diminished its importance and relevance for delimiting the scope of Schedule “A” income tax.²⁸

Aside from these curiosities of Ethiopian income tax law, there is little doubt that the meaning of “employee” is offered in the Income Tax Proclamation in order to define and delimit the scope of Schedule “A” vis-à-vis Schedule “C” in particular, with which Schedule “A” income tax has come

²⁷ Income Tax Proclamation No. 286/2002, see Articles 10-12

²⁸ For those who read and understand the income tax law as a whole, this is not an important issue, but for those who are inclined to read only sections they think are relevant for their purposes, this has in practice led to misapplications of the law.

frequently into conflict (**see below**). The definition of “employee” is followed by the definition of “contractor,” and these two terms are contrasted by the income tax law to delineate the boundaries of Schedule “A” vis-à-vis that of Schedule “C” and the boundaries are drawn through the parties upon whom the burden of the income tax falls, namely employees and contractors respectively.

An employee is contrasted directly with a contractor in terms of the existence and degree of “direction and control” involved in the contractual relationship during the performance of services. Thus, Article 2(12) defines “employee” as:

... any individual other than a contractor, engaged... to *perform services under the direction and control of an employer* (italics added)

A little further down, the same Article offers a definition of a “contractor” as:

... an individual who is 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 performed* (italics added)

The operative phrase in contrasting an employee from that of a contractor,²⁹ and indirectly “employment” from that of “self-employment” or “independent contract services” is the existence or otherwise of the elements of “direction and control.” As far as the literal language of the Proclamation is concerned, all income derived from relationships that display or evince “direction and control” is presumed to be “income from employment” and all the rules of Schedule “A”, and not Schedule “C”, apply to the whole of that income from employment.

²⁹ A more common expression to refer to what the income tax law calls “contractor” is “independent contractor,” defined in Black’s Law Dictionary as “one who is hired to undertake a specific project but is left free to do the assigned work and to choose the method for accomplishing it;” see Black’s Law Dictionary, s.vv. “Independent contractor;” in this section, the expression “independent contractor” is used interchangeably with “contractor” and the contract is referred to as “independent contract services” or “self-employment.”

The Proclamation appears to regard “direction and control” as decisive factors in distinguishing employment relationships in particular from self-employment or independent contract relationships, but the absence of definition or description of the phrase “direction and control” combined with the inability or reluctance of the tax authorities to come to terms with the factors of “direction and control” has swung the practice in a direction none of the language of the Proclamation countenanced (**see below**).

b. The Nature and Source of Disputes

The Proclamation has provided enough hints as to how “employment” can be distinguished from “self-employment,” but “self-employment” is not the only other relationship with which “employment” is confused. Ethiopian income tax practice has yielded a number of cases (not many by the standards of mature income tax systems) in which employment may be confused with other relationships which form the subject-matter of other schedules of the Ethiopian income tax. Employment relationships may appear to overlap with relationships giving rise to the payment of royalties, interest, and dividends, to name the few instances in which conflicts might arise. Neither the Proclamation nor the subsidiary pieces of legislation have produced guidance for distinguishing employment from these other relationships. Few cases of conflicts have ever made to Ethiopian courts, with the result that there are virtually no parameters for delimiting the scope of employment from these other relationships. Not surprising, the practice has been as inconsistent and diverse as one might expect – providing preponderant examples of disputes in connection with Schedule “A” income tax (**see below**).

Preliminary studies done in some select higher education institutions and interviews with tax officers and tax practitioners reveal that disputes arise in this area all the time and in many

places. The studies and interviews also reveal substantial disparities in characterization of income obtained in connection with employment. These disputes may not always be articulated in terms of “income from employment” vs. “income from independent contract,” or “income from employment” vs. “income from royalties,” etc. The disputes often arise over the proper withholding tax rates, which are fundamentally about the nature of the relationships between the parties and the sources of income.

The most common disputes in this connection relate to the characterization of income as one from “employment” vis-à-vis “independent contract.” The less common disputes arise in the characterization of income as “employment income” vis-à-vis “royalties,” or in the characterization of income as “employment income” or “interest.” The ambiguities of Ethiopian income tax laws on the different sources of income, the lack of adequate and uniform guidelines for employers in this regard and the absence of adequate administrative monitoring on the part of the tax authorities as well as the lack of understanding among withholding agents in various places have combined and conspired to create significant disparities in withholding practices of various organizations, with inevitable negative consequences upon tax equity in the Ethiopian income tax system.

Disputes pertaining to the characterization of income obtained in connection with or in the context of employment are perhaps as common in Ethiopia as they are elsewhere, but curiously, none of these disputes have ever found their way to tax dispute tribunals and/or courts.³⁰ A number of factors may be said to have contributed to this state of affairs, but the principal blame

³⁰ Interviews with Dawit Teshome, Tax Appeal Commission, May 11, 2012; Eshetu Atlaw, ERCA, Civil Division, August 28, 2012 and Tewedaj Sima, ERCA, Civil Division, April 30, 2012

must go to the restrictive language of dispute resolution provisions of Ethiopian tax laws that seemed to have established dispute settlement schemes largely for Schedule “C” taxpayers.³¹

One of the reasons that has provided a fertile ground for disputes in this area is the existence of multiple withholding obligations among the various income tax schedules of Ethiopian income tax system and the significant differences in withholding tax rates and income tax burdens among the various schedules of Ethiopian income tax law. Ethiopian income tax laws impose withholding obligations upon organizations or institutions under different contexts. The most prominent of these withholding obligations is the withholding under Schedule “A” against income from employments (also known as the PAYE or Pay-As-You-Earn). In addition, withholding obligations may arise in connection with Schedule “B”, Schedule “C” and Schedule “D” incomes. Organizations or institutions making payments which may be characterized as Schedule “B” income (rental payments) or Schedule “C” income (payments for supplies of goods and services) are required by law to withhold 2% from the payments and transmit the proceeds to the tax authorities.³² Organizations or institutions making payments that are in the nature of royalties and dividends are also required to withhold 5% or 10% respectively from the payments of royalties or dividends. Since the withholding tax rates vary so starkly in each case, it is incumbent upon these organizations to distinguish cases in which withholding under Schedule “A” is appropriate as opposed to the other Schedules. These processes have given rise to a

³¹ Under the restrictive language of the provisions regarding tax dispute settlements, taxpayers can object only to assessments sent by the Tax Authorities. Employees generally do not receive assessments from the Tax Authorities, as they are subject to withholding schemes; see Income Tax Proclamation No. 286/2002, Articles 104-116; see also Taddese Lencho, *The Ethiopian Tax System: Excesses and Gaps*, pp. 373-378

³² Income Tax Proclamation No. 286/2002, see Article 53; and Income Tax Regulations No. 78/2002, Article 24

number of conflicts between payors and payees. The following table summarizes the withholding obligations of organizations under Ethiopian income tax laws.

Table 5.1: Income Tax Withholding under the Schedules of Ethiopian Income Tax

No.	Type of income	Schedule	The nature of withholding	Tax rate	Withholding organization
1	Income from employment	A	Progressive and aggregate if all of them are from employment	Progressive (0-35%)	Employer/s
2	Income from rental of buildings	B	Advance withholding	2%	Lessee
3	Professional and/or business income	C	Advance withholding	2%	Purchaser of goods and services from Schedule "C" taxpayers
4	Royalties	D	Final withholding	5%	Payor
5	Income from technical services rendered abroad	D	Final withholding	10%	Ethiopian resident purchaser of technical services
6	Dividends	D	Final withholding	10%	Company making dividend distributions
7	Interest on deposits	D	Final withholding	5%	Bank paying interest on deposits
8	Income from games of chance	D	Final withholding	15%	Runner of games of chance

Source: Income Tax Proclamation No. 286/2002

**c. Delimiting the Scope of “Employment” in Practice: Distinguishing
“Employee” from “Contractor”**

The conflicts over characterization arise most commonly in connection with payments made for the performance of specific services, which may as easily be characterized as employment or independent contract services. These cases of conflicts affect most directly those employees who provide specific services either to their full-time employer or other employers or clients. Employees may provide additional services to their employer and these additional services are often provided after the signing of special contracts for services as they are not part of their regular duties as employees. A full-time professor of a university may provide special services of research, translation, training, or consultancy to the very university for which she works. A professor in one university may provide similar services to other universities on contractual basis. These special services may not be treated as part of her regular duties and special contracts may be and are often signed between the professor and the university. It is these kinds of special services that often lead to conflicts over the characterization of the services.

The ambiguities, generalities, and at times inconsistencies among the different rules governing this area have compounded the conflicts over the characterization of certain types of income as one from “employment” or “independent contract.” The existing rules are so inadequate that it is fair to conclude that withholding agents possess substantial authority and discretion over the characterization of income. These discretionary powers can be deployed to benefit or hurt

employees. We shall examine the inconsistencies in practice by reference to the practice in three higher education institutions in Addis Ababa.

i. Case Study: Income Tax Withholding in Three Higher Education Institutions of Ethiopia

The withholding practices of three higher education institutions (two public and one private) and the interviews conducted with a number of tax officers and tax practitioners reveal substantial differences in withholding practices among these institutions. At times, the same institution follows completely different practices at different periods of time. These practices are partly the result of conflicting signals from the tax authorities over the characterization of certain types of payments to employees or independent contractors (**see below**). Sometimes, the subjective readings of a withholding agent can determine the appropriate withholding tax rate in a given institution.

The practices of three higher education institutions in respect of certain payments for specific services are shown in the table below:

Table 5.2: Comparison of Withholding Practices on Sample Payments in three Higher Education Institutions of Ethiopia (valid up to March, 2012)

No	Type of payment	Full time			Part-time		
		PU1	PU2	PRVU	PU1	PU2	PRVU
1	Day-time teaching (regular)	Schedule "A"	Schedule "A"	Schedule "A"	Schedule "A" aggregated	2%	Schedule "A"
2	Part-time (extension)	Schedule "A"	Schedule "A" aggregate	Schedule "A"	Schedule "A" aggregated	2%	Schedule "A"
3	Provisions of short term training	Schedule "A" aggregate	Honorarium (paid net of tax) ³³	2%	Schedule "A" aggregated	Honorarium (tax free)	2%
4	Presentation of conference papers	Schedule "A" aggregate	Honorarium (tax free)		Schedule "A" aggregated	Honorarium (tax free)	
5	Advising Invigilation Examination boards	Honorarium (paid net but tax paid by PU1)	Honorarium (tax free)	N/A	Honorarium (paid net but tax paid by PU1)	Honorarium (tax free)	N/A
6	Consultancy services	Schedule "A" aggregate	2%	2%	Schedule "A" aggregated	2%	2%
7	Translation services	Schedule "A" aggregated	2%	2%	Schedule "A" aggregated	2%	2%

³³ Merriam Webster's Dictionary describes "honorarium" as "a payment usu. for services on which custom or propriety forbids a price to be set;" see Webster's Ninth New Collegiate Dictionary, s. v. "honorarium;" see also Black's Law Dictionary, s.v. "honorarium."

8	Editorial services ³⁴	Schedule "A" aggregated	5% royalties tax	2%	Schedule "A" aggregated	5% royalties tax	2%
9	Assessment of research papers/ scholarly articles	Schedule "A" aggregated	Honorarium (tax free)	2%	Schedule "A" aggregated	Honorarium (tax free)	2%
10	Preparation of modules ³⁵	Schedule "A" aggregate	5% royalties tax	2%	Schedule "A" aggregate	5% royalties tax	2%
11	Payments for writers of textbooks ³⁶	Honorariums (paid net but PU1 pays tax)	5% royalties tax	5% royalties	Honorarium (paid net but PU1 pays tax)	5% royalties tax	5% royalties

NB: This table is a summary of interviews conducted with the finance staff of PU1 and PU2 and PRVU, March 06, 2012; March 27, 2012, and March 28, 2012.

As can be readily observed from the table above, PU1 stands out for treating most kinds of payments to natural persons as "income from employment" and therefore withholding taxes under Schedule "A" upon aggregation of the income from specific services with the regular salary of the employee. If a person who provides specific services is a full-time employee of PU1, the practice is invariably to aggregate the income from specific services with the employee's monthly salary and withhold the tax under the progressive tax rates of Schedule "A". If a person who is engaged for that specific service comes from outside the University, the University withholds tax under Schedule "A" after aggregating the income from specific service with the

³⁴ PU1 finance staff may apply 5% under special advisement

³⁵ PU1 finance staff may deduct 5% royalties tax under advisement

³⁶ PRVU takes as royalties any payments for writing of published works.

income of a person from her full-time employer elsewhere. PU1 demands a certificate from the full-time employer showing the monthly salary of the employee from her full-time employment. If a person is not employed elsewhere, the University treats the income from specific service as the person's sole income from employment and withholds tax under Schedule "A". Except on rare occasions, PU1 treats all payments to individuals as consideration for performance of specific work as income from employment.³⁷

PU2, in contrast, has treated many payments for specific work as "income from independent contract," which is quite favorable as far as the recipients of the payments are concerned. PU2 divides employees roughly into two categories for purposes of applying withholding tax rates. Provision of services by part-time employees is mostly treated as income from "independent contract" regardless of whether "direction and control" are exercised by the University during the performance of the work. For example, if a person who works full-time for the Ethiopian Revenues and Customs Authority (ERCA) teaches part-time at the PU2, the person's part-time payment is treated as "income from independent contract" and 2% flat tax is withheld from the payment.

This practice has led to some curious discrepancies among those individuals who provide the same kind of work for PU1 and PU2. If a full-time professor of PU1 teaches part-time at the PU2, her income from part-time work at the PU2 is treated as "income from independent contract." If a full-time professor of PU2 teaches part-time at PU1, her income from part-time work at PU1 is treated as "income from employment" and subject to tax under the progressive tax rates of

³⁷ There are rare instances in which some individuals succeeded in persuading the withholding agents of PU1 to withhold the flat 2% tax for payments made for specific work, but it is not clear on what grounds the withholding agents budged and decided to create exceptions for these individuals.

Schedule “A” after aggregation of her income with her monthly full-time salary from PU2. The same type of work under virtually identical circumstances is being treated differently for tax purposes simply because of the accident of the institutions involved. At times, the same type of work in the same institution is treated differently owing to the accident of prior relationships. A full-time professor of PU2 is subject to tax under Schedule “A” for all her part-time work while a part-time professor who comes from elsewhere is subject to Schedule “C” withholding (2%) although the underlying service is virtually identical.

PRVU, a private university college in Addis Ababa, follows a slightly different approach in withholding income taxes on payments made to individuals that provide specific services to it. The University College treats most part-time teaching by both full and part-timers as “employment” and therefore withholds income tax under the progressive tax rates of Schedule “A”. If the part-time work involves some writing, translation or consultancy work, however, PRVU treats the payments for these services as income from independent contract and withholds 2% under Schedule “C” of Ethiopian income tax laws. Thus, if a full-time employee of PRVU agrees to write “modules” or “instructional materials” for the University College, the payment under this specific contract is treated as income from independent contract and 2% income tax is withheld.³⁸

In addition to the real differences in withholding practices among the three higher education institutions sampled in this study, some of the institutions have also created some “tax free” payments, which are not expressly countenanced as “tax free” by any of the income tax laws. PU1 occasionally makes special payments called “honorariums” for special commitments by full-

³⁸ For cases in which some of these payments are currently treated as royalties in connection with the production of written materials or works, see below

time employees, such as for committee work. PU1 does not aggregate these kinds of special payments with the regular salary of the employees involved. In fact, according to the finance officers involved, PU1 has administratively agreed to “bear” the tax due on these payments and to make payments designated as “honorariums” “net” or “tax free” to the recipients. There are no rules for distinguishing “honorariums” from other specific payments, and it appears that certain payments become “honorariums” simply because the University has traditionally and customarily called them “honorariums.” PU1 makes special payments for student advising, external and internal assessment of theses, and invigilation, which are currently treated as “honorariums” and therefore paid net of tax.

PU2 too makes payments which go under the name “honorariums” for performing services like presenting research papers in conferences, reviewing the works of others, editing journals and reviews and moderating at conferences. Like PU1, these honorariums are paid to recipients free of tax. The difference is that PU2 treats these payments as free from tax although there are no express legal supports in the income tax laws for exemption of these payments from income taxes. It appears that the practice of exempting “honorariums” from income tax has developed by custom and tradition and has little to do with any express support in the laws of Ethiopia.

The discrepant practices in three higher education institutions might be dismissed as aberrations were it not for the nationwide controversy surrounding the scope and nature of employment for income tax purposes. A recent study, done on selected colleges and universities

in the Northern city of Mekelle, found substantial disparities in the treatment of different payments made to university staff.³⁹

It is difficult to blame one particular factor for the significant disparities among different institutions. A number of factors may have contributed to the current state of affairs in this regard. The first blame must of course go to the ambiguity of the laws in this area. The Income Tax Proclamation itself uses tests that are difficult to understand for withholding agents, if these agents (most of whom have no background in law) ever read the income tax laws themselves. The Proclamation uses the test of “direction and control” by the employer as a test of employment, but this test has never been defined in the Proclamation itself nor satisfactorily explained by the tax authorities for easy application by withholding agents. The subsidiary rules and circular letters that were issued by the tax authorities have suffered from inconsistencies and ambiguities over the years, resulting in confusion we observe in the understanding of the rules in this regard (**see below**). The complete lack of coordination by the tax authorities, in monitoring and providing guidance where necessary, has also aggravated the problems in this area. The authorities have followed a hands-off approach of sitting back and allowing different employers to withhold taxes under different schedules of Ethiopian income tax.

The paradox of Ethiopian income tax system in this regard is that the distinction rests on a difficult test of “direction and control” (which has proven intractable even for judges) and this test is expected to be applied by withholding agents who have never gone to law schools or taken any prior training in law, most importantly “employment law” where the test is a common staple of discussion. The tax authorities have quietly sought to replace the difficult test of “direction

³⁹ Muuz Abreha, Income Tax Withholding in Higher Education Institutions in Mekelle City

and control” from withholding practices altogether, but they too have failed to communicate simple-to-follow rules to all withholding agents so that the rules will apply uniformly even if the rules violate the “direction and control” test adumbrated by the Income Tax Proclamation. We shall examine some of the “guidance letters” written by the tax authorities which were issued purportedly to help withholding agents decide the appropriate withholding rates.

ii. Analysis of Some Private Letter Rulings of the Tax Authorities on the Scope of Employment Income Tax

The inconsistencies of withholding practices in various institutions in Ethiopia are attributable at least in part to the written guidance letters the tax authorities have issued over the years. The tax authorities have written tens, perhaps hundreds, of guidance letters purportedly to help various withholding organizations decide cases in which withholding under Schedule “A” is appropriate and cases in which withholding under the other schedules is appropriate. These guidance letters (somewhat equivalent in import to private letter rulings in the USA) are written by various branch offices of ERCA and at times by the Regional Revenue Bureaus. Withholding organizations request guidance from the nearest branch offices of ERCA simply because they frequently communicate with branch offices as a result of transmissions of withheld taxes from time to time. The branch offices of ERCA as well as the Regional Bureaus do not always relay these requests to a central body in ERCA and instead write guidance letters to requesting organizations interpreting the relevant provisions of the Income Tax Proclamation the way they see these provisions. Since guidance-letter writing is decentralized in practice, inconsistent interpretations of the Proclamation are bound to arise and have in fact arisen. Sample guidance-

letters addressed to a few higher education institutions in Addis Ababa will show the inconsistencies that riddle guidance-letters in Ethiopia.

A Letter written in 1999 E.C. (2007), addressed to one of the public universities, gives directions to the University in the following terms:⁴⁰

... ከኮሌጁ ጋር በፈፀሙት የቅጥር ውል መሰረት አገልግሎት የሚሰጡትን በተመለከተ እነዚህ ተቀጣሪዎች ከተቀጠሩበት መደብኛ ስራ በተጨማሪ አገልግሎት በማበርከታቸው የሚከፈላቸው የትርፍ ሰዓትና መሰል ክፍያ ከደሞዛቸው ጋር ተደምሮ ግብር ተቀናሽ የሚደረግበት ይሆናል። እንደዚሁም በሌላ አሰሪ ዘንድ ተቀጣሪ የሆኑ እና በኮሌጁም ተቀጥረው አገልግሎት በመስጠት የሚያገኙት ገቢ በአዋጁ አንቀፅ 65 ንዑስ አንቀፅ 5 መሰረት ገቢው በሌላ ቀጣሪ ያለተጣመረ መሆኑን በማረጋገጥ ገቢው ተጣምሮ ግብሩ መወሰን ያለበት ስለሆነ በዚህ መሰረት ሊፈፀም ይገባል።

በሌላ በኩል በገቢ ግብር አዋጅ ቁጥር 286/96 አንቀፅ 2(12) ድንጋጌ ለተቀጣሪው የተሰጠው ትርጉም አንድ የተወሰነን አገልግሎት ለመስጠት በውል የሚቀጠርን ሰው የማይጨምር መሆኑ ተመልክቷል።

ከዚህ ድንጋጌ አኳያ የሌላ መስርያ ቤት ሠራተኞች ሆነው የምክር፤ ጥናታዊ ፅሁፍ የማቅረብ ወዘተ... አገልግሎት ለተወሰነ ጊዜ ለመስጠት ከሌላ መስርያ ቤት ወይም ድርጅት ጋር በሚደርጉት ውል መሰረት የሚያገኙት ገቢ በመቀጠር የተገኘ ገቢ ተደርጎ ሊቆጠር አይችልም።

በመቀጠር የተገኘ ገቢ ካልሆነ ደግሞ ከሚያገኙት ደመወዝ ጋር ተደምሮ በሠንጠረዥ ሀ መሰረት ግብር እንዲከፈል ማድረግ አይቻልም። በአንጻሩ ግን በዚህ ዓይነት የተገኘ ገቢ በአዋጁ አንቀፅ 2 ንዑስ አንቀፅ 6 ለንግድ ሥራ በተሰጠው ትርጉም የሚሸፈን በመሆኑ በዚህ አዋጅ አንቀፅ 19 ንዑስ አንቀፅ 2 ድንጋጌ በሠንጠረዥ ሐ መሰረት ግብር የሚከፈልበት ይሆናል።

Roughly translated, this reads:

.... With respect to those providing services pursuant to contracts of employment, any payments received as a result of providing of additional services shall be aggregated with their salaries and appropriate tax should be withheld [under Schedule “A”]. In addition, income of employees of other organizations who provide part-time services shall be aggregated with their full-time income from these organizations pursuant to Article 65 (5) of Income Tax Proclamation of 2002 once the College ascertains that their full-time employer has not already aggregated their income [from employments].

... the notion of “employee” as defined in Article 12 (sic) of Income Tax Proclamation No. 286/2002 does not cover persons who provide specific services. According to this sub-article, employees of other organizations who provide consultancy services, research papers, etc. under a definite and specific contract with the College may not be regarded as employees and their income may not be treated as income from employment. ...

⁴⁰ See Federal Inland Revenue Authority, Ministry of Revenue, letter written to the Ethiopian Civil Service College [now University], 25/2/1999 E.C., in Amharic, unpublished

Income derived in this way is income from business pursuant to Article 2(6) of the Income Tax Proclamation of 2002 and shall be subject to tax under Article 19(2) of the same Proclamation.

The obligations of the withholding agents that make payments for these kinds of services is to withhold 2% from the payments pursuant to Article 53(2) of the Income Tax Proclamation No. 286/2002 and Article 24 of the Income Tax Regulations No. 78/2002.

The Letter, portions of which are cited above, establishes different criteria for cases involving full-time employees and cases involving part-timers. If the person providing the services is a full-time employee of the College, it appears that all income from the part-time work of that employee with the College is to be aggregated with her full-time salary and tax withheld under Schedule “A,” regardless of the nature of the part-time work involved. The Letter provided a simple test to the College: is the person providing the service already a full-time employee of the College? If the answer is “yes,” the Letter instructs the College simply to aggregate the income from part-time engagement with her full-time salary and withhold tax under the progressive tax rates of Schedule “A.” This seems to be the case even if the nature of the part-time work is a consultancy or writing commitment or a translation work, or any other work that ordinarily falls under the independent contract of services.

If, on the other hand, the provider of a service is an employee of another organization, the said Letter instructed the College to distinguish those services that are in the nature of “employment” and those that are in the nature of specific services, such as consultancy work, research work, etc. In this regard, the language of the Letter is not as clear as one might wish, but it seems to pull the withholding agents back to the issue of whether or not the work is performed under the “direction and control” of the employer (in this case, the College) – the basic tipping point under the Income Tax Proclamation. Since the specific services that trigger 2% withholding are given

only as examples, the Letter leaves so much discretion to the College to determine in specific cases whether the payment demands 2% withholding or withholding under Schedule “A” of Ethiopian income tax laws.

A second sample letter is also written to another public higher education institution in Addis Ababa.⁴¹ The relevant paragraph of this Letter reads:

ግንኙነቱ በአሰሪና ሰራተኛ ደንብ ተቀጥሮ የሰራ ያለ ከሆነ እና ከመደበኛው ደመወዝ ውጪ በኮንትራት መልክም ይሁን ያለኮንትራት ተጨማሪ ክፍያ የሚያስከፍል ስራ በተቀጠረበት ኮሌጅ ወይም መ/ቤት እየሰራ ያለ ከሆነ በገቢ ግብር አዋጅ 286/96 አንቀፅ 12 መሰረት ከወር ደመወዝ ጋር ተጣምሮ የሰራ ግብር እንዲከፍል ይደረጋል። የኮሌጁ ተቀጣሪ ሆኖ በሌላ አካባቢ በኮንትራት መልክ ሰርቶ የሚያገኘው ገቢ በዚሁ አዋጅ አንቀፅ 53 መሰረት የኮንትራት አገልግሎት በሰጠበት ኮሌጅ ወይም መ/ቤት ወይም ድርጅት 2% የቅድምያ ግብር ክፍያ እንደሚቀነስበት ይደነግጋል። ይህ 2... ተቀናሽ የሚደረገው አገልግሎት ሰጪው ሰራተኛ የግብር ከፋይ መለያ ቁጥር ሲኖረው ብቻ ይሆናል። ከሌለው ግን በዚሁ አዋጅ አንቀፅ 91 መሰረት 30... እንዲቀነስበት ይደረጋል።

Roughly, this translates as:

Where the relationship is one of employer-employee relationship and a full-time employee receives additional payment (other than her regular salary) for providing specific services as a result of special contractual relationship or not, the payment so received shall be aggregated with the regular salary of the employee in accordance with Article 12 of the Income Tax Proclamation. Where [on the other hand], a full-time employee of a college performs special contractual service in another place (another college or another institution), the law requires that 2% tax be withheld from the payment for the specific contractual service. The law prescribes 2% withholding if the person providing the service possesses a TIN. If the person providing the services does not possess a TIN, Article 91 of the Income Tax Proclamation requires that 30% shall be withheld from the payment. [translation by author]

The Letter brushes aside the elements of employment – “direction and control” and prescribes its own conditions for withholding income tax under Schedule “A” or Schedule “C.” The Letter makes no mention of the elements of “direction and control” in the Proclamation and quietly

⁴¹ Ethiopian Revenues and Customs Authority, Arada Sub City Small Taxpayers Branch Office, Letter written to Kotebe Teachers’ College, on 22/08/04, in Amharic, unpublished

supplants these requirements by elements that are not intimated in the Proclamation. The Letter stipulates a presumption that any additional payments to full-time employees are to be assumed to be income from employment and aggregated with their full-time salary, and any additional payments to part-time employees are to be presumed to be income from business and subject to 2% or 30% tax withholding, depending on whether the employees possess TIN or not.⁴²

A third sample Letter is written to the Natural Science Faculty of Addis Ababa University:⁴³

..ፋክልቲው/ዩኒቨርሲቲው በትርፍ ጊዜ የተቀጠረው ባለሙያ ሌላ መ/ቤት የተቀጠረበትን ማስረጃ በመጠየቅ የትርፍ ጊዜ ክፍያውን ከደመወዙ ጋር በማጣመር የስራ ግብር ማስከፈል ያለበት መሆኑን ፤ በሌላ በኩል ባለሙያው የንግድ ፈቃድ በማውጣት የንግድ ትርፍ ግብር ከፋይ ከሆነ እና ከዩኒቨርሲቲው ጋር የስራ ኮንትራት ውል ካለው የግብር ከፋይ መለያ ቁጥር ሲያቀርብ 2% ዊዝሆልዲንግ የሚቀነስበት ሲሆን የግብር ከፋይ መለያ ቁጥር ካላቀረበ 30% የሚቀነስበት መሆኑን እንገልጻለን።

Roughly translated, the above paragraph reads:

The Faculty/University shall require part-time staff to produce a letter of employment from their full-time employer and aggregate income from part-time work and full-time salary under Schedule “A”. If the part-time staff possesses a business license and pays tax under Schedule “C,” the University shall withhold 2% tax from part-time payments if the part-time staff has a TIN or 30% where the part-time staff is unable to provide a TIN. [author’s translation]

The Letter addressed to the Faculty of Science of Addis Ababa University shares one common feature with most of the letter rulings issued by the tax authorities over the years. This letter ruling completely disregards the substantive requirement of the Income Tax Proclamation and

⁴² Incidentally, the letter purportedly advises the College over the treatment of payments to Kotebe Teachers’ College employees who work elsewhere, but this is of little use to the College because it is not the concern of the College as to how their payments elsewhere should be treated; the letter should have addressed the concerns of the College on cases in which the college makes payments to part-time employees or to full-time employees who provide specific services outside their regular employment duties)

⁴³ ERCA, Customers Education and Support, Letter written to Addis Ababa University, Natural Science Faculty, Addis Ababa, 18 Miazia 2004 E.C, in Amharic, unpublished.

seeks to resolve the issue on the basis of the presentation or lack of presentation of specific documents, such as business license and the TIN. What sets it apart from similar letters is the fact that it introduces a new requirement to the whole saga of the distinction between “employment” and “independent contract of services” – namely possession of a business license and even an intimation that the withholding agents should ascertain whether the person providing the service pays income tax under Schedule “C”. These requirements are not mentioned in the Income Tax Proclamation, and the Letter does not even pretend to have relied upon any specific provision of the Income Tax Proclamation – other than rationalizing somehow that 2% is an advance payment for business profit tax under Schedule “C”.

The three letters issued by the tax authorities to different withholding organizations appear to share some common features although they reached wildly divergent conclusions on the same set of issues.

- i. The letters have been issued by the Authorities in response to queries from various withholding organizations and although the questions asked are at bottom the same, the Authorities have deemed it appropriate to respond individually and in general have refrained from issuing rulings that would be uniformly applied by all withholding organizations;
- ii. The letters have been written to individual organizations without any obvious reference to similar letters written in response to similar set of queries from withholding organizations;

- iii. Although many of the letters refer to one or two provisions of the Income Tax Proclamation, none of the letters has provided guidance on how to identify the requirement of “direction and control” – the key factor in the Income Tax Proclamation. Instead, the letters have quietly set aside this requirement and replaced it by factors not countenanced in the Proclamation. Some of the letters have considered a number of factors to be decisive to resolving the appropriate withholding tax rate and the schedule, but none of these factors are considered relevant under the Income Tax Proclamation. Some of the factors introduced anew by the letters include factors like the nature of employment – i.e., part-time vs. full-time, or the prior engagement of the employee – i.e., part-timer or full-timer, and in the case of at least one of the letters, whether an employee or service-provider possesses a business license.

In sum, although the letters are entitled “guidance letters” in the administrative practices of the tax authorities, they have failed to provide adequate and uniform set of guidance to withholding agents. The letters are not the sole reason for discrepant withholding practices in different institutions but they have played an important part in these practices. The letters, while purportedly based on the Income Tax Proclamation, have also in the end set aside the key requirement of the Income Tax Proclamation – namely that of “direction and control.” Whether the letters were consistent with the language of the Income Tax Proclamation, it is important to remember that the letters constitute an important source of authority for withholding practices by the withholding agents involved. Many withholding agents know that they are safer following the letters than the language and the spirit of the Income Tax Proclamation.

d. Delimiting the Scope of “income from employment” from “income from sources other than Independent Contract Services”

i. Income from Employment or Royalties

Most disputes regarding withholding taxes revolve around issues of whether a withholding agent should aggregate specific income in the context of employment with the regular income from employment (wages and salaries) or treat the specific income as “income from independent contract” and deduct 2% (or 30% in the absence of TIN). The resolution of these disputes hinges, as we have seen above, on whether the relationship is one of employment or independent contract of services. The Income Tax Proclamation regards “direction and control” as decisive to the distinction, but as we have seen above in relation to some higher education institutions and the guidance letters written by the tax authorities over the years, the requirements of “direction and control” have been quietly set aside and in their place have been installed arbitrary requirements like the status of an employee as a “full-timer” vs. “part-timer,” whether a person possesses a TIN and/or a business/professional license and in some cases, an evidence of profit tax payment under Schedule “C”.

The practice of some higher education institutions in the City of Addis Ababa and Amhara Regional State has revealed that in some situations, the characterization may bifurcate into the other sources of income chargeable with income tax under the Ethiopian income tax laws. Employers or withholding agents are worried not only about employment vs. self-employment, but also about a whole raft of issues arising in connection with the miscellaneous sources of

income chargeable under Schedule “D” of Ethiopian income tax laws: “income from employment” or “royalties,” “income from employment” or “dividends,” and “income from employment” or “interest.” Since the tax rates diverge quite considerably among these different sources of income, employees and sometimes employers have every incentive to characterize specific income under one of the lower-taxed miscellaneous sources.

We have already seen how the three higher education institutions sampled in this study treat cases potentially involving “royalties” (**see Table 5.2 above**). The higher education institutions seen above have relied upon their own internal resources of interpretation to come up with their own, “quirky,” version of which payments for what services qualify for “royalty” treatment (literally and metaphorically) and which payments are subject to tax under Schedule “A” and which payments under Schedule “C” or the other schedules.

In this connection, it is perhaps instructive to relate the story of how the tax administration in Amhara Regional State resolved the common conflicts that arise in connection with the withholding of taxes on various payments to instructors of universities in the State. Initially, the tax authorities took the position that payments for the preparation of modules and instructional materials were income from employment and therefore ought to be aggregated with the salary of the university instructors involved. In response to the widespread dissatisfaction among instructors with this characterization, Bahr Dar University assembled an ad hoc committee of lawyers who penned a legal opinion arguing that the payments for the preparation of modules and instructional materials were in the nature of royalties for the materials.⁴⁴ ERCA was persuaded by these arguments and agreed with the position of Bahr Dar University to treat the

⁴⁴ Telephone conversation with Ato Balew Mersha, Legal Counsel to Bahr Dar University and Lecturer, July 17, 2013

payments as “royalties,” rather than as income from employment.⁴⁵ In its concurrence with the position of Bahr Dar University, ERCA wrote:⁴⁶

... የሞጁል ዝግጅት የስነ-ፅሁፍ ሥራ ለመሆኑ የዩኒቨርሲቲው ሕግ አገልግሎት ባለሙያዎች ከሰጡት ማብራርያ በላይ አሳማኝ ማብራርያ ለማቅረብ መሞከር አስፈላጊ ሆኖ አላገኘነውም። ምክንያቱም አዋጅ ቁጥር 410/96 አንቀፅ 2(3) ጥበቃ የሚያደርግለትን «ሥራ» ሲተረጉም መፅሐፍና ቡክሌት የመሳሰሉትን የስነ ፅሁፍ ስራዎች እንደሚያካትት ገልጿል። በዚህ አዋጅ የተጠቀሱት መብቶች ያለአንዳች ልዩ ቅድመ ሁኔታ ጥበቃ የሚደረግላቸው መብቶች ናቸው።

ስለሆነም ... መምህራኑ ከዩኒቨርሲቲው ጋር በሚገቡት ልዩ ውል መሰረት የመደበኛ ስራቸው አካል የሆነውን የርቀት ትምህርት መማርያ ሞጁል አዘጋጅተው የሚያገኙት ገቢ ከማናቸውም የስነ ፅሁፍ ስራ እንደሚገኝ ገቢ ተቆጥሮ በገቢ ግብር አዋጅ ቁጥር 286/94 አንቀፅ መሰረት ግብሩ ሊወሰን እንደሚገባ በመግለፅ ይህን አስተያየት የላከን ሲሆን...

When roughly translated, this reads:

We did not think it was necessary to add to the written opinions submitted by the legal advisers [of the University] who made a convincing case for why modules constitute “copyrighted materials.” As Article 2(3) [sic] of Proclamation No. 410/2010 stipulates, works protected as “copyrighted materials” include books, booklets and other materials. All works listed in the Proclamation are accorded copyright protection without any conditions.

Thus... the income the university lecturers derive from the preparation and writing of modules after signing special contracts with the University should be treated as income from royalties and tax withheld in accordance with Article 31 of the Income Tax Proclamation of 2002 (author’s translation).

The characterization of payments for writing commitments by university professors and lecturers as “royalties,” rather than as “income from employment” is not really unique to Bahr Dar University. As can be seen from the survey of sample higher education institutions, many institutions have unilaterally interpreted the Income Tax Proclamation to reach similar conclusions. As can be clearly seen from **Table 5.2** above, PU2 withholds 5% from payments

⁴⁵ Interview with Ato Sewagegn Gedifew, ERCA, Bahr Dar Branch, February 13, 2012

⁴⁶ Ethiopian Customs and Revenues Authority, Bahr Dar Branch, Customers Services Business Process, 08/10/2001 E.C., in Amharic, unpublished; this position of ERCA has reportedly been contradicted and reversed by the Ministry of Finance and Economic Development. Responding to similar questions originating from another university, Madda Walabu University, the Ministry wrote a letter (which was copied to all other universities) instructing all universities to treat payments for the preparation of modules and other instructional materials as income from employment, rather than as royalties; telephone conversation with Ato Balew Mersha, Legal Counsel to Bahr Dar University and Lecturer, July 17, 2013

made in consideration for the preparation or writing of various instructional materials and modules. PRVU too follows this policy, although its rendition of written materials is narrower than those of PU2. PRVU withholds 5% royalty tax only when the payments are made for articles or other contributions made in its publications and not for modules and instructional materials that remain unpublished but are used by the University College. For PRVU, therefore, “publication” appears to tip the balance in favor of taxation of the income as income from royalties. Some of the higher education institutions have subjectively decided that payments for modules and other writing materials deserve to be treated as “royalties,” rather than as “income from employment.”

These practices illustrate once again that the withholding practices in different places are as divergent as can be. The differences boil down to some arbitrary incidents: the bargaining powers of the recipients, the persistence with which the recipients insist on getting a fair deal out of withholding taxes, the concurrence (and perhaps collusion) and willingness of the withholding agents to listen to the arguments and persuasions of the recipients, etc. In some cases, the tax authorities have acquiesced in writing and in others the universities have adopted their own withholding approaches in full view of the tax authorities. Sheer personal animosities or sympathies cannot be ruled out of how decisions are made in different places. The tax authorities have also flip-flopped over the same kinds of issues over the years.

ii. Income from Employment or Interest or Dividends

Apart from possible conflicts with “income from independent contract of services” and “royalties,” other conflicts of perhaps less frequency may arise in practice. As the relationships between employees and employers are complex and intricate, so are some of the forms of

income flows from employers to employees. The relationships between employers and employees cannot be reduced to the simple matrix of employment, although that often forms the basis of employer-employee relationship. The relationships between employees and employers may at times be found in concurrence with the personal relationships of husbands and wives, of fathers and sons, mothers and daughters, debtors and creditors, shareholders and companies, writers and publishers, donors and donees, etc. Sometimes, these other relationships are so closely intertwined with the employment relationships that it is by no means clear whether the benefits flowing therefrom are income from employment or from the other relationships.

One possibility or incident for conflict is between income from “employment” and “interest income.” Many employees are known to have organized credit unions which serve as saving financial institutions for the benefit of employees. As taxes are withheld from salaries and wages of employees, a certain amount is withheld monthly from the salaries of employees, which are then placed under the administration of employers for investment and provision of credit facilities to employee members of the credit unions. Employees are paid interest (at least interest accrues in favor of employees) and dividends every year from the saving funds of the credit unions.

Some employers are known to borrow from the saving funds in return for the payment of interest, as *Shell Ethiopia* case illustrates. In ***Shell Ethiopia Ltd.vs. IRA.***⁴⁷ Shell Ethiopia Ltd (the predecessor of Oil Libya) entered into a collective agreement in which the Trade Union (representing employees of Shell Ethiopia) allowed Shell Ethiopia Ltd to use provident funds held in the name and on behalf of employees, and Shell Ethiopia agreed to pay interest at the

⁴⁷ See ***Shell Ethiopia Ltd. v. Inland Revenue Administration***, Civ/App/File/No. 763/78, in Amharic, unpublished

annual rate of 7% for the use of the funds. The then Tax Authority – IRA (Inland Revenue Administration) – thought that Shell Ethiopia should have withheld the tax due on the interest paid for the use of the provident funds in the name of employees. Shell Ethiopia protested and denied that it had the obligation to withhold tax on the interest, arguing that the interest was not income from employment but from the use of the loan, which was not taxable.

The Tax Appeal Commission at the time decided in favor of the Tax Authority and ruled that Shell Ethiopia should have withheld tax on interest as it did on the salaries of its employees. Shell Ethiopia appealed this decision to the High Court, but the High Court confirmed the decision of the Tax Appeal Commission. The case went for final appeal to the Supreme Court, which reversed the decisions of both the Tax Appeal Commission and the High Court. The reasoning of the Supreme Court was that the payment was in the nature of “interest” and not an income from employment and therefore did not give rise to the obligation of the employer (Shell Ethiopia) to withhold tax under Schedule “A.”

The Shell Ethiopia case illustrates that disputes regarding income from employment or payments in the context of employment may raise questions as to whether in specific cases employers have the duty to withhold income taxes, or if they have to withhold income taxes, under which of the schedules, and sometimes if they have any obligation to withhold income taxes at all.

Due to innovations in employment and industrial relationships, characterization of income obtained in the context of employment has become more and more complicated. In many parts of the world, and, perhaps increasingly so in Ethiopia, employees obtain benefits, which are difficult to characterize as income solely from employment. The famous John Lewis model in

England, for example, runs on the philosophy of full employee participation in which employees serve as board directors, managers and shareholders of a business enterprise.⁴⁸ Employees of these types of companies obtain income from two principal streams, both of which are closely related: salaries or wages, and dividends. Employees may also be invited to purchase shares at less than market value or be guaranteed a repurchase of the shares at a certain fixed price even though the price of the shares has fallen in the market.⁴⁹

In Ethiopian context, the conflict over “income from employment” vs. “income from dividends” arises frequently with respect to payments to corporate directors.⁵⁰ Some companies have provisions for the payment of a percentage of the profits of a company to corporate directors as an incentive and compensation for the latter’s services. These payments have already divided opinions within the tax authorities.⁵¹ Some are of the opinion that these payments should be characterized as “income from employment” and be subject to income tax withholding under Schedule “A” of Ethiopian income tax laws, while others have argued that these payments are in the nature of “dividends” as they are made from the “profits of the company.”⁵² It has been reported that many companies and corporate directors are reluctant to pay income tax under Schedule “A” (for obvious reasons of the higher marginal tax rates under Schedule “A”) and have

⁴⁸ See Bradley and Estrin, Profit Sharing in the British Retail Trade Sectors, p. 291

⁴⁹ See Olowofoyeku, Kirkbride and Butler, Revenue Law, pp. 107-108

⁵⁰ Revision Proposals of the Large Tax Taxpayers’ Branch Office, ERCA, Addis Ababa, 2004 E.C., in Amharic, unpublished; see also Report Seeking Professional Guidance from Lawyers, Finance Managers Committee, Ethiopian Banker’s Association, Miazia 2003 E.C., in Amharic, unpublished, pp. 10-12

⁵¹ Revision Proposals of the Large Tax Taxpayers’ Branch Office, ERCA, Addis Ababa, 2004 E.C., in Amharic, unpublished

⁵² Ibid

only shown willingness to pay the 10% dividend withholding tax.⁵³ The tax authorities attribute the problem to the lack of clarity and of details in the Ethiopian income tax laws.⁵⁴

The absence of detailed rules on many of the issues surrounding withholding of income taxation has opened the Ethiopian income tax system to abuses of one kind or another. Unless the boundaries are defined properly through detailed rules, the incidences for tax planning and abuse can be numerous. Thus far, Ethiopian tax administration has not developed any systematic approach to these problems, and indeed has in many cases been responsible for the divergent practices of income tax withholding by various withholding agents. The discrepant practices of income tax withholding in various places are some of the most conspicuous examples of income tax discrimination among employees of various organizations in Ethiopia.

III. Application of the Income Tax on Income from Multiple Employments and on Employees of Organizations Enjoying Diplomatic Immunity

One of the distinctive, if not unique, features of Schedule “A” income taxation in Ethiopia is the preponderance of simple PAYE scheme in the assessment and collection of taxes on employment income. The simple PAYE involves, as its name suggests, a simple process of withholding taxes from monthly wages and salaries, without any adjustments for overpayments or underpayments resulting from the differences in the monthly accounting system from the annual accounting system.⁵⁵ The Ethiopian simple PAYE scheme disregards any differences that arise in connection with the implementation of the PAYE withholding. The Ethiopian simple PAYE scheme also disregards employee expenses incurred in the course of employment, however significant these

⁵³ Ibid

⁵⁴ Ibid

⁵⁵ See van der Heeden, “The Pay-As-You-Earn Tax on Wages,” p. 567

expenses might be. The administrative simplicity of the simple PAYE has counted against possibilities of adjustments and deductions in favor of employees.

The basic feature of a simple PAYE system of taxation is that employers, rather than employees, bear most of the burden of collection of the tax on behalf of government. Consistent with this feature, Schedule “A” income tax rules impose most of the obligations upon employers. Article 65(3) of the Income Tax Proclamation relieves employees of the obligation to declare their income (from employment) if the income of employees “for a tax year consists exclusively of Schedule “A” income.” It is employers who should maintain all the books and records necessary to withhold and transmit the tax due on income from employment. In many instances, the withholding scheme on income from employment operates upon a simple rule of employers’ withholding taxes from the salaries, wages and other emoluments made to their employees and the employees’ passive acceptance of the whole procedure.

There are, however, some exceptions to this rule. Employers shoulder additional obligations of withholding when they hire employees (part-time or full-time) who also work for others.⁵⁶ Employees, who are normally absolved completely from self-assessment, are also subject to self-assessment obligations when they derive income from multiple-employments and when they work for organizations that are exempted from withholding obligations. The ostensible rationale of these rules is ensuring some modicum of parity (horizontal equity) between employees who work for one employer alone and employees who work for multiple employers and between employees who work for employers that are obligated to withhold taxes and employees who work for employers enjoying immunity from withholding obligations. Unfortunately, the

⁵⁶ Income Tax Proclamation No. 286/2002, see Art. 65(4)

practical implementation of the rules of aggregation by employers and of self-assessment by employees is so deficient that these rules, far from being guarantors of tax equity among employees, have been responsible for some of the most obvious sources of discrimination among employees of various organizations. We shall examine the practical implementation of aggregation by employers and self-assessment by employees in the following sections.

a. Aggregation by Employers in Practice

The Income Tax Proclamation obligates employers to aggregate income when “employers find out” that their employees have more than one job and upon ascertaining that the other employers of the same employee have not aggregated.⁵⁷ Absence of adequate data on aggregation practices by employers means that we have to rely upon statements of a number of tax officers and tax practitioners to assess whether employers comply with their obligations of aggregating the income of employees who work part-time or full-time elsewhere. There is no data on how many employees work in multiple employments or jobs in Ethiopia, and the tax authorities rely upon the good offices of employers to aggregate the income of employees.

The general assessment of respondents is that not many employers aggregate income of employees. The few that aggregate the income of employees are the government bodies and enterprises, which, largely because of their affiliation with the government, are more likely to comply with government regulations and laws. It is alleged that many private enterprise employers do not bother with aggregation of the income of their employees at all. A number of reasons are given by the respondents. The reasons may be summarized into three:

⁵⁷ Id, see Art. 65(5)

- i) The existing rules of aggregation impose the obligation to aggregate when employers find out that their employees also work for other employers;
- ii) Employers do not have any credible way of finding out whether their employees work for others and simply assume that they are the sole employers of their employees;
- iii) Some employers treat income from part-time employment as income from independent contract, and not as income from employment and therefore are content to withhold the 2% withholding tax rather than aggregate the income from part-time employment with the employee's full-time employment income elsewhere.

The existing rules make it extremely easy for employers to dodge their aggregation obligations. Employers may always pretend not to have known the fact that their employees work for other employers as well. Some employers that wish to protect their employees against the consequences of aggregation can simply ignore the fact that their employees work elsewhere. It is quite easy to allege lack of knowledge about this fact. There are currently no national databases to verify whether an employee works elsewhere. The tax authorities have only recently started issuing TIN for all employees, but the database for TIN is not available to employers as such. There are also recent developments to incorporate private employees under the compulsory social security scheme, but these developments have not yet taken hold as to become reliable databases for cross-references.⁵⁸ Even if the tax authorities wish to press employers to aggregate income of employees, they cannot enforce these against employers that are determined to ignore facts about their employees' multiple employments.

Another reason why aggregation by employers (or at least some employers) has failed is because the current legal and institutional arrangements make it easy for some employers to treat

⁵⁸ See Private Organizations Pension Proclamation No. 715/2011

income from additional or part-time employment as income from independent contract rather than as income from employment. Some employers are content to withhold 2% from part-time employment and the tax authorities are generally content to have 2% withheld as long as the part-time employments are not of a continuous nature. It is very easy for some employers to characterize all part-time work as “income from independent contract” as it is for them to characterize what is substantively an “independent contract” as one of employment (as aptly shown above). In any case, the withholding of 2% from part-time employment forecloses in practice the aggregation of that income under Schedule “A.” For various psychological and institutional reasons, the tax authorities have tolerated these practices.

Some members of the Tax Administration have argued that while this is a questionable practice in terms of tax equity, it is not worth the administrative resources of the tax authorities at the moment to police employers on their aggregation practices.⁵⁹ These members have argued that the amount of revenue loss from non-compliance by employers is not significant given the reality that very few employees ever get the opportunity to work for more than one employer. Part-time employments are common in universities, private schools, clinics, hospitals and health centers. Ethiopia’s Higher Education Proclamation even encourages “joint appointments” so that some highly educated individuals will be able to teach in higher education institutions as well as working for other government and non-governmental institutions.⁶⁰ The booming private sector health industry has also seen the increasing popularity of health specialists working for different health centers at different times in a day and during a week.

⁵⁹ Interviews with Ato Girma Tafesse, ERCA Branches Directorate, May 09, 2012; Ato Gebrelibanos W/Aregay, ERCA, Yeka Branch, April 1, 2012

⁶⁰ See Higher Education Proclamation No. 650/2009, Article 34

For the tax authorities, the aggregation of income from these sectors is not really that significant as to require the attention of their limited administrative resources to monitor whether employers comply with their aggregation obligations. They are happy to see employers voluntarily comply with their obligations or at least employers withhold some tax from these payments (whether the withholding is under the progressive tax rate of Schedule “A” or the flat tax rate of 2% under Schedule “C” is immaterial at the moment to them).

However the tax authorities view aggregation of income from multiple employments, the disparities in aggregation practices among different employers as well as the withholding tax rates are some of the principal sources of discrimination among employees. Employees that are subject to aggregation are made to pay more in income taxes than employees of whom employers do not demand to disclose their income from the other employment. Employees that are subject to 2% withholding (which is practically a final tax) are given even more generous dispensation by their employers, as their additional income is subject to a lower tax rate than even the lowest tax rate under Schedule “A” (which is 10% at the moment). An employee whose income from part-time employment is withheld at 2% under Schedule “C” rather than under the progressive tax rates of Schedule “A” receives huge tax benefits, whereas an employee whose income from part-time employment is aggregated with his full-time employment is made to bear the full brunt of progressive tax rates under Schedule “A.”

Employees that are denied these generous treatments may cavil at the tax rate under Schedule “A,” but under current dispute settlement practices, employees are really resigned to accepting the withholding by employers as final. They do not have real recourse against abuses by employers or mischaracterizations other than hoping for generous treatments by employers.

b. Employee Self-Assessments in Practice

Almost all of the taxes due on employment income in Ethiopia are collected by withholding schemes. Employers discharge most of the obligations of maintaining records, computing the taxes due, withholding the taxes and transmitting the taxes withheld to the tax authorities at set times.⁶¹ For employees that derive their income from one employment, the system of withholding currently acts as a final tax obligation.

Nonetheless, self-assessments are not completely ruled out for employees. Ethiopian income tax laws impose self-assessment obligations implicitly or otherwise in three distinct cases:

- i) Where employees derive additional income from sources which are subject to self-assessment under Ethiopian income tax laws (e.g., where an employee derives income from rental of buildings (Schedule “B”) or the carrying out of business (Schedule “C”));⁶²
- ii) Where employees derive income from multiple employments;
- iii) Where employees derive income from employment with exempt organizations;

The requirement of self-assessment in connection with employment income in addition to withholding schemes clearly indicates the desire on the part of the law to meet the demands of tax equity (both in horizontal and vertical equity terms). But the peculiarities of Ethiopian income tax system are such that these rules do not go far enough in achieving tax equity. There are also practical problems in implementation of self-assessment obligations which aggravate

⁶¹ Income Tax Proclamation No. 286/2002, see Articles 51 and 65 (1) & (2)

⁶² Where these are the case, employees are subject to the rules of self-assessment under the respective schedules of Ethiopian income tax

the inequity of the income tax system further. We shall explore the practical problems that arise in connection with self-assessment by employees for income arising from employment.

i. Self-Assessment of Income from Multiple Employments

Some employees may derive income from multiple employments, all of which fall under Schedule “A”. Most people in Ethiopia are lucky to have one employment as a source of livelihood. There are however, some employees who may work for several employers either to make ends meet or supplement their income from their principal employment or because they have skills or specialized knowledge that tends to be demanded by multiple employers. Part-time employments with several employers in addition to one principal employment are common in university settings, clinics, health centers and hospitals, among others.

The income tax laws have these kinds of employment arrangements in mind when they impose exceptional obligations either upon the employers to aggregate income and/or the employees to self-assess. In these types of arrangements, the income tax laws impose the first obligation upon the second or third employer to aggregate income from second or third employment with income from first employment.⁶³ In effect, the income tax laws continue the withholding scheme upon those employees that derive income from multiple employments. However, since these withholding schemes rely upon the precarious circumstance of the knowledge of the second or third employer to aggregate income, the laws prudently impose additional obligations upon employees to self-assess – in other words, to declare their income from multiple employments and pay the tax due on the difference between the tax withheld separately by their individual

⁶³ Income Tax Proclamation No.286/2002, see Art. 65(5)

employers and the tax due on the aggregate.⁶⁴ Second or third employers can always feign ignorance of the engagement of their employees elsewhere, and those employees who withhold this information are likely to escape the levying of the heavier burden of taxation upon their aggregate income. Even if employers exercise utmost diligence to collect information regarding the other employments of their employees, they may not be able to find out in some cases.

In practice, the tax authorities rely completely upon the voluntary compliance of employers to withhold the tax due upon the aggregate income of employees from multiple employments.⁶⁵ Certain organizations conscientiously comply with their obligations and insist upon the production of letters of employment from the previous and first employer showing the monthly salary paid to an employee before they pay income from the second and third employer. These organizations are mostly government institutions, whose compliance with tax obligations is driven by the public spirit or solidarity with government programs and laws.

The tax authorities are aware that many organizations do not even bother to enquire about the engagement of their employees in other places, but so far they have not deployed any systematic administrative scheme to ensure that all employers comply with their obligations to aggregate income and deduct the tax due on the total when some employees derive income from multiple employments. The tax authorities also lack a database of what employees generate income from multiple employments and what employees do not, which means that they are currently completely at the mercy of the voluntary compliance of employees to meet their obligations in this regard. Some employers routinely demand certificates of employment or self-employment

⁶⁴ Id, see Art. 65(4)

⁶⁵ Interviews with Ato Gebre Libanos W/Aregay, Ethiopian Revenues and Customs Authority, April 1, 2012; Ato Sewagegn Gedifew, ERCA, Bahr Dar Branch, February 13, 2013; Ato Getachew Mesfin, Amhara Regional State Revenues Bureau, Tax Enforcement and Collection Business Process, February 15, 2012

from their part-time employees while similar institutions elsewhere are content to simply withhold the 2% withholding tax assuming generally that income from part-time engagement is income from business, and not employment.⁶⁶

The situation is even more dismal when it comes to self-assessments by employees. Few employees currently report their income from multiple employments to the tax authorities.⁶⁷ Many respondents agree that most employees do not even know that these obligations of self-assessment exist and as a result assume that the withholding of taxes by their respective employers is sufficient to meet their obligations under the income tax laws. There are a few reported cases of self-assessment by certain employees. The few that voluntarily report their income from multiple employments tend to be those that worked with the tax authorities in the past and are therefore brought into greater awareness of their obligations under the tax laws or some prominent personalities whose high profile engagements with certain organizations are well-known in the Government circles and therefore concerned that their non-compliance might tarnish their public image in the future.⁶⁸ There are also unconfirmed reports of some employees being turned away by tax officers because the officers are unused to self-assessments by employees. Once again, the tax authorities have so far been content to see employees voluntarily report their income from multiple employments or their employers comply with their obligations to aggregate and deduct the tax due. They have yet to pursue any concerted strategy to monitor those employees that obtain income from multiple employments.

⁶⁶ Interviews with finance officers of PU1, March 06, 2012

⁶⁷ Interview with Ato Gebrelibanos W/Aregay, ERCA, Yeka Branch, April 1, 2012

⁶⁸ Interviews with Ato Yonas Argaw, ERCA, Tax Audit, April 27, 2012 and W/ro Roman Menberu, Arada Small and Micro Business Taxpayers' Branch Office, Tax Assessment and Enforcement Business Process Coordinator, April 17, 2012

A number of factors have accounted for low level of compliance with self-assessment obligations by employees. One factor, already mentioned, is ignorance of the very existence of self-assessment obligations by employees and perhaps the expectation that the government will not have enough information to pursue those employees who fail to meet their self-assessment obligations under the income tax laws. Since withholding by employers has generally been taken as the final tax, many employees are content if their employers withhold the tax without any concomitant obligation upon them to self-assess. The information data base of the tax authorities is generally known to be weak and the employees are confident that they will not be pursued if they fail to self-assess.

The tax authorities themselves have frankly been tardy in pursuing those employees that do not meet their self-assessment obligations. Over the years, the tax authorities have devised various administrative strategies to enforce certain tax obligations, like aggressively registering businesses for VAT and providing various tax incentives to encourage some taxpayers to file tax returns, but they have yet to devise effective strategies to enforce employment income taxes upon employees who derive income from multiple employments.⁶⁹ The income of employees has never been within the radar of their tax enforcement strategies over the years presumably because the authorities are aware of the high tax burdens upon employees in general and the comparatively high tax compliance of the tax on employment income largely because of the withholding schemes upon employers. The tax authorities have so far focused their attentions

⁶⁹ The authorities have devised various strategies to improve voluntary compliance by taxpayers, including providing rewards for informants; see, for example; Ethiopian Revenues and Customs Authority, Directive on Rewards to Informants on the Use of Cash Register Machines, Nehassie 2001 E.C.; see also Ethiopian Revenues and Customs Authority, Directive on Issuing a Certificate of Tax Clearance to Taxpayers who Complied with their Tax Obligations; Nehassie 2001 E.C., both in Amharic, unpublished.

upon areas where there are reports of massive tax evasion or underreporting, such as businesses that fail to register for VAT or fail to declare or underreport their income.

There are also structural problems in the current design of employee self-assessments. The income tax rules do not contain special provisions for self-assessments by employees. The rules seem to require monthly accounting of employment income by employers as well as employees. Given the normal monthly payroll cycle of most employers, it may be deemed reasonable to require employers to withhold taxes as they pay (hence Pay-As-You-Earn – PAYE) but to require employees to comply with these monthly self-assessment obligations can be cumbersome to many employees. Even if employees are aware of their obligations to self-assess, they are unlikely to accept the monthly accounting system of self-assessment as fair, which weighs upon their decision to comply with these obligations. The Ethiopian income tax system has not devised schemes for these employees to self-assess at the end of each accounting year and pay the tax on the difference between tax withheld by their employers and tax due upon their total employment income.⁷⁰ It is not clear how many employees in Ethiopia are aware of their obligations but are discouraged from complying with their obligations as a result of the onerous monthly accounting system for employment income. But it clearly points to one structural loophole of Ethiopian income tax system that needs to be reformed if the self-assessment by employees is to be fully realized in the future.

⁷⁰ Interview with Ato Getu Jemaneh, HST Consulting, April 09, 2012

ii. Self-Assessment by Employees of Organizations Enjoying Diplomatic Immunity (Exempt Organizations)

Employment income taxes have been the most effective income taxes in Ethiopia largely because these taxes rely upon the withholding of taxes by employers. Enforcement of the income tax is a straightforward affair as long as employers are obligated to withhold income taxes from salaries and wages of their employees. This administrative advantage of withholding taxation breaks down when the government cannot by law compel employers to withhold income taxes. This is the case for diplomatic missions like embassies, consulates, and international organizations, which, by the operation of international law, enjoy diplomatic immunity from the operation of most domestic laws of host nations, including the obligations to withhold income taxes. The Vienna Convention, which regulates the diplomatic immunities of missions and members of diplomatic staff, grants exemptions from withholding obligations to diplomatic missions and members of the diplomatic staff.⁷¹ The Convention extends income tax immunity to members of the diplomatic staff, but these are not the only staff constituting diplomatic missions.⁷² In addition to diplomatic staff, diplomatic missions and international organizations enjoying diplomatic immunity have administrative and technical staff as well as service staff and private servants as employees.⁷³ These other staffs of diplomatic missions and international organizations do not enjoy diplomatic immunity from the income tax. The problem is that it is difficult to enforce the ordinary rules of the income tax (which as we have seen relies heavily upon withholding by employers) as the diplomatic missions and international organizations

⁷¹ See Vienna Convention on Diplomatic Relations, done at Vienna on 18 April 1961 available at http://www.eisil.org/index.php?sid=4a1s&id=423&t=link_details&cat=519 accessed on May 29, 2012

⁷² Id., Article 34

⁷³ Id., see Article 1 (f)(g) and (h)

themselves enjoy diplomatic immunity. The only option left to governments is to resort to the precarious scheme of self-assessment by the employees themselves.

Taxation of employees of exempt organizations is a source of concern for income tax systems throughout the world. In 2006, the IRS estimated that as many as half of the employees of foreign embassies, foreign consular offices and international organizations in the United States either fail to report their wages, claim deductions they are not entitled to, incorrectly establish retirement plans, fail to pay self-assessment tax or fail to file tax returns at all.⁷⁴ The IRS offered a settlement initiative in 2007 in which those employees that came voluntarily to declare their income and pay the tax due were relieved from the imposition of penalties and were entitled to certain privileges.⁷⁵ Some news accounts in some countries report massive non-compliance by employees of embassies, consulates and international organizations enjoying diplomatic immunities. A BBC Persian' Afghanistan website reported about the troubles of the Afghan Government to collect taxes from local employees of foreign embassies operating in Afghanistan and as a result the Government lost huge revenues from a source which could be an important source of revenue for the Government in Afghanistan.⁷⁶

Under Ethiopian income tax law, non-exempt employees of exempt organizations (embassies, consulates and international organizations) are required to pay their employment income tax through their own self-assessment.⁷⁷ Unlike employees holding multiple employments, employees of exempt organizations are unlikely to pay any employment income tax through

⁷⁴ IRS, IR-2006-180, November 17, 2006) available at <http://www.irs.gov/uac/News-Releases-for-November-2006> accessed on May 29, 2012

⁷⁵ Ibid

⁷⁶ See Foreign Embassies in Kabul and tax evasion, May 27, 2011 by the lost flaneur, thelostflaneur.wordpress.com/.../foreign-embassies-in-kabul-and-tax-, accessed on May 28, 2012

⁷⁷ Income Tax Proclamation No. 286/2002, see Article 65(4)

withholding unless they themselves come forward and pay the tax due or unless the exempt organizations voluntarily take it upon themselves to deduct income tax from their non-exempt employees.

To the extent it is possible to generalize from interviews with a number of tax officers, the practice in this regard has left much to be desired. As a result of some sporadic efforts of the tax authorities in collaboration with the Ministry of Foreign Affairs, some employees of embassies and international organizations have been brought within the self-assessment network. Some employees of embassies and some international organizations are said to have regularly paid their tax by reporting to the various Tax Offices in Addis Ababa or by appointing their own representatives for purposes of complying with their tax obligations. Some embassies are also said to have voluntarily complied with withholding obligations although they do not have legal obligations to do so. But it is learnt that many employees of exempt organizations do not comply with their self-assessment obligations and many embassies and international organizations are not willing to withhold income taxes for the Ethiopian Government.

Some reported studies of the problems in this regard have shown that many employees of exempt organizations never reported to tax offices since the beginning of diplomatic relationships in the country.⁷⁸ Having been apprised of this, the tax authorities extended blanket amnesties to these employees and encouraged the employees to comply with their self-assessment obligations, with some apparent success. However, the tax authorities still lack adequate information to pursue non-compliant employees and enforce self-assessment obligations. Given the number of embassies, consulates and international organizations that

⁷⁸ The author was unable to secure the said document, but contacted tax officers who allegedly conducted the study; interview with Ato Yohannes Gizaw, ERCA, Addis Ketema Branch, ERCA, May 14, 2012

operate in Addis Ababa (considered the political capital of Africa), the tax authorities understand that the rate of compliance in this regard is, to put it very mildly, far from perfect.

Once again the structural loopholes that plague the compliance of employees of several employers may have contributed to the psychological and administrative barriers that stand in the way of self-assessment by employees of exempt organizations. Employees of exempt organizations are expected under the current arrangements to show up in the tax offices every month to comply with their obligations. This, needless to say, is onerous to many such employees. Some of the employees, particularly of international organizations, operate outside the capital but are still expected to come to Addis Ababa every month to file their tax returns. These employees meet their monthly obligations through self-appointed employee representatives but the onerous obligations remain. Even for those employees that operate in Addis Ababa, where the tax offices are located, the onerous requirements of monthly tax filing are undeniable, for which the current rules have nothing in the way of relief, such as annual filing of tax returns.

Addis Ababa has one of the largest concentrations of embassies and consulates in the world. It is also headquarters for the African Union and a number of regional and international organizations, like the UN Economic Commission for Africa (UNECA). Thousands of non-exempt employees serve in these embassies and international organizations. By Ethiopian standards, these employees are some of the most highly-paid employees in the country. Apart from occasionally calling upon the employees involved to come forward and pay their taxes, the tax authorities have neither devised any special schemes nor really aggressively pursued the said employees to comply with their obligations. The legal loopholes coupled with practical

indifference to adequate enforcement of the income tax upon employees of exempt organizations has combined to produce a state of affairs in which some of the highest paid employees remain beyond the reach of the income tax while most employees whose monthly income is less than ten dollars a month are subjected to withholding taxation.

IV. The Treatment of Employment Fringe Benefits⁷⁹ under Ethiopian Income Tax Laws

In theory, Schedule “A” income tax charges all sorts of income from employment – in cash and in-kind. In practice, however, the application of Schedule “A” has been confined to employment cash benefits only. One of the most obvious misses of the Ethiopian income tax has been its inability to come up with detailed rules governing the taxation of employment fringe benefits, particularly those provided in-kind to employees.

The treatment of fringe benefits is one of the most prominent sources of discrimination among employees in Ethiopia. Although the laws have started well in declaring “fringe benefits” as income, they have not fulfilled their promises to tax fringe benefits received in kind, primarily because of the absence of subsidiary rules regulating the valuation of employment fringe benefits received in kind.

The provision of fringe employment benefits in Ethiopia, as in elsewhere, depends on the nature of employment and the rank of employees. The most prominent fringe benefits in Ethiopia are the free air tickets provided to employees of Ethiopian Air Lines. Top level managements of many big companies also receive significant economic gains in the form of in-kind fringe

⁷⁹ “Fringe benefits” loosely describe “in-kind” benefits provided to employees in addition, usually, to regular salaries and wages; see Graetz and Shenk, *Federal Income Taxation*, p. 103; see also Lathrope, *Global Issues in Income Taxation*, pp. 18-42

benefits like free housing and company cars. High ranking government officials receive significant economic gains in the form of in-kind fringe benefits such as free housing, cars and other benefits. At times, the in-kind fringe benefits far outweigh the actual salaries and wages that are paid in cash. The official salaries of ministers and top government officials in Ethiopia are lower than what the top management of private enterprises and highly skilled employees of international organizations would normally earn, but that is clearly not the perk for which high government positions are prized. Holding top government positions brings with it a variety of fringe benefits which constitute the primary attraction for those drawn to these positions. Some have argued that this reality has so far prevented the government from issuing detailed regulations governing the taxation of in-kind fringe benefits in Ethiopia.⁸⁰ The fact that the Income Tax Proclamation delegates the power to issue detailed regulations to the Council of Ministers, in whose ranks are members who happen to receive most of their employment benefits in the form of in-kind fringe benefits, makes one to believe that the suspicion is probably true. Whatever the case may be, it remains to be the case that the provision of fringe benefits in Ethiopia remains exempted from income tax not because the Proclamation declares these benefits to be exempted but because of the absence of detailed rules governing the taxation or otherwise of in-kind fringe benefits. As a result, some employers that are able to provide these benefits to their employees are able to provide their employees with tax-free benefits and to attract employees through government tax subsidies.

Since fringe benefits are most commonly provided to top-level management and high ranking government officials, the upshot of the existing framework of income taxation in Ethiopia is to erode the apparent progressivity of employment income taxes in Ethiopia. Some of the lowest

⁸⁰ See Solomon Gizaw, *Income Tax Proclamation*, p. 29

paid employees are being subject to income taxation due to the low thresholds of income brackets, while some highly compensated employees are able to receive most of their employment income free from taxation.⁸¹

Most tax officers and practitioners are aware of the inequity of the current income tax rules in this regard, although some have tried to explain the problem away by citing administrative difficulties in valuating income received in-kind. It is true that fringe benefits present tax administrations with extra-administrative obligations in terms of setting down rules for valuation of the benefits and monitoring compliance with the valuation rules. But the administrative burden of these rules upon the tax administration should not be exaggerated. Many countries that are at the same or comparable economic stage as Ethiopia have taken that extra-administrative measure to impose tax upon some employment fringe benefits. The following table shows that administrative difficulties are merely used as pretexts for subsidizing certain employees in Ethiopia (**see Table 5.3**). Three African countries (South Africa, Kenya and Uganda) have all taken some legislative steps to capture at least some common employment fringe benefits. If these countries can do something about some prominent and common employment fringe benefits, so can Ethiopia. The only missing link in Ethiopian case is the political will.

⁸¹ The minimum monthly wage for government employees at the moment is 420 ETB, but the exemption floor of employment income tax is 150 ETB; this means that almost all of the government employees and most of private employees pay income tax (assuming 100% compliance rate by employers).

Table 5.3: Treatment of Some Employment Fringe Benefits in Three African Countries: South Africa, Kenya and Uganda

No.	African country	Type of fringe benefit	Modality of valuation	Fringe Benefits exempted
1	South Africa	Private use of motor vehicle	Fixed determined value Second discretion of SARS	Benefits received by reason of superannuation, ill health or infirmity
		Free or subsidized housing	Rental value as determined under four alternative valuation methods less any rental consideration given by an employee	Casual loans that do not exceed ZAR 3, 000; or loans granted for enabling the employee to further employee's own studies
		Loans granted on favorable methods	The amount of interest that would have been payable at the official rate	

		Medical expenses and health insurance	The amount incurred by the employer	
		Free or subsidized telephones; club memberships	Market value	
2	Kenya	Private use of company vehicle	Annual rate determined based on engine capacity	Staff meals; Costs of medical services; Educational fees; Low interest loans Employer pension contributions
		Housing benefit	15% of employment income or the rent paid by the employer, whichever is the higher	
		All other non-cash benefits	Higher cost to the employer or	

			market value	
3	Uganda	Private use of cars	<p>(20% x A x B x C)- D;</p> <p>Where A = the market value of the motor vehicle;</p> <p>B = number of day in the year during which the vehicle is made available for private use;</p> <p>C = number of days in the year of income;</p> <p>And D = any payment made by the employee for the benefit</p>	
		Housing	The lesser of the amount of allowance, reimbursement, discharge, or rental market value of the	

			housing; and 15% of the employment income	
--	--	--	--	--

Source: Country Surveys, IBFD, Amsterdam;⁸²

⁸² Omondi, Kenya – Individual Taxation, Section 1.3.2; Hattingh, South Africa – Individual Taxation, Section 1.3.2; Namubiru, Uganda – Individual Taxation, Section 1.3.2

CHAPTER SIX

SCHEDULE “B”: TAXATION OF INCOME FROM RENTAL OF BUILDINGS

I. Introduction

Schedule “B” income tax, sometimes referred to as “Rental Income Tax,” was identified as a separate source of income taxation since 1949.¹ The tax base of Schedule “B” was much broader during the Imperial period when land and buildings were privately owned. After the social revolution of 1974, Schedule “B” was completely removed from the income tax system of Ethiopia with the abolition of private ownership of land and extra-houses.² Schedule “B” thus remained vacant during the period 1974-1993 when it was illegal to use buildings for anything other than one’s own residence. Schedule “B” was restored into the income tax system only after the removal of the Derg in 1991 and the liberalization of the Ethiopian economy, but even then its coverage shrank from that of “income from rental of land and buildings” to “income from buildings”. While the right of individuals and companies to lease buildings was restored in the post-1991 period, land remained state property. The first “Rental Income Tax” law which came into force after a long absence of this Schedule recognized this policy and defined the scope of Schedule “B” to be “income from rental of buildings” only.³ In the Income Tax reforms of 2002, the scope of Schedule “B” has not changed and now Schedule “B” constitutes one of the principal sources of the main income tax system of Ethiopia.⁴

¹ See Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, p. 117

² See *id.*, p. 120

³ See Income Tax (Amendment) Proclamation No. 62/1993

⁴ See Income Tax Proclamation No. 286/2002, Article 14

Like all the schedules of the Ethiopian income tax system, Schedule “B” raises serious questions about its scope of application vis-à-vis the other schedules of the Ethiopian income tax system. The problems are perhaps even more pronounced in the case of Schedule “B.” This is partly the result of the checkered history of the Schedule in Ethiopian income tax history and the absence of detailed provisions regulating the operation of Schedule “B” income tax. Even within the framework of the schedular structure of Ethiopian income taxation, Schedule “B” strikes us as the least legitimate and persuasive in terms of the stability and autonomy of the sources chargeable with tax under Schedule “B”. Partly because of controversies surrounding its scope and partly because of the way Schedule “B” income tax has been conceived and enforced in practice, the operation of Schedule “B” has given rise to a number of legal and practical problems and challenges, with serious implications upon the overall equitability and administrability of the Ethiopian income tax system.

II. The Scope of Schedule “B”: the Law

The scope of Schedule “B” is defined in Section III of the Income Tax Proclamation of 2002.⁵ Section III has the fewest number of provisions of all the other schedules of Ethiopian income tax. The section defines the base of Schedule “B” as “income from rental of buildings,” but is silent on what structures qualify as buildings.⁶ Section III, provides for what appears to be a non-exhaustive list of income that is includible in “income from rental of buildings.” Apart from income from rental of buildings, Schedule “B” is designed to cover such related incomes like

⁵ Id, see Articles 14-16

⁶ The Building Proclamation issued in 2009 has provided a definition for “buildings” but it is not clear if that definition can become relevant for defining the scope of Schedule “B”; Article 2(2) of Building Proclamation defines a building as “a permanent or temporary construction used for the purpose of dwelling, office, factory or for any other purpose”; see Building Proclamation No. 624/2009; in practice, the operation of Schedule “B” is triggered by a formal contract of lease of a building; interview with Ato Gebrelibanos W/Aregay, ERCA, Yeka Branch, April 01, 2012

income from “lease of furnished quarters and equipments,” and, where the building is sub-leased, Schedule “B” may also cover “the income of sub-lessors on the difference between income from sub-leasing and the rent paid to the lessor.”⁷

The Income Tax Proclamation is not the only piece of legislation defining the scope of “income from rental of buildings.” The Income Tax Regulations of 2002 add their own list to the catalogue of rental income chargeable with taxation under Schedule “B”. These include:⁸

- i. “All payments in cash and all benefits in kind received by the lessor from the lessee;”
- ii. “All payments made by the lessee on behalf of the lessor;” and
- iii. “The value of any renovation or improvement made under the contract of lease to the land or building, where” such cost “was borne by the lessee in addition to rent payable to the lessor.”

Although Schedule “B” is sometimes referred to as “Rental Income Tax Schedule,” it is apparent from the language of Schedule “B” that the Schedule is not intended to cover all forms of income from rental of property. Apart from Section III, two provisions in other schedules of Ethiopian Income tax law explicitly charge specific types of income from property and thus serve to delimit the scope of Schedule “B”. The first is Article 35 of the Income Tax Proclamation which charges one of the sources of income chargeable under Schedule “D” of the Ethiopian income tax system, namely “income from [casual] rental of property.” Article 35 prescribes that a “final tax” at the rate of 15% shall be levied upon the annual gross income from casual rental of property.⁹ Article 35 of the Income Tax Proclamation gives examples of the types of property which may be

⁷ Income Tax Proclamation No. 286/2002, see Article 16(1)(b)

⁸ Income Tax Regulations No. 78/2002, Article 5(1)

⁹ Income Tax Proclamation No. 286/2002, see Article 35

casually rented and thus become a subject of Schedule “D” final tax; they include land, building, or movable assets.¹⁰ As shall be seen in Chapter Eight below, the meaning and scope of the final withholding tax under Schedule “D” for “casual rental of property” remains uncertain. Since the possible list of property that can be casually leased and become a subject of Article 35 (Schedule “D”) includes “buildings,” the potential for conflicts between Schedule “B” income tax and Schedule “D” (casual rental of property) tax is real.

Another explicit exclusion of “rental income” from the coverage of Schedule “B” is made for what the Income Tax Regulations call “business lease.” Under the schedular arrangement of the Ethiopian income tax system, income from “business lease” [which is clearly a species of rental income] is chargeable with income tax under Schedule “C”.¹¹ The nature and scope of “business lease” is equally shrouded in mystery, but it appears to involve the lease of a business as a whole, which may or may not include buildings held for business.¹² Under the Commercial Code of Ethiopia, a business is conceived as an “incorporeal movable” consisting mainly of “good will,” but it may also include business premises.¹³ Where a person leases her business including the business premises, it seems that the lease as a whole is treated as a “business lease” and not as a “lease of buildings.” Although there is a lot of uncertainty surrounding the nature and scope “business lease,” it is clear that income from the lease of businesses is not covered by Schedule “B” even if the lease of a business includes the lease of business premises.

Article 35 of the Income Tax Proclamation (income from casual rental of property) and Article 7 of the Income Tax Regulations (income from lease of business) constitute the two obvious

¹⁰ For problems regarding the meaning and scope of Article 35, see below, Chapter Eight

¹¹ Income Tax Regulations No. 78/2002, see Article 7

¹² For business lease, see Chapter Seven below

¹³ The Commercial Code of Ethiopia, see Article 124

exceptions to Schedule “B” income taxation of rental of buildings, but as a matter of practice there are a number of cases in which rental of buildings does not necessarily attract income tax under Schedule “B” of Ethiopian income tax and is charged instead under the other schedules of the Ethiopian income tax system. In practice, a number of businesses whose business involves rental of buildings as a matter of course are not subject to income tax under Schedule “B”. The most common examples are hotels,¹⁴ hostels,¹⁵ pensions,¹⁶ and guest houses. Hotels involve rental of rooms and buildings as matter of business, but they are currently not subject to tax under Schedule “B” for the rental part of their operations. They are subject to income tax under Schedule “C” for the whole of their operations (catering, rental, entertainment, etc).

For some types of businesses (e.g., hotels, pensions and guest houses), the “rental business” part of their activities is fully integrated into their other businesses (catering and entertainment). For many other types of businesses, however, their rental activity is not integrated with their other businesses. A number of otherwise Schedule “C” taxpayers are therefore required to keep their rental activities separately from their Schedule “C” activities for purposes of reporting and filing income taxes under Schedules “B” and “C.” Since the practice is a little confusing, we shall explore the treatment of “rental income” under various scenarios in practice.

¹⁴ A dictionary meaning of a “hotel” is “an establishment that provides lodging and usually meals and other services for travelers and other paying guests;” see The American Heritage Dictionary of the English Language, s.v. “hotel”

¹⁵ A dictionary meaning of a “hostel” is “a supervised, inexpensive lodging place for travelers, especially young travelers;” Merriam Webster’s Dictionary of American Heritage English, s.v. “hostel”

¹⁶ Webster’s Dictionary defines a “pension” as “a boarding house or small hotel in Europe; Merriam Webster’s Dictionary of American Heritage English, s.v. “pension”

III. The Scope of Schedule “B”: Schematic Representation of Taxation of Income from Rentals in Practice

The practice surrounding the scope and meaning of Schedule “B” is sketchy, patchy, anecdotal and at times inconsistent. There are no cases in practice to illuminate for us the scope of Schedule “B” vis-à-vis the other schedules of Ethiopian income tax law. The absence of cases is not an absence of practice. In the absence of cases, we are compelled to outline the multiple scenarios under which rental income may be generically derived and use these scenarios to fix the scope of Schedule “B” on the basis of information collected from the various units of Ethiopian tax administration.

As alluded to before, individuals as well as companies may derive income from rental of property under various situations. Some of these situations include:

- i) A real estate company engaged in the construction of buildings, houses, villas and various other structures for the purpose of renting them out to third parties for profit;
- ii) A real estate company engaged in the construction of buildings, houses, villas and various other structures for the purpose of selling them to third parties for profit;
- iii) A real estate company engaged in the construction of buildings, houses, villas and various other structures for the purpose of both renting and selling of real estate for profit;
- iv) A non-real estate business engaged in the rental of buildings, offices, apartments on the side;

- v) A person constructs or buys or in any other way acquires a building for residence and then rents a part or whole of the residence;
- vi) A person or company engaged in rental of buildings, offices, halls for special occasions (e.g, weddings, conferences, etc);
- vii) A person or company engaged in rental of business equipments and machinery;
- viii) A hotel, pension, or guest house involved in transient rental of rooms or buildings;
- ix) A person or company involved in leasing of capital goods under hire-purchase and finance lease arrangements.

The taxation of these different types of leases in practice, as collected from several respondents, is shown in the following table

Table 6.1: Taxation of Rental Income under Different Scenarios

No.	Type of rental activity	Schedules			
		A	B	C	D
1	Real estate engaged in rental of buildings, apartments, villas, etc		X		
2	Real estate engaged in sale of buildings, apartments, villas, etc...			X	
3	Real estate engaged in both rental and sale of buildings		For rental part	For sale of buildings	
4	Non-real estate business engaged in rental of buildings for offices, residence, factory, etc		For rental part	For their main /core business	

5	Rental of residential houses, buildings, apartments, condominiums, facilities		X		
6	Rental of equipments, machinery, vehicles on a regular basis			X	
7	Rental of business equipments, machinery, vehicles on casual basis ¹⁷			X	X
8	Lease of a business as a business (even if it involves building or business premises)			X	
9	Lease of Warehouses ¹⁸			X	
10	Transient rental of rooms by hotels, pensions, guest houses or motel operators along with such other services like catering and entertainment			X	
11	Rental of equipments under operating leases, finance leases or hire purchase agreements ¹⁹			X	

¹⁷ Some of the respondents have argued that casual rental of business equipments should fall under Schedule “C,” as other income while others have said that this is a subject of the final tax on the gross income from casual rental of property under Article 35, see Chapter Eight below

¹⁸ The standard assessment table which is applicable upon small businesses (so-called category C taxpayers) in Addis Ababa lists the following rental activities as trading activities subject to Schedule “C”: rentals of warehouses, rentals of buildings and spaces for animal stables, rentals of utensils and equipments, such as utensils, tents, and plates; rentals of wedding dresses; rentals of recreational places and resorts; rentals of car parking spaces; and rentals of businesses; see Addis Ababa City Administration, Finance and Economic Development Bureau, Revenues Agency, 21/5/2003, in Amharic, unpublished

¹⁹ Lease of equipments requires a license from the Ministry of Trade; see Capital Goods Leasing Business Proclamation No. 103/1998, Article 3

As can be clearly seen from the table above, real estate businesses may pay income taxes either under Schedule “B,” “C” or sometimes even “D” depending on the nature of their real estate business alone. Those real estate businesses that are involved in the sole activity of constructing real estate for the purpose of rental are subject to income tax under Schedule “B”; those that are involved in the sole activity of constructing real estate for the purpose of sale of the real estate upon construction are subject to tax under Schedule “C,” while those that are involved in both activities are subject to income tax under both Schedules “B” and “C.”

The proportion of rental activity vis-à-vis business activity (sale of real estate) in each type of real estate is irrelevant for purposes of the current income taxation. Thus, if a real estate company is involved in sale of real estate as well as rental of real estate, the company is required to file two and separate income tax returns under Schedule “C” and B, even though the rental portion of the real estate business constitutes only about 10% or less of its real estate business. The current income tax structure, perhaps inadvertently, leads to the splitting of income as well as expenses of real estate businesses that are involved in both sale and rental of real estate (**for the problems in practice, see below**).

It is not just real estate businesses, however, that are subjected to the splitting of their income and expenses in relation to rental of buildings, apartments, structures, offices, etc. Many large enterprises as well as sole proprietor businesses, particularly in the capital Addis Ababa, are engaged in real estate along with their main line of business (such as banking, insurance, manufacturing, etc). Many non-real estate businesses are engaged in the business of leasing real estate for residence, offices, factory, and in general for commercial purposes. The Government-owned Commercial Bank of Ethiopia, for example, owns real estate in many parts of the country

and leases the extra space in these buildings to others for residence, offices, commercial activities, etc. The Commercial Bank of Ethiopia, as well as many other non-real estate enterprises, is required under the current rules of Ethiopian income tax to maintain separate accounts and records and file the income from rental of its real estate under Schedule “B”.

The current structure of income taxation in Ethiopia forces some businesses not only to split their incomes but also to report their income tax returns to two different jurisdictions. Under the current fiscal federalism arrangements, companies that are involved in real estate along with their main line of business are required to file their income tax under Schedule “B” to the Regional Governments in which the real estate is located, and their income from their core or other business (e.g., banking) to the Federal Government. Once again, the proportion of the rental income vis-à-vis their other income is not taken into consideration for purposes of separate filing. A business enterprise is required to report the income from rental of buildings regardless of the extent of the rental income vis-à-vis its other or core income. Thus, even if the rental income constitutes less than 1% of its total income, the business is required to report that less than 1% income separately and to the Regional Government.

It can already be seen that the delimitation of the scope of Schedule “B”, vis-à-vis that of the other schedules of the Ethiopian income tax system is riddled with a number of problems. The inadequacies as well as loopholes of Ethiopian income tax laws relating to rental income and the inability of the tax administration to define the scope of Schedule “B” vis-à-vis that of other schedules have created a number of problems in practice, with enormous ramifications on the equitability and administrability of the Ethiopian income tax system as a whole. We shall

examine some of the major practical problems arising from interpretation and application of Schedule “B” income tax.

IV. Practical Problems and Challenges Surrounding Schedule “B” Income Tax

a. Splitting of Income

We have seen above that some real estate and non-real estate businesses are required under the current structures to maintain and file separate tax returns under the different schedules of Ethiopian income tax system. To repeat but some of the examples, real estate businesses that are engaged in the business of both rental and sale of real estate are required to maintain and file separate returns for the two activities, which are at the bottom real estate businesses nonetheless: tax returns under Schedule “B” for rental side of their business, and tax returns under Schedule “C” for the sale side of their real estate business. Similarly, non-real estate businesses that are involved in the rental of buildings on the sideline are required to maintain and file separate tax returns under Schedule “C” (for their core business) and Schedule “B” (for the rental of real estate). This structure leads to the splitting of income of essentially one business into two schedules. This affords opportunities (for tax planning) and problems of allocation of income.

The differences in tax liabilities as a result of the artificial split of income from rental of buildings and income from business activities may lead to real differences in tax liabilities among natural persons largely because of the progressive income tax rate structure that is in place for individuals. The differences are illustrated in the following table. If we assume two individuals A and B, with A involved in rental of buildings only and B involved in rental and sale

of buildings, and if we assume identical taxable income for both them – 100, 000 ETB, their tax liabilities would be as follows:

Table 6.2: Tax Burden Differentials between Sole Proprietor Real Estate Businesses

Taxpayer	Type of activity	Taxable income		Tax liability
		B	C	
A	Rental of Buildings	100, 000 ETB		27, 050
B	Rental of buildings and Sale of Buildings	50, 000	50, 000	20, 460

Note: the calculations are based on the current tax rates.

As can be clearly seen from the example in the table above, even if two individuals had identical taxable income, their tax burdens can be significantly different. Under the current schedular arrangements, sole proprietors that are engaged in both rental and business activities benefit from the splitting of income into Schedule “B” and Schedule “C” income. In the above example, B was able to save more than 6000 ETB (27, 050 – 20,460) as opposed to A although the two generated the same amount of taxable income.

The tax burden differentials arise not only because of the artificial distinctions currently in place under the Ethiopian income tax laws but also because those individuals that carry out the two activities – rental and business – are able to take double dip exemptions in taking advantage of

exemption provisions – currently up to 1800 ETB of income from both Schedule “B” and Schedule “C” activities enjoy a floor exemption.²⁰

b. Differences in Deduction Rules

Tax on Schedule “B” income is imposed after deduction of expenses. In allowing deduction of expenses, Schedule “B” shares some common features with Schedule “C” income tax. However, the accident of source (rental income) seems to determine the type and extent of allowable deductions under Schedule “B”. Schedule “B” income tax has separate rules of deductions under Section III of the Income Tax Proclamation and these rules of deductions are different in many respects except in the case of depreciation (once again, perhaps inadvertently).²¹ In the case of depreciation allowances, Schedule “B” taxpayers are entitled to deduction in accordance with the depreciation rules of Schedule “C” taxpayers under Article 23 of the Income Tax Proclamation.²²

In other cases of deduction, Schedule “B” income tax rules lay down their own rules of deduction. Schedule “B” taxpayers are generally entitled to deduct taxes (other than income taxes) paid with respect to land and buildings leased.²³ The other rules of Schedule “B” income tax deduction operate on the basis of whether taxpayers maintain books and records. If Schedule “B” taxpayers do not maintain books and records, they are entitled to a standard deduction, which is 1/5th of the gross income under Schedule “B”.²⁴ If Schedule “B” taxpayers maintain books and records, they are in principle entitled to deductions for expenses in

²⁰ Income Tax Proclamation No. 286/2002, see Articles 15(b) and 19(2)

²¹ Id, Article 16

²² Id, see Article 16 (c) (iii)

²³ Id, Article 16(a)

²⁴ Id, Article 16(c) (ii)

accordance with the books and records.²⁵ The basic principle of deduction is that the expenses are incurred “in earning, maintaining and securing rental income,” a language that imitates the principle of deduction for Schedule “C” taxpayers.²⁶

In general, Schedule “B” has fewer rules than Schedule “C” on deduction of expenses. Schedule “B” does not have rules of deduction on trading stocks (perhaps legitimately, because Schedule “B” taxpayers do not have trading stocks), on bad debts, reinvestment deductions, and on losses. As a result, the tax authorities are inclined to deny many types of expenses simply because Schedule “B” rules are silent on the deductibility or non-deductibility of these expenses. The separate rules of deduction for Schedule “B” might have been intentional or unintentional, but they have at times led to differences in allowable deductions for Schedule “B” taxpayers. In ***Makwor Ethiopia PLC vs. IRA***,²⁷ for example, the differences in deduction rules between Schedule “B” and Schedule “C” income taxes affected the deductibility of certain expenses for a Schedule “B” taxpayer. Makwor Ethiopia PLC, a Schedule “B” taxpayer, owns and manages a medium-sized building in Addis Ababa for which it incurred a number of expenses like salary for employees (security guards and cleaners of the building), costs of stationary materials, office furniture, transportation, insurance, license renewal fees, legal costs and cost of amortization and depreciation. The Tax Authority rejected some of these expenses as unrelated to the management of a building, upon which the case went on appeal to the Tax Appeal Commission. The Tax Appeal Commission allowed some of the expenses presented by Makwor Ethiopia and disallowed others. The Commission reasoned in its judgment that some of the expenses like salary paid for security guards and sanitation employees, are not mentioned as deductible

²⁵ Id, Article 16(c)(iii)

²⁶ Compare, Article 16(c)(iii) with Article 20 of Income Tax Proclamation No. 286/2002

²⁷ Tax Appeal Commission, File No. 480, in Amharic, unpublished

expenses under Schedule “B” deduction rules and therefore should not be deducted from gross income.

The upshot of the decision of the Commission in Makwor Ethiopia is that these expenses would have been deductible had Makwor Ethiopia been a Schedule “C” taxpayer since there are detailed rules for deduction under Schedule “C”. Makwor Ethiopia lost the right to deduction in that case only because of the absence of detailed rules for Schedule “B” taxpayers. The Tax Appeal Commission, of course, failed to read the basic principle of deduction under Schedule “B”, that of expenses “incurred in earning, maintaining and securing rental income” but this case, although not representative and controlling of decisions in other cases, illustrates that the different rules of deduction for Schedule “B” income tax might lead the Tax Appeal Commission and courts to believe that certain expenses that are deductible for Schedule “C” income tax are not deductible for Schedule “B” income tax.

Members of the tax administration appear to take the differences in the rules of deductions seriously. Interviews with a number of tax officers have revealed that expenses which are deductible for Schedule “C” taxpayers are non-deductible for Schedule “B” taxpayers even if these expenses in principle meet the basic requirement of having been incurred for “earning, maintaining and securing rental income.”²⁸ Some tax officers have argued that the loss carry-forward rules of Schedule “C” (Article 28), the bad debt deduction rules of Schedule “C” (Article 25), among many others, are not intended for Schedule “B” taxpayers.²⁹ Thus, if a Schedule “B” taxpayer incurs net operating losses, s/he would not be entitled to deduct her losses from future income, simply because of the accident of the source of income (rental income as opposed to

²⁸ Ato Mekonnen Ayele, Legal Advisor to the Director of ERCA, March 28, 2012, Ato Girma Tafesse, ERCA Branches Directorate, May 09, 2012, Ato Girma Cherinet, ERCA, Tax Audit, May 23, 2012, Obbo Lammessa Likki, Oromia Revenues Bureau, Finfinne, March 07, 2012

²⁹ Ibid

business income). Similarly, a Schedule “B” taxpayer is denied (by omission) deduction of bad debts, whose deduction is expressly recognized under Schedule “C” income tax rules.

c. Allocation of Expenses

Since the rules of Schedule “B” regarding the separate treatment of income from rental of buildings are sparse, they fail to anticipate cases in which a taxpayer, that is organizationally one and the same, may incur costs common to both Schedule “B” and Schedule “C” activities. A typical example is that of a real estate company that mobilizes all its resources to carry out both activities and employs workers and raises finance (loans) to carry out both activities. The same employees that sell buildings may be involved in arranging and facilitating rental of buildings. A real estate company may construct a multi-storey building, sell some floors and rent others. All the costs of the building (e.g., lease costs, construction costs, financing costs, etc.) are common to that building. It is difficult for companies to allocate the whole cost to their rental and non-rental activities. In the absence of rules, the accountants of these businesses have found it appropriate to allocate the costs in terms of the proportion of their rental revenue vis-à-vis their total revenue, but that is because they felt compelled to allocate the costs anyway not because they are required to.³⁰

The taxpayers that are currently required to maintain two books of accounts for income tax purposes determine the rules of allocation by themselves. The existing income tax laws do not contain rules that help businesses allocate common expenses of business and rental activities, presumably because they assume that the two activities are always separate. In practice, those businesses that report income taxes under both Schedule “B” (for their rental activities) and Schedule “C” (for business activities) often incur common expenses to generate income under

³⁰ Interview with Ato Girma Cherinet, ERCA, Tax Audit, May 23, 2012

both Schedules. A real estate company may decide to rent some floors of a single apartment and sell others. Most of the expenses related to this apartment are common: financing expenses (interest on loans), costs of construction, management, lease of land and some license fees. Although most of these expenses are common and perhaps indivisible, the real estate company is being required to sever the expenses related to its rental activities from expenses related to its business (sale of buildings or apartment floors and rooms) activities. In order to figure out the expenses, the real estate company is forced to adopt extra accounting methods that entail costs. It is also required to maintain separate accounts to the extent possible. All these entail costs.

The absence of rules on allocation of expenses also presents these companies and real estate businesses with some opportunities, with a potential to yield substantial tax benefits for these companies and businesses. Since there are currently no rules for allocation of common expenses incurred for rental and business activities, the companies and businesses involved can potentially turn that to their advantage by shifting some common expenses to an activity that generates more revenue from an activity that is running at a loss or running even. Under normal circumstances, Schedule “C” businesses are more likely to generate losses for a company while Schedule “C” rental activities are generative of revenues.³¹ These realities give the businesses involved the extra advantage of shifting their expenses from one part of the business that runs at a loss to a business that generates revenues, thus reducing their tax liabilities by considerable margin. Whether businesses actually understand these loopholes and use that to reduce their

³¹ There is a myth (borne of limited past experience) within the tax authorities that Schedule “B” or generally real estate business activities do not incur losses, but the recent experience of some prominent real estate companies attests the contrary; see Elleni Araya, “Is There Redemption for Access Real Estate?” *Fortune*, vol. 14, No. 686, June 23, 2013

tax liabilities is beside the point, but it is necessary to point out these loopholes and their implications upon tax equity in Ethiopia.

**d. Constitutional Jurisdiction Issues arising over Schedule “B” and Schedule
“C” Income Taxes**

The treatment of “income from rental of buildings” has also given rise to constitutional problems, particularly when the same entity is required to report its “income from rental of buildings” separately from its income from business activities. In keeping with the schedular structure of the Ethiopian income tax system,³² the Federal Constitution of Ethiopia has given powers over taxation of “rental income from buildings” primarily to the Regional States³³ and powers over taxation of “business income” to both the Federal Government and the Regional States.³⁴ The fiscal power, over taxation of “income from rental of buildings,” is assigned based primarily upon the location of the buildings, while the taxation of “business income” is based on the nature of the business organization. Most of the fiscal powers over “income of rental of buildings” are assigned by the Constitution to the Regional States. In contrast, only the business income of sole proprietors is assigned to the Regional States, with taxation of the income of companies assigned concurrently to both the Federal Government and the Regional States.³⁵

The fiscal arrangement of the Ethiopian Constitution, perhaps once again unintentionally, creates another layer of complexity to the administration of income taxation on rental of buildings. Individuals as well as companies that are involved in rental of buildings are required

³² The Federal Constitution of Ethiopia assigns revenue powers to the Federal and Regional states on the basis largely of the existing tax structures of Ethiopia; see Taddese Lencho, *Income Tax Assignment under the Ethiopian Constitution*, pp. 37-43

³³ The Constitution of Ethiopia, see Article 97(6)

³⁴ See *id.*, Articles 97(4) and 98(2)

³⁵ This is effectively a federal power, because all concurrent taxes in Ethiopia are administered by the Federal Government; see Taddese Lencho, *The Ethiopian Tax System: Excesses and Gaps*, p. 332

to file their tax returns and pay the tax due to the respective Regional States where the buildings are located. This leads to the problem of a split of not just the income of certain businesses but also of jurisdictions to which payments are made. Individuals and companies that are involved in real estate are required under the current constitutional fiscal arrangements to file their income tax returns to the Regional Governments (and at times multiple Regional Governments if they own rental properties in different Regions) for the rental part of their business.

Real estate companies in particular are affected most by this constitutional arrangement. If a real estate company is involved in the sole activity of building and selling real estate, it is required to file one profit tax to the Federal Government.³⁶ If a real estate company is involved in both activities of rental and sale of real estate, it is required to report its rental income to the Regional States in which its real estate is located, and its business profit tax (Schedule “C”) to the Federal Government.

Similarly, those companies that are ordinarily subject to income tax under Schedule “C” and therefore report their profit tax returns to the Federal Government are required to file separate rental income tax returns with the Regional States in which their real estate is located or situated. For example, if Awash International Bank has a real estate in Oromia Regional State, the Bank is required to file its profit tax (for its income from banking activities) with the Federal Government and its real estate income in Oromia Regional State with the Oromia Regional State. If this Bank has real estate in several Regional States, it has the duty under current fiscal arrangements to file rental income taxes in several Regional States. As a company, it is required to report its income from banking to the Federal Government (see table below).

³⁶ The Constitution of Ethiopia, see Article 98(2)

Table 6.3: Constitutional Division of Revenue Powers over Real Estate Income

No.	Type of real estate activity	Type of business	Jurisdiction
1	Sale of real estate	Real estate company	Federal Government
2	Rental of real estate	Real estate company	Regional Governments
3	Rental as well as sale of real estate	Real estate company	Regional Governments for rental and Federal Government for sale
4	Rental of real estate along with non-real estate business	Non-real estate company	Regional Governments for rental and Federal Government for non-real estate business
5	Rental of real estate along with non-real estate business	Non-real estate sole proprietor business	Regional Governments for rental for non-real estate business, but the two incomes must be reported separately nonetheless

Source: The Constitution of Ethiopia, Articles 96, 97 and 98

The implications of this fiscal arrangement upon the businesses or companies are enormous. For companies that are currently required to report two income tax returns to two different layers of governments in the Ethiopian federation, the obvious implication is that they have to bear the extra administrative and compliance burdens involved in the reporting of income taxes solely because of the accidental differences in the types of activities they are involved in. Apart from the obvious extra compliance burden in maintaining separate accounts for tax purposes,

the companies are also required to adjust to different tax compliance standards that are potential byproducts of different layers of governments. In addition, because of the indivisibility of the underlying business operations, the amounts of taxes payable to the different layers of governments are likely to raise questions particularly if one of the layers feels that they are getting the short end of the revenue. There are also potential fronts for conflicts when one layer of government refuses or fails to acknowledge the amount of tax paid to the other layer.

Since the two layers are structurally and constitutionally separate, a potential for loss of revenues as result of lack of oversight and coordination among the different layers of governments cannot be ruled out. A company that reports income taxes to both layers of governments may take advantage of lack of coordination among the two separate layers of governments and claim double deduction for the same expense from both layers of governments. This fear may be dismissed as an exaggeration of the administrative problems of mis-coordination, but the potential for exploitation cannot be denied.

V. Should Schedule “B” be separate?

Most of the problems and challenges surrounding the taxation of “income from rental of buildings” raise serious existential questions about the separate treatment of “rental income” in Ethiopia. It is difficult not to be struck by the incongruity of Schedule “B” in the whole scheme of income taxation in Ethiopia. The question of whether Schedule “B” should be separately computed and whether it should exist at all under the income tax system of Ethiopia has generated divided opinions among various tax officers. Nobody within the Ethiopian Tax Administration has been able to come up with adequate explanation for the separate treatment of “rental of buildings” under an autonomous schedule in Ethiopia.

There is little doubt that the tax treatment of Schedule “B” income has been affected by the checkered history of taxation of rental income in Ethiopian tax history. Schedule “B” income tax, which was originally an integral part of the schedular structure of Ethiopian income tax system during the Imperial period (1944-1974), was removed from the income tax when the 1974 Revolution took Ethiopia along a socialist path and abolished private ownership of land and buildings. Schedule “B” was therefore most affected by the Ethiopian Revolution of 1974. With the downfall of the Derg in 1991 and the consequent liberalization of the Ethiopian economy in the post 1991 period, Schedule “B” was reintroduced as it became legal again not only to own buildings but to lease and derive income from the lease of buildings.³⁷ When rental income tax was reintroduced into the Income Tax System in 1993, the predominant policy mindset was probably the need to impose income tax on rental of buildings as much as on other sources of income and the structural niceties of the income tax system were probably not even considered or contemplated at the time. Those who re-introduced Schedule “B” probably did not anticipate the accommodation of Schedule “B” vis-à-vis that of the other schedules. The schedular income tax structure of Ethiopian income tax system has seen little changes over the course of over six decades, which shows that there was little rethinking about whether the structural designs of Ethiopian income tax are appropriate to the overall policy of the Ethiopian income tax system.

In view of the many problems and complications arising from the operation of Schedule “B”, it is now legitimate to raise some existential questions about the need for and scope of a separate taxation of rental income of buildings. Now that a question has arisen as to whether Schedule “B” income (from rental of buildings) merits a separate treatment under the Ethiopian income tax system, opinions are divided over its relevance.

³⁷ See Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, pp. 121-122

Some long-time members of the Tax Authority³⁸ insist that Schedule “B” income should remain separate from other sources of income, such as Schedule “C” income. These members argue that some policy considerations warrant the separate taxation of rental income from buildings, even if that led to the artificial split of the income of some businesses and/or increased the compliance burden of some businesses. One policy consideration they point to is the need to protect government revenue from a source (i.e., real estate) that is comparatively profitable and relatively passive. The proponents of the separate treatment of Schedule “B” income argue that there are significant differences in the profitability of Schedule “B” activities vis-à-vis Schedule “C” activities. They argue that Schedule “C” activities are more prone to losses and they point to recognition of loss-carry forward privileges of Schedule “C” as evidence that the income tax laws treat Schedule “B” and Schedule “C” differently.³⁹ The apparent limitation of the loss carry-forward provisions to Schedule “C” activities, in the opinion of these proponents, is intended to protect the revenue interest of the government by cordoning off Schedule “B” income from a possibility of offset by Schedule “C” losses. If the two schedules (B and C) are merged, they argue, those enterprises that carry on both rental and business activities will be able to offset their losses from the current Schedule “C” activities with their gains/profits from Schedule “B” activities, thus effectively reducing and even eliminating their income tax liabilities. The separate treatment of Schedule “B” income from Schedule “C” income under the current structures prevents businesses from doing so and ensures that the government gets reliable income tax cash flow even if Schedule “C” activities are losing concerns.

³⁸ Interviews with Ato Mekonnen Ayele, ERCA, legal advisor to the Director of ERCA, May 28, 2012 and Ato Girma Cherinet, ERCA, Tax Audit, May 23, 3012

³⁹ Income Tax Proclamation No. 286/2002, see Article 28

Those who support the separate treatment of Schedule “B” income from Schedule “C” income buttress their arguments by their long time following of Schedule “B” activities. They argue that it is rare for Schedule “B” activities to incur losses in any tax year. They surmise that this is because of the nature of Schedule “B” activities. The expenses associated with Schedule “B” activities are pretty well known and well defined. They include depreciation, maintenance and repair costs and some costs for security and a few other expenses.⁴⁰ Once these costs are factored as deductible expenses, it is difficult to see in what years the renting business places its books in “red.”⁴¹ One respondent pointed to the average profitability rates fixed by the government for presumptive tax purposes as an indication of the higher profitability rate of Schedule “B” activities.⁴² At the time of writing, the average profitability rate of most Schedule “C” businesses subject to the presumptive tax regime is between 7 and 10% while for rental of buildings it is 50%.⁴³ According to this respondent, the average profitability rates reveal significant differences between Schedule “B” and Schedule “C” activities, strengthening the position that Schedule “B” income should remain separate if the government were to preserve its revenue interests.

⁴⁰ Interviews with Ato Girma Cherinet, ERCA, Tax Audit, May 23, 2012

⁴¹ Well, it is not at all improbable that these businesses incur losses in as much as other businesses, particularly in those (early) years when the buildings, apartments, rooms or offices remain vacant and are therefore insufficient to recoup the costs of construction, maintenance and repair; there is no adequate reason why these businesses should not be allowed to carry their losses forward as much as other businesses

⁴² Interview with Ato Girma Cherinet, ERCA, Tax Audit, May 23, 2012

⁴³ Incidentally, the average profitability rates fluctuated over the years; when the income tax proclamation was issued, the profitability rate was fixed for Schedule “B” tax payers that did not maintain books and records to be 80%, but these rates fell to 10% during the 2005 elections and then were progressively raised to 30% and the current 50%)

A number of respondents have, however, cast doubts over the current separate treatment of rental income from other business income.⁴⁴ Some respondents doubt whether the separate treatment of rental of buildings is a product of serious deliberation over policies (like the need to maintain government revenue) or a mere accident of history. Even if the government were concerned about the loss of revenues as a result of the merger of income from rental and non-rental businesses, some respondents have argued that the revenue considerations do not outweigh the current requirement of certain businesses to file separate tax returns and incur extra administrative costs to comply with their tax obligations. They view the current structures in this regard as irrational. Some long time auditors have also pointed out that the current rules encourage businesses to shift the income from one type of activity to reduce the tax due under another schedule. For example, those taxpayers that operate both Schedule “B” and Schedule “C” activities may be able to shift some common expenses (e.g., financing costs) to an activity that generates more revenue thereby reducing their overall income tax liability. Thus, far from preventing businesses from shifting their losses from one activity to another, the current rules are susceptible to manipulation, particularly where the expenses are in reality common to both activities. The critics of the current arrangement fear that these loopholes of the law will be exploited by those businesses that have common expenses and discriminate against those businesses that are not in a position to exploit the loopholes. In sum, the current structures are unfair to certain taxpayers and may violate both principles of horizontal and vertical equity.

Taking stock of both sides of the issue, it is difficult to give much credence to the argument that the government was concerned about protecting its revenue interest when Schedule “B” was

⁴⁴ Interviews with Ato Gebreegziabher Reda, ERCA, Arada Branch, April 14, 2012; Ato Getu Jemaneh, HST Consulting, April 9, 2012; Ato Solomon Gizaw, HST Consulting, April 23, 2012; Ato Yonas Argaw, ERCA, Tax Audit, April 27, 2012; Ato Tibebe Mengistu, Tibebe Mengistu & Co., April 07, 2012

considered as a separate source of income taxation. Due to poor record keeping of tax reform processes in Ethiopia, it is impossible to discover the real intention of policy makers with respect to the treatment of Schedule “B” income. It is also difficult to know if the policy makers weighed in on the problems that have transpired in connection with the taxation of “income from rental of buildings” vis-à-vis that of “business income.” If they were presented with all the facts on the grounds, with all the problems and complications arising out of the split of income and expenses under different Schedules, they might have either abandoned the idea of designing a separate schedule for “income from rental of buildings” or restricted the scope of Schedule “B” to “income from rental of buildings” in non-commercial context. What is certain is that the incongruities surrounding Schedule “B” are perhaps the product of historical accidents and lack of deliberation about the policy implications of separate treatments for or against specific sources of income in the Ethiopian income tax system.

Whether Schedule “B” fits well in the structure of the Ethiopian income tax system, the existence of Schedule “B” as a separate source of income taxation is no longer a matter of the organization of the income tax system. The Ethiopian Constitution has added another complication of its own in assigning fiscal power over Schedule “B” income to the Regions and fiscal power over Schedule “C” to both the Federal and Regional Governments. Any proposal for merger of Schedule “B” with Schedule “C” income tax might lead to the loss of fiscal power over Schedule “B” income tax and it is not going to go down well with the Regional Governments, unless an amendment to the Constitution restores and preserves their revenue powers over some sources of income. Any rethinking about the autonomy of Schedule “B” must therefore start from the Constitution.

CHAPTER SEVEN

SCHEDULE “C”: TAXATION OF INCOME FROM BUSINESS AND PROFESSIONAL ACTIVITIES (BUSINESS INCOME TAX)

I. Introduction

Schedule “C” income tax is headlined “Business Income Tax” and like Schedule “A” has been a separate source of income taxation since the beginning of modern income taxation in Ethiopia.¹ One of the principal sources of Ethiopian income tax system – business income – was initially chargeable with income tax under Schedule “B” of the early income tax laws, but later moved to its current home – Schedule “C.” Other than the change of letters, however, the content as well as modality of taxation of “business income” has changed very little throughout the modern history of income taxation in Ethiopia.²

Schedule “C” charges the income of businesses, professional, vocational, occupational and any other activities considered as trade by the Commercial Code of Ethiopia. Since Ethiopia does not have separate income tax laws for businesses organized as entities (called bodies), Schedule “C” serves as the basic source of rules for taxation of all income from businesses, whether the businesses are run by sole proprietors or entities organized mainly as companies. With the exception of tax rates, most of the rules of Schedule “C” are common to both sole proprietors and entities organized as bodies (mainly companies). At the time of writing, the tax rates applicable on sole proprietor businesses are progressive, ranging from 0 to 35%, and the tax

¹ See Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, pp. 116-124

² *Ibid*

rates applicable to businesses organized as bodies are flat – 30% of the taxable income of bodies.³

With respect to entities organized as companies (private limited companies and share companies), the Ethiopian income tax system follows the classical system of corporate taxation whereby companies are first subject to tax on their taxable income at flat tax rates and then required to withhold final withholding taxes on dividends distributed to their shareholders.⁴ The treatment of partnerships is not well-regulated by the Ethiopian income tax laws, but since partnerships are treated as entities by the Commercial Code of Ethiopia, they are subject to the flat tax rates just like companies. The only difference from that of companies is that the profits distributed by partnerships are not subject to dividend withholding taxation.⁵

The rules of Schedule “C” are comparatively more detailed and well-developed than the other schedules of Ethiopian income tax system. The great majority of the provisions of the Income Tax Proclamation are devoted to the affairs of Schedule “C” taxpayers. Most of the rules pertaining to accounting, assessment and dispute settlement schemes in the main Income Tax Proclamation are almost exclusively designed for Schedule “C” taxpayers. The fact that the dispute settlement schemes are, either by design or accident, deployed for Schedule “C” taxpayers, means that the great majority of income tax cases in Ethiopia are initiated by and

³ Income Tax Proclamation No. 286/2002, Article 19

⁴ Id, see Articles 19 and 34; for withholding taxation on dividends, see Chapter Eight below

⁵ There is an apparent intention to extend dividend taxation to registered partnerships (whatever that means!) but the charging provisions of the Income Tax Proclamation have failed to attach a tax rate profits distributed by registered partnerships; compare Article 6(f) with Article 34 of the Income Tax Proclamation No. 286/2002; businesses organized in the form of “cooperatives” are not subject to income tax as cooperatives but their members are subject to dividend taxation when the cooperatives distribute the share of the profits of cooperatives among members; see Cooperative Societies Proclamation No. 147/1998; see also Taddese Lencho, Ethiopia – Corporate Taxation, Section 1.2

decided for Schedule “C” taxpayers.⁶ It is, therefore, comparatively easier to find cases on Schedule “C” income taxation than it is on the other Schedules of the Ethiopian income tax system, particularly in areas of deductible and non-deductible expenses.

Schedule “C” operates primarily upon the principle of self-assessment, although the involvement of the tax authorities in the assessment process is quite extensive in Ethiopia. For purposes of book-keeping obligations and assessment, Schedule “C” taxpayers are sub-classified into three categories: A, B, and C, primarily for purposes of assessment.⁷ Of the three categories of taxpayers under Schedule “C” (Category A, Category B and Category C),⁸ the two categories (A and B) are in principle subject to the rule of self-assessment and must maintain books and records and fill out tax return forms and pay the taxes due.⁹ The third category of taxpayers (C) – representing small, informal or simply hard-to-tax groups – are relieved from the regime of self-assessment and subject to the presumptive income tax regime known as “standard assessment.”¹⁰

Unlike Schedule “A” and most Schedule “D” taxpayers, but like Schedule “B” taxpayers, all categories of taxpayers under Schedule “C” are in principle allowed to deduct “business-related expenses,” in accordance with the actual books and records kept by the taxpayers (in the case of

⁶ For problems of tax dispute settlement in Ethiopia, see Taddese Lencho, the Ethiopian Tax System: Excesses and Gaps, pp. 372-378

⁷ Income Tax Proclamation No. 286/2002, see Article 66(1), and Income Tax Regulations No. 78/2002, Articles 18 and 19

⁸ Category A are all companies and other forms of businesses whose annual turnover exceeds 500, 000 ETB; Category B are all forms of businesses, other than companies, whose annual turnover is less than 500, 000 ETB but more than 100, 000 ETB and Category C businesses are all businesses, other than companies, whose annual turnover is less than 100, 000 ETB); see Income Tax Regulations No.78/2002, Article 18; cutting through the technicality of the income tax laws, the categories of businesses may be conveniently named “large,” “medium” and “small” businesses respectively.

⁹ Income Tax Regulations No. 78/2002, see Article 19

¹⁰ Income Tax Proclamation No. 286/2002, see Article 68; Income Tax Regulations No. 78/2002, see Article 21

Categories A and B) and under the presumptive regime (in the case of Category C). Schedule “C” income tax can therefore be roughly characterized as a tax on taxable income, rather than gross income.

Like many of the schedules of the Ethiopian income tax system, Schedule “C” income tax raises a number of questions regarding its scope of application, the treatment of specific sources of income and the application of the rule of aggregation for Schedule “C” taxpayers. The gaps in the rules of Schedule “C” as well as the problems of income tax administration in practice have created a number of problems surrounding issues like the definition and the scope of Schedule “C” and the application of the principle of aggregation, as to significantly impact the equitability as well as administrability of the Ethiopian income tax system in general. We shall investigate some of these problems in the following sections.

II. Delimiting the Scope of Schedule “C” vis-à-vis the other Schedules of Ethiopian Income Tax Law

Like all the other schedules of Ethiopian income tax, the demarcation of Schedule “C” “Business Income” vis-à-vis incomes falling under the other schedules is fraught with problems. The lack of clear provisions treating this subject can pit Schedule “C” income tax with the other schedules of Ethiopian income tax. Schedule “C” shares borders with all the other schedules of Ethiopian income tax, which may increase the cases of conflict over the characterization of a certain income as either “business income,” or “employment income,” “rental income,” “royalty,” “dividends,” or “interest” etc.

We have seen in Chapter Five above the numerous cases in which “business income” of independent contractors is confused with “income from employment” of employees. The characterization of income as either “income from employment” or “income from independent contract services” has been a source of numerous controversies between withholding agents, taxpayers involved as well as the tax authorities. Although the Income Tax Proclamation turns the distinction upon the existence or non-existence of the elements of “direction and control,” we have seen how in practice these elements have been disregarded and the authorities and withholding agents have by turns chosen to rely upon easy-to-apply standards like “whether the provider of the service is a full-timer or a part-timer,” “whether the provider of the service has a TIN” or most recently “whether the provider of the service has a business license and is registered as a taxpayer under Schedule “C”.” The Authorities, particularly through their so-called “guidance letters” have sought to cut the Gordian knot by short-circuiting the more substantive but difficult to apply standard of “direction and control.” The divergent applications of various standards have been responsible of disparate treatment of similarly situated individuals.

Schedule “C” also shares substantial borders with Schedule “B” of the Ethiopian income tax system. We have seen in Chapter Six above that in practice all income from “lease of buildings” is treated as “rental income” under Schedule “B” regardless of the context under which the leases of buildings are provided. The only exception in this regard is where the lease of buildings or rooms is integral to the nature of a business, as in the case of hotels, in which case Schedule “C” applies to the whole income of the business involved (**see Chapter Six above**). All leases of buildings have been the subject of Schedule “B” whether the lease involves the lease of residential building, or a commercial building, or whether the lease is provided by a company

that has a business license in real estate or by a private person that wishes to generate income from the lease of a portion of her residential building. We have seen how these treatments of various types of businesses and activities result in discrimination among businesses and taxpayers involved in these kinds of businesses.

Schedule “C” activities are responsible for generating many forms of income that are currently chargeable with taxation under Schedule “D.” Many of the miscellaneous forms of income currently chargeable under Schedule “D” can therefore come into conflict with Schedule “C” income. Businesses may obtain income in the form of “royalties,” “dividends,” “income from games of chance” and “income from casual rental of property.” In practice, Schedule “C” taxpayers that obtain incomes falling under Schedule “D” are subject to final withholding taxes under Schedule “D” and are not required to add miscellaneous incomes in their Schedule “C” income. But the potential for conflicts remains. We can take the case of interest income. If a company derives “interest income” from loans to other companies or businesses, the company is required to add the “interest income” with its other Schedule “C” business income and pay tax under Schedule “C.” If a company derives “interest income” from deposits in a bank, the company is subject to a final withholding tax rate of 5% under Schedule “D” and is not required to add the “interest income” in its Schedule “C” business income. Similarly, a publishing company is required to include income from the sale of books in its business income under Schedule “C” and income from royalties from the sale of same books by others under Schedule “D.” The tax rates and burdens under Schedule “C” and Schedule “D” are wildly different. These disparities in the treatment of income from various sources may give businesses incentives to characterize and channel their income to a source which attracts lower tax burdens.

III. Defining the Scope of “Trade” or “Business” for Income Tax Purposes

Like most schedules of the Ethiopian income tax system, the application of Schedule “C” income tax hinges on certain key concepts which delimit the sources of income chargeable with tax under Schedule “C.” Some of these concepts are defined in the income tax law itself, although these definitions have not obviated the frequent need for reference to related pieces of Ethiopian legislation. One of the key concepts for the application of Schedule “C” is the concept of “trade” or “business.” The concept of “trade” or “business” is defined in the Income Tax Law itself, but references to other pieces of legislations in the Income Tax Law mean that it is imperative to understand how the concepts of “trade” or “business” are understood in other pieces of Ethiopian legislation.

The notion of “trade” or “business” is as critical to the definition of the scope of Schedule “C” as the notion of “employment” is to Schedule “A” or “rental of buildings” is to Schedule “B.” The trouble with these terms is that they are understood differently under various legal regimes of Ethiopia. Sometimes the term “trade” is understood in its narrow sense (e.g., in the Commercial Code), sometimes it is widely understood (e.g., in Ethiopian Standard Industrial Classification (ECIS)). The Income Tax Proclamation provides a definition of its own (**see below**) but also makes references to other laws, particularly the Commercial Code of Ethiopia. While the operation of the Income Tax Law is not constrained by other laws of Ethiopia, it is naïve to assume that the understanding of “trade” in some of these other laws will not have a bearing on the scope of the Income Tax Proclamation. It is therefore imperative to analyze the notion of “trade” by reference to some of these other laws and assess the impact of these upon the taxation of business income in Ethiopia.

a. The Notion of “Trade” in the Commercial Code of 1960

The basic text governing the meaning and operation of businesses in Ethiopia for more than half a century has been the Commercial Code of 1960. The Commercial Code devotes a whole section of its first Book to the definition and regulation of trade.¹¹ Article 5 of the Commercial Code defines “traders” in general as “persons who professionally and for gain carry on...” any of the activities listed under Article 5 and then goes on to list 21 different activities as “trades.” The activities listed under Article 5 of the Code range from the purchasing and selling of movables and immovables to operating financial services through banking and insurance.¹²

The Commercial Codes does not only list down activities that are considered as “trade” but also, for various policy reasons, excludes certain activities from “trade” even when they are carried on professionally (translated as habitually) and for gain. Agricultural or forestry undertakings, occupations of fishermen and handicraftsmen are excluded from the ambit of “trade” even if they are carried on professionally and for gain.¹³ Those who undertake agricultural or forestry activities are not to be considered as traders as long as their activities are limited to the exploitation or use of land or animals and sell products from the exploitation or use of the land or animals.¹⁴ Similarly, fishermen and handicraftsmen are excluded from the regulation of the Commercial Code as long as they are confined to selling the products of their fishing or breeding (for fishermen) or live mainly on their own manual work and assisted only by members of family who cannot number more than three employees or apprentices.¹⁵

¹¹ See Commercial Code of Ethiopia, Title I, Articles 1-27

¹² Id, Article 5

¹³ Id, see Articles 6-9

¹⁴ Id, see Article 6(1)

¹⁵ Id, see Article 9(2)

The Commercial Code lists 21 different types of activities or occupations as trade activities. It is in general widely believed that the Commercial Code of Ethiopia follows an exhaustive approach of listing all those activities that can be considered as “trades” as activities, although it is difficult to believe that the Code could do that with just 21 lists of activities.¹⁶ This approach of the Commercial Code is often contrasted with an opposite approach which rests the characterization of a specific activity as trade upon the existence or lack of certain general markers or badges of trade.¹⁷

However the Commercial Code may be construed, its approach has led to debates in practice as to whether certain activities not listed in the Commercial Code would be treated as “trades.”¹⁸ While some have insisted that only those activities listed in the Code should be treated as “trades,” the Ministry of Trade (and Industry) (the main regulatory body of commercial businesses in Ethiopia) appears to have taken a more expansive approach to the concept of “trade” and has taken measures that may be construed as quietly setting aside the limitations of the Commercial Code. The Ministry has been able to set aside the strictures of the Commercial Code in a number of Licensing and Registration laws issued over the years. For instance, the Commercial Code does not recognize “consultancy services” as trades in its list, but the Ministry of Trade has included many consultancy and management services as trades, requiring licensing and registration as much as any trade recognized in the Commercial code.¹⁹ While subscribing to

¹⁶ See Tilahun Teshome and Taddese Lencho (eds.), *Position of the Business Community on the Revision of the Commercial Code of Ethiopia*, pp. 8-9

¹⁷ *Id.*, p. 8; see also Taddese Lencho, *Ethiopia – Corporate Taxation*

¹⁸ See Tilahun Teshome and Taddese Lencho (eds.), *Position of the Business Community on the Revision of the Commercial Code of Ethiopia*, p. 9

¹⁹ Article 2(2) of the current Commercial Registration and Business Licensing Law sets itself apart from the Commercial Code by defining a “business person” as “any person who professionally and for gain carries on any of the activities specified under Article 5 of the Commercial Code, *or who dispenses*

the basic framework established by the Commercial Code, the licensing and registration laws have expanded the list of trades quite considerably. The licensing and registration laws for commercial activities record the latest trends in the understanding of “trade” in Ethiopia and they are accorded considerable weight in how the Ministry of Trade and the Regional Bureaus of Trade proceed in regulating commercial activities in practice.

One of the professionals that have so far resisted this expansive gesture of the Ministry of Trade are private legal practitioners. Presumably because the members of the legal profession are argumentative by occupation, the legal status of legal practitioners has been one of the most controversial issues in the context of the commercial and/or licensing laws of Ethiopia. Some members of the lawyers’ community have argued against the incorporation of legal practice among trade activities but the Ministry of Trade representatives have insisted that “legal practice” should be treated as a trade.²⁰ A Draft Revised Commercial Code prepared by the Ministry of Justice reflects this expansive trend in the understanding of which activities should qualify as “trades.” The Draft recognizes “consultancy services” among activities that should be treated as “trades.”²¹ In this regard, the Ministry of Justice has taken the expansive position on the notion of “trade.”

The Ministry of Trade continues to expand the frontiers of what activities should be considered as “trades.” The latest example in this regard is the Ministry’s newly issued Ethiopian Standard Industrial Classification (ESIC). The taxation of “business income” has largely followed the

services, or who carries on those commercial activities designated as such by law;” (italics added); see Commercial Registration and Business Licensing Proclamation No. 686/2010

²⁰ For these controversies, see Tilahun Teshome and Taddese Lencho (eds.), Position of the Business Community on the Revision of the Commercial Code of Ethiopia; pp. 8-9

²¹ See Ministry of Justice, Commercial Code of Ethiopia (Draft), unpublished, Article 5(17)

licensing and commercial registration trends set by Ministry of Trade, and it is expected that the classification of trades by the Ministry of Trade will have implications on how the tax authorities pursue various types of activities for income taxation purposes. We will review this classification of “trades” briefly below and see its implications upon the scope of Schedule “C” of the Ethiopian Income Tax Proclamation.

b. The Notion of “Trade” in the New Ethiopian Standard Industrial Classification (ESIC)

The Ethiopian Standard Industrial Classification (hereinafter ESIC), published in January 2010, represents the latest example of the effort on the part of the Ministry of Trade to expand the catalogue of trade activities in Ethiopia. Although most of the activities incorporated in ESIC are mere extensions of “trades” already recognized in the Commercial Code,²² the ESIC has been issued with the full intent of incorporating activities that were hitherto never recognized as “trades” in the lexicon of Ethiopian commercial activity. The ESIC divides all kinds of trading activities into ten major categories; namely:

1. Agriculture, hunting, forestry and fishing;
2. Mining and quarrying;
3. Manufacturing;
4. Electricity, gas and water supply;
5. Construction;

²²The list of “trades” in the Commercial Code stresses the “activities” that constitute trade while the ESIC is more interested in the major economic sectors in which most or all activities of humans may be subsumed.

6. Wholesale and retail trade; repair of motor vehicles, motor cycles and personal and household goods; hotels and restaurants; import and export;
7. Transport, storage and communication;
8. Financial intermediation, insurance, real estate and business services;
9. Community, social and personal services; and
10. Private household, extraterritorial, non-governmental organizations; representatives of foreign governments and other activities not adequately defined.

It is not yet clear if ESIC is a guide for placing different kinds of activities under the various headings or can be used as a source of authority for incorporating all those persons that carry on one or more of the activities mentioned in the ESIC. For example, agricultural activities are listed as one of the activities in the ESIC, but it is not yet clear from the list if the Ministry of Trade is then to require all farmers and pastoralists in Ethiopia to obtain a license because they engage, well, in agricultural activities “professionally and for gain.” The Commercial Code, as we have seen above, excludes farmers, fishermen and handicraftsmen from the list of “traders.”²³

In some respects, however, the ESIC reflects the intent of the Ministry of Trade of incorporating all possible activities carried on “professionally and for gain” under its licensing and regulatory regimes. Category 9 of the ESIC, for example, includes in its ranks activities which were not considered “trades” under the Commercial Code. Educational services, health and social work services, activities of business nature carried out by professional associations (all of which were classified under category 9 in ESIC) were not regarded as “trades” by the Commercial Code.

²³ Commercial Code of Ethiopia, see Articles 6, 8 and 9; in its exclusion of basic agricultural activities, the Commercial Code reflects some fundamental public policy in Ethiopia and is unlikely to be reversed by the inclusion of “agriculture” in the ESIC. The ESIC is more likely to apply to agricultural activities when these activities go beyond the basic agricultural activities of farmers.

Similarly, the ESIC clearly intends to bring services provided in private households within the ambit of “trades.” It also includes activities carried out by non-governmental organizations and foreign government representatives as long as these activities have attributes of “trade.”²⁴

The ESIC also lists private legal practice as a “trade.”²⁵ As an industrial classification document, the ESIC disaggregates most consultancy services by the types of consultancy (engineering, architecture, agriculture, etc.) and treats consultancy services as “trade” as long as they are carried on professionally and for gain.²⁶ In its expansion, the ESIC goes from the frugal number of twenty-one (21) of the Commercial Code to more than nine-hundred eighty (980) different types of trading activities.

The regulatory and administrative reach of the Ministry of Trade as well as the tax authorities has been quite constrained, and as a result many of the activities which are traditionally considered as “trades” are regulated only because these activities clearly fall within the limited list of activities defined as “trades” by the Commercial Code. It is known that many individuals (particularly in Addis Ababa) are engaged in so-called “informal” activities but they are not well-regulated by the government. Many people make a living informally as “brokers,” “negotiators,” “executors,” “property administrators,” “trustees.” These kinds of “traders” do not have fixed places of business, and thus they are not in practice properly regulated as “traders.” There are also many who earn a living from their craft, painting and art but because these individuals

²⁴ ESIC, see Category 10, which is entitled “private household, exterritorial, non-governmental organizations, representative of foreign governments and other activities not adequately defined”

²⁵ Id, see Nos. 843 and 844

²⁶ Research & Training and Service Activities incidental to mining of minerals (No. 61) under the category “Mining and Quarrying”; accounting, bookkeeping and auditing activities; tax consultancy; hotel and tourism consultancy, art and culture consultancy, quality management system consultancy, etc., under “Community, Social and Personal Services;” see id, Nos.836-870

usually operate in non-commercial settings, mainly in their homes, they are not well-regulated as “traders” either. The regulatory arm of the Government, even in the best of times, is limited.

Perhaps, the ESIC will help spur the authorities to bring all these activities within the ambit of the “trading” community so that they will be subject to all the regulatory and taxing powers of the government. The objective of the ESIC is to provide the Ministry with the roadmap for pursuing all activities listed therein and bring them within the regulatory framework. Once an activity is considered as trade, it will open up the way for income taxation of the activity.

c. The Notion of “Trade” or “Business” in the Income Tax Law

At the outset, it is worth noting that the Income Tax Proclamation uses the terms “trade” and “business” interchangeably to mean the activities which generate “business income.”²⁷ This is to be contrasted with the Commercial Code, which uses “trade” exclusively to refer to as the type of activity and reserves the word “business” to mean a type of property.²⁸ Although the Income Tax Proclamation offers its own definition of “trade,” its definition does not completely supplant the Commercial Code in its definition of “trade.” The Income Tax Proclamation follows the long standing tradition of paying homage to the Commercial Code as the basic legal text from which offshoots of the definition of “business” or “trade” are created.²⁹ Article 2(6) of the Income Tax Proclamation defines “trade” or “business” as:

²⁷ Income Tax Proclamation No. 286/2002, see Article 2(6); there is an element of sloppiness in the use of the terms “business,” “trade” and “entrepreneurial activity” in the Income Tax Proclamation and Regulations of Ethiopia.

²⁸ Commercial Code of Ethiopia, see Article 124

²⁹ Commercial registration and licensing laws often define “trade” by reference to the Commercial Code, although they seldom limit themselves to the Code; see Commercial Registration and Business Licensing Proclamation No. 686/2010, Article 2(2)

... any industrial, commercial, professional or vocational activity or *any other activity recognized as trade by the Commercial Code of Ethiopia* and carried on by any person for profit (italics added).

The Income Tax Proclamation describes the types of activities that qualify as “trades,” but, perhaps realizing the impossibility of exhausting all activities, throws the question back to the Commercial Code, which is customarily assumed to be the source for answers to the ultimate question of which activities should qualify as “trades.” In any case, the Income Tax Proclamation appears to require two cumulative requirements for “trade”:

- i. The type of activity (activity test);
- ii. The motive of the activity, i.e., profit (profit test)

We will analyze the two elements of trade as laid down by the Income Tax Proclamation to delineate the convergences and basic differences between the Commercial Code and the Income Tax Proclamation in this regard.

i. The “Type of Activity” Test

To the extent one is able to infer from language, the Income Tax Proclamation makes it clear by the use of phrases, “any industrial, commercial, professional or vocational activity or any other activity recognized as trade by the Commercial Code of Ethiopia...,” that almost all human activities can be treated as “trade.” Literally, there is no human activity that cannot intrinsically be conducted as a “trade.” Be that as it may, we can also infer from the language of the Income Tax Proclamation that the scope of activities that are considered as “trades” for income tax purposes is not to be constrained by the niceties of the Commercial Code. The scope of activities that are potentially subject to income tax under Schedule “C,” as suggested by the definition in Article 2(6), is not predetermined by the activities that are regarded as trades under the

Commercial Code, although the Code remains relevant in many instances. The Income Tax Proclamation pushes the envelope of the Commercial Code by adding that Schedule “C” income tax applies not just to “industrial or commercial activities” but also to so-called “professional or vocational” activities, which are mostly excluded by the Commercial Code. It is therefore immediately apparent that the scope of “trade” in the Income Tax Proclamation is far wider than that of the scope of trade activities under the Commercial Code.

The Commercial Code has excluded many professionals from its ambit even when the professionals are engaged in “profit-making” independent practices. The exclusions of the Commercial Code are irrelevant for purposes of the application of Schedule “C” income tax. All sorts of professional services, as long as they are carried out under independent contracts,³⁰ are subject to the income tax under Schedule “C.”

Similarly, the Commercial Code appears to exclude certain vocational services (e.g., handicraftsmen) but the Income Tax Proclamation has made it clear that these vocational services are the subject of income taxation under Schedule “C.” The only type of activity, over which the Commercial Code and the Income Tax Proclamation are in agreement, is agricultural activities. Income from agricultural activities is excluded from the ambit of the Income Tax Proclamation as it is from the Commercial Code, which may seem to suggest that the Income Tax Proclamation is in agreement with the Commercial Code with respect to agricultural activities. Income from agricultural activities is excluded from Schedule “C” of the Ethiopian income tax system, not because it is not a subject of income taxation but because it is regulated

³⁰Income Tax Proclamation No. 286/2002, see Article 2(12) for the definition of a “contractor;” performance of services under dependent contracts is categorized under “employment” and for income tax purposes is a subject of Schedule “A.”

under an autonomous income tax regime, which is the subject of regional income tax jurisdiction under the fiscal arrangement of the Ethiopian Constitution.³¹

In all honesty, the scope of “activities” that can be considered as “trades” under the Income Tax Proclamation is less circumscribed by the operation of the Commercial Code than the operation of the other schedules of the Ethiopian Income Tax System. An activity is more likely to be excluded from the operation of Schedule “C,” because it is the subject of the other schedules of the Ethiopian income tax system than because it is excluded by the language of the Commercial Code. We can see this at work by reference to the activities that are subject to Schedule “A” – namely “employment,” to Schedule “B” – rental activity – or Schedule “D” – miscellaneous activities. “Employment” as an activity meets the activity test of Article 2(6) of the Income Tax Proclamation, but it is not a trade because it is already the subject-matter of taxation under Schedule “A” of the Income Tax Proclamation. Similarly, the transfer of shares or buildings can be considered to have met the activity test in Article 2(6), but because it is a subject matter of “capital gains taxation” under Schedule “D,” it is not considered as a trade.

Nonetheless, in terms of the broad language of the first element of “trade” for income tax purposes, it is fair to read the first part of the phrase “industrial, commercial, professional, vocational or any other activity” in its inclusive sense rather than in excluding activities. This position is supported by a number of factors. Article 2(10) of the Income Tax Proclamation defines “income” in the broadest terms possible as “every sort of economic benefit...” and an

³¹ The Constitution of Ethiopia, see Article 97(3); except for a brief period between 1967 and 1976, agricultural income taxation has always been treated under the autonomous agricultural income tax regimes in Ethiopia; see Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, pp. 108-113; it is important to remember that income from “commercial agricultural activities” is the subject of Schedule “C” as much as any other activity.

inclusive rendition is therefore generally more consistent with the spirit of the Income Tax Proclamation than an exclusive one, which seems to imbue the approach of the Commercial Code. The definition of “trade” in Article 2(6) of the Income Tax Proclamation uses phrases that distance the Income Tax Proclamation from the restrictions of the Commercial Code. The Income Tax Proclamation could have simply said “trade shall have the meanings ascribed to it under the Commercial Code” but it did not. The Income Tax Proclamation starts out with its own definition and then refers us back to the Commercial Code, just in case the language of the Income Tax Proclamation is not able to capture the diverse forms of “trade.”

If the Income Tax Proclamation is not constrained by the Commercial Code and is read to include all sorts of human activities, it may be asked why “activity test” is inserted as one of the elements of “trade” at all in the Income Tax Proclamation. While it is doubtful if any activity is excluded from Schedule “C” because of the nature of the activity, it appears that the “activity test” is included in the definition in order to convey the message of inclusiveness and above all reverse the “exclusive” trend of the Commercial Code. The Income Tax Proclamation appeals to the Commercial Code only as an additional reference, having already made a list of activities subject to income tax (commercial, professional, vocational, etc.) which are subject to the income tax no matter what the Commercial Code says about them.

**a. The Notion of “Trade” or “Business” in Practice: the
Association of Trade with Regulatory Licenses**

It is one thing to wax expansive in definitions of trade or business; it quite another to implement these on the ground. Because of administrative limitations, the Ethiopian tax authorities have so far taken a conservative approach of calling “businesses” or “trades” only those for which

business and/or professional licenses have been issued. By and large, the tax authorities have in practice taken a pragmatic approach of acting primarily upon the lead given by the other regulatory bodies of the government, mainly the Ministry of Trade or the Regional Bureaus of Trade. The typical process it takes for a person to come under the profit income tax of Ethiopia is therefore for that person to obtain a business license and/or professional license either from the Ministry of Trade or the Regional Bureaus of Trade and the various ministries that register and license professionals. The issuance of a business or professional license is nowadays accompanied in practice by the issuance of the Tax Identification Number (TIN) and this gives the tax authorities the lead they need to charge the person with income taxes.

This conservative approach leaves out many other unlicensed “businesses” either because the persons who carry out these businesses do not see themselves as such or because the authorities have not taken the trouble to go after these “businesses.” For instance, in *Mercato* area, generally believed to be the largest outdoor market in Ethiopia, and perhaps in Africa, the tax officers suspect that some individuals carry out activities that generate huge income but they are unable to pursue them because these individuals do not have official places of business.³²

The authorities have yet to design an income tax system that is capable of capturing the income of so-called hard-to-tax groups. These traders, known popularly as “*Ayer-Bayer-Negadewoch*,” literally and roughly translated as “Air-to-Air Traders” (to signify that they are not seen on the ground and therefore difficult to detect), negotiate all sorts of contracts and prices in the market. They are found in significant numbers in the thriving business of land deals (which has gone underground because it is illegal to sell or exchange land), building rents and other kinds of

³² Interviews with Ato Yohannes Gizaw, ERCA, Addis Ketema Branch, May 14, 2012, Ato Dereje Mekonnen and Ato Dawit Gebremedhin, ERCA, Addis Ketema Branch, May 18, 2012

deals. Many of the activities in which the “Air-to-Air Traders” are involved are either downright illegal or border on shady deals from which the “actors” extract huge profits largely because of the illegal nature of the activities. The very success of these traders depends on secrecy and eluding government supervision. Many tax officers are aware of their presence in the market but find it hard to detect and impose taxes upon them.

There are however exceptional situations where the tax officers succeed in detecting these types of traders and in bringing them within the tax network. One signal success in this regard has been the administrative measures to force so-called “executors” (or *Guday Asfetsami* in Amharic) to register and pay taxes, like VAT and income taxes. The executors are engaged in the business of carrying out administrative duties on behalf of their clients. They normally do not have official place of business and undertake their business whenever and wherever they are able to find clients. The executors that have been brought within the tax network are the ones that prepare and file tax returns on behalf of many business clients. These executors have found a niche in the market and provide “useful” services to the clients that do not want to spend much time filling out tax declaration forms and going through the trouble of paying the taxes due. The reason why the tax authorities are able to bring these executors should be immediately obvious. It is because these executors represent their clients before the tax authorities and the latter could deny them their good offices if they did not comply with their tax obligations. It must however be noted that this represents a tiny fraction of even the number of possible executors that are likely to represent clients in various places other than the tax authorities. It is likely that the other executors whose business is not related with the tax authorities continue to be outside the detection of the tax administration.

In the end, it remains to be the case that only those persons who take the initiative to obtain business and/or professional licenses are currently subject to income tax under Schedule “C” of Ethiopia. Practical limitation of Ethiopian tax administration means that the recurrent issues addressed in other tax systems like the “badges of trade” are remote possibilities for the Ethiopian income tax system. Profit income taxation follows the lead of business and/or professional licenses.

Having said this, there is some glimmer of hope for expanding the notion of trade from the badge or association of business or professional licenses. A recent decision of the Cassation Division of the Supreme Court may help disassociate the notion of “business” from that of “business license,” although the decision has little bearing on income taxation. In ***FIRA vs. Mekonnen Tsion Central Automotive***,³³ the FIRA (Federal Inland Revenue Authority, the predecessor of ERCA) sought to foreclose the business of the respondent (Mekonnen Tsion) as a business although the respondent was stripped of his business license. The respondent objected to such a move on the ground that the business of the respondent could not survive the return of the business license. The Cassation Division of the Federal Supreme Court held that the business could be sold as a property even though the license was returned as the business consisted primarily of “good will.” The Court also held that the license was a mere regulatory tool and a business could exist independently of a business license. The Court even intimated that illegal businesses could exist without the license and this fact alone would not exclude them from being a business. The implications of this decision are yet to be known, but the Court has drawn an important distinction between businesses as “incorporeal entities or properties” and the licenses under which the businesses are operated. The Court has in the process cleared up a recurrent

³³ Federal Supreme Court, vol. 1, No. 2, pp. 109-110

confusion in practice between business licenses and businesses themselves. The case can be used to go after all those individuals that carry out “business-like” activities without obtaining a business license.

ii. The “Profit Motive” Test: the Case of Religious Institutions and Charitable Organizations

An activity in and of itself is not a sufficient condition for application of Schedule “C” income tax. An activity must be coupled with the intent to generate profits. This raises a question of whether this element of “profit” requires actual proof or evidence of “profit” or whether intent to generate “profits” is enough. In other income tax systems, the question of “profit motive” motive arises frequently in connection with activities that are characterized as “hobbies or entertainment” activities that generate income on the side.³⁴ In Ethiopia, the question of “profit motive” arises commonly in connection with the income generated on the side by religious institutions and charitable organizations. Some have resisted the application of income taxation on the ground of lack of profit motive on their part.

Religious institutions and charitable organizations have long held the view that they should not become the subject of income taxation under Schedule “C” as long as they use income from “unrelated” activities for religious and/or charitable purposes. Religious institutions and charitable organizations have invoked the phrase “carried on for profit” in the definition of

³⁴ See Cooper, Kreyer & Vann’s *Income Taxation*, pp. 241-249; Graetz and Schenk, *Federal Income Taxation*, 375-383

“trade” in the Income Tax Proclamation and demanded exemption from Schedule “C” income tax.³⁵

The proper treatment of the income of charitable organizations and religious institutions has been a continual source of controversy in different legal systems.³⁶ Even well-developed income tax systems have struggled to come to terms with the appropriate treatment of the income of these organizations and institutions. The United States, which has detailed rules and regulations in this regard,³⁷ at first chose to exempt charitable organizations as a whole even if these organizations were engaged in unrelated business activities.³⁸ Their blanket exemption continued until 1950 when the U.S. changed its course towards charitable organizations that were involved in generating income from “unrelated” businesses.³⁹

A number of historical factors spurred the United States to change its original approach. One factor that is usually taken as a decisive factor was the increasing awareness at the time that charitable organizations were acquiring commercial businesses through so-called “feeder organizations” and the concern on the part of the United States Congress that these organizations were engaged in unfair competition with taxpaying commercial establishments.⁴⁰

³⁵ See Selam Tadesse, *Income Tax Exemption for Religious Institutions and NGOs*, pp. 36-39

³⁶ Hines, *Non-Profit Business Activity and the Unrelated Business Income Tax*, , pp. 57-84; Bittker and Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, pp. 299-358

³⁷ See IRS Publication 598 (Rev. March 2012), *Tax on Unrelated Business Income Exempt Organizations*

³⁸ Bittker and Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, pp. 301-307;

³⁹ Hines, *Non-Profit Business Activity and the Unrelated Business Income Tax*, p. 59

⁴⁰ Bittker and Rahdert give one of the celebrated cases that caused a change of heart at the time: the purchase of a large macaroni company by a feeder organization established by the New York University Law School; it was feared that this acquisition might eventually lead to a monopoly in the pasta products by exempt organization squeezing out those businesses that pay their income taxes; Bittker and Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, , pp. 318-319; incidentally

The status of religious institutions and charitable organizations in Ethiopia was closely related with the special relationship of church and the state in Ethiopian history. Traditionally, the Ethiopian Orthodox Church (hereinafter EOC) constituted a powerful arm of the State and at times was more powerful than some of the Ethiopian Emperors who had to please the powerful clergy to stay on power. The Church considered itself as part of the state and therefore taxation of the church was completely out of the question. For a long time in highland Ethiopian history, not only was the Church exempted from the payment of taxes, it held a third of the land available over which it exercised dominion including appropriating the taxes and tributes due over those lands. This position of the Church is powerfully represented in the Amharic saying “*Siso laarash, siso laqadash and siso laangash*” (a third of the produce of the land for the tiller, a third for the clergy (the church) and a third for the crown (state)).⁴¹ The exemption of the Church in ancient Ethiopia was also said to have been recognized in the Fetha Nagast (or the Law of the Kings).⁴² The Civil Code of Ethiopia (of 1960) gave a special status to the Ethiopian Orthodox Church by according it the power to exercise certain state functions granted through administrative laws.⁴³

This privileged position of the Ethiopian Orthodox Church continued up until the 1974 Revolution when the Ethiopian Monarchy was removed from power and the association of the Church with the State of Ethiopia came to an end. The Ethiopian Revolution, influenced by the

Bittiker and Rahdert argued in this work that much of the fear-mongering was based on anecdotes and speculations and had little solid empirical foundations; see *ibid*, pp. 319-321

⁴¹ See Teshale Tibebu, *The Making of Modern Ethiopia*, p. 82

⁴² “Let the King give honor to the order of the clergy... Let him give from his wealth to each of them, according to their rank. He shall exempt them from tribute, presents, and the other things to be given to the rulers... And let the King assign to God a part of the presents and of the spoils of war, as King David and other righteous kings did. Let him not raise his hand against priests or God’s saints, so that what befell the evil kings of Israel and others may not befall him,” Fetha Nagast, pp. 272-73, quoted in Teshale Tibebu, *The Making of Modern Ethiopia*, p. 80

⁴³ See the Civil Code of Ethiopia, 1960, Article 398

communist revolutions at the time, was generally hostile to the interests of the EOC. Far from being considered as part of the State, therefore, the EOC found itself in a much diminished situation after the 1974 Revolution. Not only did the Church lose most of its political and spiritual influence upon the Government, it was also stripped of much of its economic possessions. The nationalization of major economic interests in Ethiopia in the aftermath of the Ethiopian Revolution hit the EOC hard and resulted in the expropriation of all Church property which was not destined for religious purposes.

With the change of government in 1991, the EOC campaigned hard to recover some of the properties it lost through nationalization during the hay-day of socialism and although it took the new Government sometime to decide these cases, the Government eventually returned some of the buildings which were nationalized previously, giving the Church the opportunity to generate huge revenues in rents from the use of its buildings for office, commercial and residential purposes. The EOC was also able to construct new buildings in its substantial land possessions particularly in the capital, Addis Ababa. All these developments presented the EOC with opportunities for generating “unrelated” income, raising questions of whether these incomes should remain exempted simply because they are generated by the Church.

Ethiopia is a country of multiple faiths. Other religious institutions were not as influential or as politically attached to the State as the EOC, but they own some major economic interests. The Ethiopian Catholic Church has had a dominant presence in the running of various schools in different parts of Ethiopia. Indeed, some of the most famous private schools in Addis Ababa (famous for their standard of education) are owned by the Ethiopian Catholic diocese (e.g., St. Joseph School, Nazareth School and Cathedral School in Addis Ababa). Many of these schools

charge tuition fees for their services. While customers may argue that their tuition fees are fair compared to some other (non-religious, unaffiliated) schools, it remains to be the case that these schools and many others throughout the country charge fees like any private school. The question is whether these income generating activities should be exempted from the income tax by the mere virtue of being run by religious or charitable organizations.

The status of these income-generating institutions under charitable organizations and religious institutions has never been clarified by any of the laws of Ethiopia. In practice, these institutions have operated as virtual tax exempt bodies although the income tax laws have not exempted them from the payment of the income tax. The lack of clarity in the laws as well as the historical background of some of the religious institutions in Ethiopia have combined to create a legal and administrative vacuum as to allow religious institutions to generate unrelated income without having to pay income taxes to the Government.⁴⁴

Some of the loopholes in Ethiopian laws in this regard are beginning to be closed down in some recent laws regulating the operation of religious institutions and charitable organizations in Ethiopia. One of the laws that have attempted to close down the loopholes was the Charities and Societies Law of 2009. We shall briefly review the relevant rules of the 2009 law to understand the tax treatment of income generated by religious institutions and charitable organizations in Ethiopia.

⁴⁴ See Selam Tadesse, *Income Tax Exemption for Religious Institutions and NGOs*, pp. 19-39

a. Charities and Societies Law of 2009

The new Charities and Societies Law was issued in 2009 to regulate the registration and operation of charities, societies and other charitable organizations.⁴⁵ The 2009 law anticipates that charities and societies may be involved in profit-making and/or income generating activities.⁴⁶ Based on the presumption that charities and societies must generate revenues primarily from donations, gifts, etc., the 2009 law imposes certain conditions upon charities that wish to generate supplemental income from “income generating activities” (IGAs, hereinafter IGAs) in accordance with the law:⁴⁷

- i) Charities and societies must obtain a written approval from the Charities and Societies Agency;
- ii) The “income generating activities” must be incidental to the achievement of the purposes for which a charity or society is established; and
- iii) The proceeds must not be distributed among members or beneficiaries of a charity or society and must only be used to further the purposes for which the charity or society was established).

Once a charity or society is permitted to operate IGAs, it is required to maintain separate books of accounts for the IGAs and must comply with the licensing and registration requirements under other laws of Ethiopia (e.g., a charity is required to obtain a business registration number and a license from the Ministry of Trade or Trade Bureaus of Regional Governments).

⁴⁵ Charities and Societies Proclamation No. 621/2009

⁴⁶ Id, see Article 103

⁴⁷ Id, see Article 103(1)

The Agency that supervises the operation of Charities and Societies, the Charities and Societies Agency (CSA, hereinafter CSA), has issued a Directive to regulate the operation of IGAs in 2011.⁴⁸ This Directive repeats most of the requirements already mentioned in the Proclamation and provides for additional details on how a charity that seeks to operate an IGA can go ahead and obtain approval from the CSA. One of the issues that has been clarified in the Directive is that Charities and Societies are subject to all the taxes that accrue as a result of the carrying out of a business. A charity or society must obtain a Tax Identification Number (TIN) in respect of the IGA and should pay or collect all the taxes that are due upon the carrying out of businesses. A charity or society must pay income tax on the profits of the IGA. A charity or society is required to collect all withholding taxes and indirect taxes that are incidental to the carrying out of businesses. A charity or society involved in income generating activities must withhold employment income taxes (incidentally, this obligation is not even attached to businesses) and VAT or turnover taxes depending on its annual gross sales from the IGA.⁴⁹

It is easy to see from recent legislation that charities and societies are not exempted from income tax in respect of their income generating activities. If the rules are fully implemented, this means that charities and societies will be subject to income taxes under Schedule “B” for rental of buildings (a common enough source of income for many charities) and profit taxes under Schedule “C” for the carrying out of businesses (e.g., the private schools which the charities may operate are subject to profit tax under Schedule “C”). However, since the Charities and Societies Proclamation of 2009 excludes religious institutions from its ambit, the legal ambiguity surrounding the treatment of unrelated income of religious institutions will continue

⁴⁸ See *Ye Bego Adiragot Dirijitoch ena Mahiberat Yegebi Masgegna Sirawoch Lay Yemisemarubetin Huneta Lamawasan Ye Weta Memeriya Quxir 07/2004*, Meskerem 2004 E.C., in Amharic, unpublished

⁴⁹ See id, Article 14(2)

until a law along similar lines of the 2009 Charities and Societies Law is issued for religious institutions as well.

b. The Income Tax Treatment of Religious Institutions and Charitable Organizations in Practice

It is widely known that some religious institutions generate significant amounts of revenue by carrying out activities that resemble business activities and compete with the private sector. The Ethiopian Orthodox Church owns and administers a number of buildings in the City of Addis Ababa alone.⁵⁰ The Ethiopian Catholic Church runs a number of private schools which are well-sought after by the public for their quality of private education. Most of these private schools charge tuition fees comparable to any private school that is not run by religious institutions.

The approach of the tax authorities up until recently has been one of deference and practical exemption from the payment of income taxes.⁵¹ However, a big push by the government to raise revenue from all tax sources (spurred by the pressures of meeting the ambitious objectives of the GTP) as well increasing awareness within the tax authorities that religious institutions and charitable organizations are exempted from taxes only in respect of their religious activities, have resulted in the tax authorities taking some measures against religious institutions and charitable organizations. Some of these measures have met with resistance from the religious institutions and charitable organizations involved. In 2003 E.C. (2011), for example, ERCA wrote a letter to the Ethiopian Orthodox Church to inform the latter of the extent of tax

⁵⁰ See Selam Tadesse, *Income Tax Exemption for Religious Institutions and NGOs*, pp. 36-39

⁵¹ Interviews with Ato Dereje Mekonnen and Ato Dawit G/Medhin, ERCA, Addis Ketema Branch, May 18, 2012, Ato Girma Tafesse and Ato Abreha Wubet, ERCA, Branches Directorate, May 09, 2012; Ato Girma Cherinet, ERCA, Tax Audit, May 2, 2012 and May 23, 2012; Ato Solomon Gizaw, HST Consulting, April 23, 2012

exemption and of the Church's duty to pay all taxes (direct and indirect) in respect of all other activities that are not religious activities in nature.⁵² The Letter urged the EOC to register for and collect VAT on non-religious services it provides to the public as well as register its income-generating activities for the payment of the income tax.⁵³ The tax authorities have written similar letters to other religious organizations and went to the extent of providing blanket amnesty for all the taxes due up to the date of the writing of the letters.

The tax authorities have engaged in face-to-face discussions with religious leaders to persuade them of their duties to pay income taxes and the leaders have orally agreed to comply with their tax obligations, but so far the religious institutions have yet to comply with their tax obligations and the tax authorities have yet to take action to bring them into compliance with the tax laws of Ethiopia.

Cases in which the tax authorities have taken religious institutions to courts are very few and far in between, perhaps because the authorities have opted to pursue the strategy of persuasion over adversarial court battles. But there is one notable case involving a religious institution in which the tax authorities succeeded in levying tax on a school affiliated with a religious institution. In ***Ethiopian Seventh Day Adventist International Church, Akaki Mission School vs. Akaki Qality Sub-City Revenues Bureau***,⁵⁴ Akaki Mission School, which was run under the management of the Ethiopian Seventh Day Adventist International Church, objected to attempts by the tax authorities to collect "municipal" taxes. The School argued that it was

⁵² See Ethiopian Revenues and Customs Authority, Arada Sub City Small Tax Payers Branch Office, Letter to Ethiopian Orthodox Tewahido Church Addis Ababa Diocese, 2003 E.C., in Amharic, unpublished

⁵³ Ibid; see also the Church's Letter instructing the various diocese to pay the said taxes; Ethiopian Orthodox Tewahido Church Addis Ababa Diocese Secretarial, 2003 E.C., in Amharic, unpublished

⁵⁴ ***Ethiopian Seventh Day Adventist Church v. Akaki-Qality Sub-City Administration Revenues Office***, Federal Supreme Court, Cassation Division, File No. 66474, vol. 13, pp. 506-510, in Amharic

exempted from the “municipal” taxes as it was run by a religious institution and enjoyed an exemption as property owned by religious institutions.⁵⁵ The dispute went all the way up to the Cassation Division of the Federal Supreme Court which ruled that the School should pay “municipal” taxes as it was separate from the Church and carried out secular educational activities unrelated to its religious mission. The Court found that the School charged tuition fees which were comparable to the tuition fees charged by other private schools and in addition the School carried out many income generating activities in the School compound. The Court dismissed the argument that the School was administratively run by the Church and instead focused on the fact that the School obtained a license to offer private education from the Ministry of Education. Although the *Akaki Mission School* case is over the payment of “land rent and house tax” (municipal taxes), it illustrates that it is possible to separate non-religious activities from religious activities and levy taxes upon the former even if the non-religious activities are directly carried out by a religious institution.

It is difficult to generalize about the position of Ethiopian courts in this regard, but it is fair to conclude from this case that if the tax authorities possess enough political will to enforce income taxes as well as other taxes against religious institutions and charitable organizations, they may succeed in bringing most of the income generating activities currently undertaken under the aegis of religious institutions and charitable organizations. But government sensitivities not to ruffle the wrong side of religious institutions in Ethiopia has so far stymied any concerted efforts to impose income taxes upon income generating activities of religious institutions, despite what the income tax laws purportedly provide for.

⁵⁵ See Urban Land and Urban Houses Tax Proclamation No. 80/1976

IV. The Scope of “Income from Business”: The Primacy of other Schedules on some Sources of Income for Businesses

The notion of “trade” or “business” is a necessary but not sufficient condition for the operation of Schedule “C” income tax. It is incumbent upon the tax authorities to show that the “income from business” is subject to Schedule “C” income tax, rather than the other schedules of the Ethiopian income tax system. The additional requirement shows that there are many types of “income of the business” that are not subject to tax under Schedule “C.” We shall give a few examples:

- i. Company A, import and export company, owns shares in other companies. Company A is subject to final withholding under Schedule “D,” when it receives dividends, or to capital gains tax under Schedule “D,” when it transfers the shares in other companies. The taxes under Schedule “D” are final, which means that Company A is neither required to include the dividends or capital gains in its Schedule “C” income nor entitled to any tax credits or reductions for payments of taxes under Schedule “D.” Company A must keep its income from import and export separate from its dividend and capital gains income.
- ii. Company B, a financial institution, leases buildings to others for office and other commercial purposes. Company B is subject to income tax under Schedule “B” for its income from lease of buildings. Company B is neither required to include its Schedule “B” income in its Schedule “C”

income nor entitled to any tax reliefs for the payment of tax under the different schedules of Ethiopian income tax system.

- iii. Company C, a publishing company, is subject to final withholding tax on royalties under Schedule “D,” separate from its income taxation under Schedule “C” for income from direct publishing activities. Company C must keep its income from publishing separate from its royalty income.
- iv. X, a private legal practitioner, is subject to wage withholding tax under Schedule “A” for part-time teaching in a university, separate from income taxation under Schedule “C” for income from private legal practice.⁵⁶

The hypothetical examples given above illustrate that proof of the existence of a business does not necessarily lead to the application of Schedule “C” income tax. It must be shown that the specific income is not subject to the other schedules of Ethiopian income tax system. The primacy of the other schedules to Schedule “C” is not the result of some peremptory provision of the income tax laws but a logical inference from the way the notion of “source” is conceived in the schedular income tax system of Ethiopia. The primacy of the other schedules over Schedule “C” is in other words a triumph of the principle of “source” over the person or the business organization that generates the income.

The characterization of specific income as “dividend” is more important than the person who derives the dividend income. This is true of most other sources of income – income from employment, income from rental of buildings, income from royalties, income from interest,

⁵⁶ The discrepancies in withholding taxes have at times resulted in withholding of 2% from the part-time employment of private legal practitioners as part-time lecturers in universities, which suggests that some private legal practitioners might use their professional licenses to force withholding under Schedule “C” for services that are in the nature of employment.

income from transfer of capital assets, etc. Once a specific income is characterized as one of the sources falling under the other schedules of the Ethiopian income tax system, it is a matter of no consequence that the income is received by a business otherwise subject to income tax under Schedule “C.” A schematic representation of various sources of income generated by a sole proprietor business is presented in the table below.

Table 7.1: Schematic Representation of Income Taxation of a Sole Proprietor Business owner under the Schedular Income Tax System of Ethiopia

No.	Source of Income	Schedules of the Ethiopian Income Tax			
		A	B	C	D
1	Trading			X	
2	Employment	X			
3	Rental of buildings		X		
4	Royalties				X
5	Lottery				X
6	Dividends				X
7	Interest on bank deposits				X
8	Interest on loans to businesses			X	
9	Casual rental of business property				X
10	Lease of sole proprietor business			X	
11	Gains from transfer of building held in business				X

From the discussion thus far, it is possible to establish one principle that determines the scope of Schedule “C.” The operation of the other schedules has a direct bearing on what “incomes from business” fall under Schedule “C.” But the task of delimiting the scope of Schedule “C” is not done by merely excluding a specific source of income from the operation of the other schedules. The sections dealing with Schedule “C” have provisions that help in defining the scope of Schedule “C,” by inclusions as well as exclusions.

The Income Tax Proclamation itself excludes, through exemptions, certain types of Schedule “C” income. Article 30 of the Income Tax Proclamation, for example, exempts the following forms of income from the operation of Schedule “C”:

1. Awards for adopted or suggested innovations and cost saving measures;
2. Public awards for outstanding performance in any field;
3. Income specifically exempted from income tax by other laws in force in Ethiopia, by international treaties or agreements made or approved by the Minister (of Finance).

A Schedule “C” taxpayer is not required to include “exempt income” if she is able to show that the income is one of those exempted under Article 30 of the Income Tax Proclamation. The third category - income specifically exempted from income tax by other laws in force in Ethiopia – is the most significant source of income tax exemption in the Ethiopian income tax system, as Ethiopia has issued a number of investment incentive laws that have granted income tax

holidays to various types of Schedule “C” businesses.⁵⁷ The standard income tax holiday period for a long time has been five years, granted primarily to those businesses that were otherwise subject to income tax under Schedule “C.”⁵⁸ Most tax incentive regimes are extended to the whole business, rather than specific source of income, with the result that the beneficiaries of income tax holidays are wholly exempted from the payment of income tax for the duration of the holiday period. Up until 2012, for example, investors involved in agro-industrial business enjoyed a five year income tax holiday period and additional holidays for expansion and upgrading of their business.⁵⁹ The current investment incentive laws of Ethiopia have extended income tax exemptions to a variety of businesses involved particularly in manufacturing.⁶⁰

The definition of the scope of Schedule “C” should proceed from the exclusion of the other schedules and the exemption of certain types of income or some types of businesses or investments from the income tax. This process takes two steps. The first step is to check whether the specific income generated by a Schedule “C” taxpayer does not fall under any one of the other schedules (A, B and D). The second step is to check whether income received by a Schedule “C” taxpayer or the type of business run by a Schedule “C” taxpayer is exempted by the Proclamation itself or other laws in force or tax treaties or agreements signed or ratified by Ethiopia. If these two processes yield the result that the income is neither covered by the other schedules nor exempted by Schedule “C” rules, the most appropriate conclusion to make is that the income is the subject of Schedule “C” income tax.

⁵⁷ See Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, pp. 149-254

⁵⁸ See Investment Proclamation 280/2002; Council of Ministers Investment Regulations No. 84/2003

⁵⁹ See Investment Proclamation No. 280/2002

⁶⁰ See Council of Ministers Investment Incentives Regulations No. 270/2012

The conventional sources of “business income” that Schedule “C” deals with are what the Income Tax Proclamation calls “business income realized from entrepreneurial activity.”⁶¹ Unfortunately which incomes constitute part of the “income realized from entrepreneurial activity” and, which incomes do not, is not clear from the reading of the Income Tax Proclamation itself. The Proclamation does not elaborate on what activities form part of “entrepreneurial activity.” The only provision of the Proclamation which addresses the issue of what incomes to include in Schedule “C” income is Article 24 of the Income Tax Proclamation. Article 24 states that gain or is loss recognized (under Schedule “C”) whenever “assets used in business are sold, exchanged or otherwise transferred.”⁶² This provision clarifies at least one issue with respect to the scope of Schedule “C” – that whenever businesses subject to Schedule “C” transfer assets, they should include the proceeds of the transfer in Schedule “C” income even if the assets involved are capital assets, rather than “trading stocks” (inventory).⁶³

The definition of the scope of Schedule “C” is further complicated by the specific inclusion of “income from business lease,” on the one hand, and the exclusion of “income from casual rental of property” on the other. The Income Tax Regulations prescribe that “income from business lease” shall be included in Schedule “C” income. This species of income is quite unlike any other regular source of income for business – a fact that perhaps explains its specific mention in the Income Tax Regulations. Another possible source of income for a Schedule “C” business – income from casual rental of business property – is paradoxically taken out of Schedule “C” and made the subject of Schedule “D” under the Ethiopian income tax system. Article 35 of the

⁶¹ Income Tax Proclamation No. 286/2002, see Article 17

⁶² Id, see Article 24(1)

⁶³ The exception is for buildings held in business, which, when sold or otherwise transferred, are subject to capital gains tax under Schedule “D”; Income Tax Proclamation No. 286/2002, see Article 37

Income Tax Proclamation prescribes that businesses should report and pay income tax on income from casual rental of business property under Schedule “D.” These two provisions – Article 7 of the Income Tax Regulations and Article 35 of the Income Tax Proclamation – add their own layers of complication on the definition of the scope of Schedule “C” under the Ethiopian income tax system. We will address the problems of Article 35 in the next Chapter and for now try to come to terms with the meaning and scope of Article 7 of the Income Tax Regulations – “income from business lease.”

a. The Enigma of Article 7 Income Tax: “Business Lease” and “Income from Business Lease”

Article 7 of the Income Tax Regulations adds another layer of complexity to the Ethiopian income tax system by placing one form of lease and the source of income therefrom under a subject-matter of Schedule “C” income tax. The specific source of income from lease placed under Schedule “C” is named business lease. We have already seen in Chapter Six that Ethiopian income tax system, wittingly or unwittingly, scrambles income from lease of property under three different schedules: lease of buildings under Schedule “B,” lease of business under Schedule “C,” and casual lease or rental of property under Schedule “D.” The basic difference among these different forms of leases boils down to the object of the lease, which for some reason, must have been thought determinative of the schedule under which income tax should be imposed.

The Income Tax Regulations mention “income from business lease” presumably out of fear that this source of income, whatever it may mean, will remain unreported and thus untaxed. The problem is that the Regulations mention “income from business lease” almost as a matter of

fact, perhaps either assuming that this source of income is pretty well-known to require any further details or that it is well-defined in other relevant areas of Ethiopian law. The problem with this matter-of-fact approach is that neither of these assumptions is entirely true. This source of income is not so well-known in practice. It is also not clear if what the Income Tax Regulations refer to as “income from business lease” is analogous to “business leases” in other areas of Ethiopia law.

The Income Tax Proclamation and the Regulations do not define the notion of “business lease.” No subsidiary pieces of legislation have been issued to elaborate the notion of “business lease.” The only other area of law where “business lease” is regulated is the Commercial Code of Ethiopia, to which it might be instructive to turn in order to understand the nature and operation of “lease of businesses.”

The Commercial Code of Ethiopia, for example, regulates what it calls “hire of business,” which in substance is comparable to what the Income Tax Regulations refer to as “business lease.” The Commercial Code of Ethiopia uses the term “business” to mean a special type of property. Article 124 of the Code defines business as “*an incorporeal movable consisting of all movable property brought together and organized for the purpose of carrying out*” any commercial activities as set out in Article 5 of the same Code. As a form of property, a business can be owned, transferred, leased, mortgaged or contributed as a form of property to another business like any other property, movable or immovable.⁶⁴

Under the Commercial Code, traders can derive economic gain, not just from the carrying out of conventional trading activities but also by transferring the business as a property as a whole

⁶⁴ Commercial Code of Ethiopia, see Articles 124-209

(sale of business), mortgaging the business or hiring (or leasing) the business. The Commercial Code declares that a business may be let out for hire (leased) like any property and when that happens, the contract for the lease of a “business” shall be regulated by both the Commercial Code⁶⁵ and the Civil Code provisions pertaining to leases in general.⁶⁶

Many of the respective rights and obligations of the parties to the “hire of a business” under the Commercial Code resemble the rights and obligations of parties to conventional lease contracts, but there are special obligations prescribed in the Commercial Code. One of these special obligations (which presumably arises from the nature of “business”) is that a lessor (the owner) of the business may not thenceforward compete with the lessee by creating or acquiring a business having similar objects while the lease of the business lasts.⁶⁷

Overall, one can infer from the provisions of the Commercial Code that the lessee becomes a trader (which is formalized by having the name of the lessor struck out and replacing it by the name of the lessee) and the lessor of a business ends her status as a trader (unless s/he starts a completely different business). For the duration of the lease, the business of the lessor becomes the business of the lessee, and the lessor turns into a party that generates a lump sum income from the lease or periodic payments in the form of business lease payments from the lessee.

If we accept the “business lease” to mean “hire of business” under the Commercial Code, the leasing or the hiring of a business creates two distinct income streams for two different persons:

⁶⁵ Id, see Articles 195-205

⁶⁶ Id, see Article 194; Civil Code of Ethiopia (1960), see Articles 2896-2974; the Commercial Code imposes special obligations and formalities for “hire of business”: the contract shall be in writing, be published in commercial gazette and newspaper empowered to publish legal notice; the “hire of a business” shall be registered; the name of the owner of the business shall be struck out of the commercial register and the name of the lessee shall be entered in its place; and the lessee shall add the word “lessee” on all her business papers; see Commercial Code of Ethiopia, Articles 195, 196 and 198.

⁶⁷ Commercial Code of Ethiopia, see Article 204

the lessor from the lease of the business, and the lessee from the carrying out of a business under lease. The terms of payments for the lease are left to the agreement of the parties. The lessor may be paid lump-sum or periodically, perhaps as the business leased generates profits.

The question that arises in connection with the meaning and scope of “income from business lease” for purposes of income taxation is if the Income Tax Regulations refer to either or both of these income streams. The Income Tax Regulations can be read in two different senses. The Income Tax Regulations can be said to have referred to taxation of the income of the lessor from the lease of a business, much as a lessor of buildings is subject to tax under Schedule “B” or a casual renter of property may be subject to tax under Schedule “D” – Article 35 (**see Chapter Eight below**). The Income Tax Regulations may also be read as to state that a business is subject to income taxation (under the identity of the lessee) in spite of the fact that the business is now under lease. The latter interpretation restates the obvious fact that a business does not cease to become a subject of the income tax under Schedule “C” simply because the business is leased to another person. However, even when we are convinced that it is the second sense which makes sense, we are still confronted by the question of as to who should report and pay income tax for the business that is now leased to another person: the lessor or the lessee?

The analysis of the nature of “business lease” in the context of the Ethiopian income tax system is complicated by the multiple senses in which “business” is understood in the Income Tax Law itself and the complete lack of adequate case law and practice addressing the meaning and scope of business leases for purposes of income taxation. The Income Tax law uses the term “business” in at least two different contexts. We have already seen before how the Income Tax Proclamation uses the term “business” interchangeably with “trade” to mean “any industrial,

commercial, professional or vocational activity... carried on by any person for profit.”⁶⁸ In this first sense, the word “business” is used to identify one type of activity that is chargeable with income tax under Ethiopian income tax law/s.

In another sense, the Income Tax Regulations use the word “business” to signify one form of property. The Income Tax Regulations appear to take it for granted that there is such a thing or property called “business” and that it is leasable, and when income is generated from the lease of a “business” as a property, it is chargeable with income tax under Schedule “C.” Unlike in the first case (where the Income Tax Proclamation refers us to the Commercial Code), however, the Income Tax Regulations neglects to refer us to the Commercial Code, where business leases are well-regulated.

Having outlined the legal contours of “business lease” from the vantage point of the Commercial Code in particular and the possible renditions of “income from business lease” for income tax purposes, we shall investigate the scope of application of this specific source of income by reference to how “business leases” are perceived in income tax practice in Ethiopia.

i. The Taxation of Income from “Business Lease” in Practice

At the time of writing, the practice of income taxation in Ethiopia has not resolved any of the issues arising in connection with the meaning and scope of taxation of income from business lease. This is largely because Article 7 income tax (to the extent it is possible to identify it as a distinct tax) is one of the least common and least known forms of income taxation in Ethiopia. Many tax officers and practitioners admit to having never come across the taxation of a business

⁶⁸ Income Tax Proclamation No. 286/2002, see Article 2(6)

under lease despite having worked in the tax authorities for a long time. Like its twin troublemaker, income from casual rental of property under Article 35 of the Income Tax Proclamation, the meaning and scope of Article 7 (taxation of income from business lease) has generated divergent opinions from the tax officers and practitioners. While admitting to not coming across the reporting of tax under this Article, the tax officers and practitioners have weighed in on its meaning and scope.

Some say that Article 7 is intended to capture the income of the lessor from the lease of a business. Some others say that it is intended to target the income of the lessee and still others hold that Article 7 is applicable upon both the income of the lessor and the lessee. A few tax officers have argued that the income of lessors should be subject to tax under Schedule “B” (although the legal authority for this position is very much in doubt) while that of the lessees should be subject to tax under Schedule “C” since they are the ones that really carry out the business activity. Some have argued that Article 7 is intended to stress the fact that the lessors remain taxpayers under Schedule “C” in spite of the fact that the business is leased to another person.

Tax officers admit to not having a clear idea of the meaning and scope of “business lease” and claim that the practice of business relationships has prevented them from having a clear notion of this form of tax. Tax officers at all levels suspect that many businesses are run under “lease” but these business transactions are rarely reported officially. The parties to business lease contracts, they allege, conceal this fact from the tax authorities; although the authorities have many hints about this, they cannot really enforce this because the business owners allege to having the business run by their close relatives (there is currently no national database about

relationships in Ethiopia). The tax authorities carry out inspections of particularly small businesses for presumptive tax purposes and come across businesses that are run by complete strangers, and sometimes the “strangers” admit to running a business under lease.

The strategy the tax authorities have pursued so far is to impose tax upon the lessee who has admitted to having run the business under lease (with a counsel to get his/her own license for the business) and also upon the lessor for the income s/he admitted to have generated from the lease of the business. This strategy is arbitrary and wholly contingent upon the personal admission of the parties themselves. The practice currently runs upon the good faith of the parties involved and has not devised any means of discovering those businesses that are run under a lease. As it is suspected that many businesses are run under lease without being reported, it is surmised that the income from the “lease of a business” goes frequently unreported and therefore untaxed in practice.

Historical factors in the availability of business premises in Ethiopia have also been unwittingly responsible for the cat and mouse game that certain sections of society play with the government. In the aftermath of the Ethiopian Revolution, all extra-houses in Ethiopia were nationalized by the Government and became public property.⁶⁹ After nationalizing all extra houses, the Government at the time transferred many of these houses at extremely low prices to individuals for residential and commercial purposes. The Government also outlawed any kind of sub-leasing of its own property. This did not arrest the pace and level of sub-leasing but created a layer of facades under which sub-leases flourished. For fear of expropriation, those who took the houses from the government simply pretended to be living in it or doing business in it while

⁶⁹ See Government Ownership of Urban Lands and Extra Houses Proclamation No. 47/1975

actually sub-leasing the premises for residential as well as commercial purposes. A whole underground economy of sub-leasing was created which gave sub-lessors substantial rent-seeking opportunity without complying with government regulations and paying the taxes. The government has at various times taken actions to take away the lease rights of the original lessors, but the more the government clamped down upon the violators of government lease laws, the more underground the whole operations went, resulting in the loss of huge revenues from this sector for the government. The whole business of leases has become such a sensitive subject for the parties involved that many parties have decided to stay underground rather than come public with it and risk losing their lease rights with the government. The owners of the lease rights exert enormous pressures upon the operators of businesses in the leased premises by threatening them with eviction if they divulge the details of the lease of the premises. If the government attempts to take over the property, the lessors claim that they have either not leased the business premise or have only leased the business as a property, and not as a business premise. The whole operation has become surrounded by shadowy deals and shady transactions that have further complicated the application of the tax on income from “business leases” even if the income is properly understood by tax administrators.

In general, the application of Article 7 income tax on “income from business lease” is hampered by the absence of any legislation that defines and explains its meaning and scope, and embroiled in complicated historical and political factors that have pushed the source of income from lease of businesses into secret alleyways about which the government has little information. There are no regulations, directives or circular letters dealing with the meaning and scope of Article 7, and the practice runs on the guesswork and conjecture of those who are charged with enforcing taxes like this at the lowest levels.

V. Aggregation of Income under Schedule “C”: Problems of the Law and Challenges in Practice

The rule of aggregation, which is recognized under Schedule “C,” requires aggregation of income from multiple sources, provided all of these sources fall under the same schedule. The basic principle of aggregation is laid down in Article 70 of the Income Tax Proclamation.

A taxpayer who derives *income from different sources subject to the same schedule* shall be assessed on the aggregate of such income (italics added).

The rule of aggregation is ostensibly there to ensure at least intra-schedular horizontal equity of persons who derive income from one business and persons who derive income from multiple businesses. Since the tax rate structure for individuals is progressive, the requirement of aggregation is tremendously significant in ensuring the equitability of the income tax system at least among persons who are subject to the same schedule. We have already deplored the fact that the principle of aggregation does not go far enough in ensuring the equitability of the Ethiopian income tax system (**see Chapter Four**). Even in its intra-schedular sense, however, the implementation of the principle of aggregation among taxpayers subject to income tax under Schedule “C” is hampered by a number of factors further undermining its limited importance in ensuring intra-schedular equity.

One of the factors that militate against the realization of aggregation among businesses has been the lack of adequate information regarding persons who carry on multiple businesses in different places. In recent times, the gathering of information regarding taxpayers has become much easier as a result of advances in information technology and the application of various types of software in tax administration. In Ethiopia, the introduction of the Tax Identification

Number (TIN) has made it possible for the tax authorities to employ unique biometric fingerprints and assign numbers which are unique to every individual taxpayer.⁷⁰ Since all business licenses are linked with TIN, it is now possible for the authorities to trace and identify who owns what businesses and where. Many tax officers are confident of their capacity to trace all businesses carried by a person through the TIN.⁷¹ The efficiency of the TIN system in tracing and identifying businesses hinges upon the efficiency with which the tax authorities are able to issue all persons who carry on business with their TIN throughout the country.

While it is easy to see how the introduction and diffusion of the TIN system may enable the tax authorities to fulfill the demands of aggregation as stipulated in Article 70 of the Income Tax Proclamation, it is important to note that the ideal of intra-schedular equity as reflected in Article 70 is far from complete in practice for a number of reasons. We shall review the legal and

⁷⁰ The Tax Identification (TIN) System was introduced for the first time by the 2001 Income Tax Amendment Proclamation; see Income Tax (Amendment) Proclamation No. 227/2001, Article 2(1)

⁷¹ Some Regional governments have detailed directives on how and where aggregation may be done. In Oromia Regional State, for example, the level of aggregation is handled in various Regional Government levels depending upon the dispersion of the business by a person. If person carries on multiple businesses in a single Woreda, the Woreda Revenue Bureaus themselves aggregate the taxable income from the multiple businesses and assess the tax due for payment at the Woreda level. If person carries on several businesses in two or more Woredas, the Zonal Revenue Bureaus are tasked with the responsibility of aggregating the taxable income from multiple businesses and assessing the tax at the Zonal level. If person carries on several businesses in two or more zones of the same Region, the Regional Government Revenue Bureau is tasked with the responsibility of aggregating the taxable incomes and assessing the tax due on the total income from the multiple businesses. The only aggregation that is currently not happening is the carrying on of businesses in two or more Regional Governments because of the absence of constitutional arrangements that address multiple revenue claims upon individuals who carry on businesses in multiple Regions. For lack of solutions, the Regional governments are at the moment content to impose income taxes upon businesses operating within their own borders. In other words, aggregation has not yet crossed regional boundaries (for more on this, see below); see *Qajeelfama Qooddi Galii Mootummaa Naannoo Oromiyaa Bulchinsa Aanaalee fi Magaalotaa Murtessuf Bahe*, in Oromiffaa, unpublished

practical obstacles to aggregation of income from multiple businesses under three headings, namely:

- a. The Legal and/or Practical Exception for Category C Businesses
- b. The Un-traceability of Businesses by Related Persons;
- c. Constitutional Hurdles to Aggregation of Income from Businesses located in several Regions

**a. The Legal and/or Practical Exceptions for Category C
Businesses**

One of the factors that stand in the way of aggregation in practice is the insistence on separate assessment of income from so-called “Category C” businesses. Article 70 of the Income Tax Proclamation does not make any explicit exception to the rule of aggregation, but in practice the tax authorities have insisted on applying the special rules of assessment for Category C (small businesses) even though the small businesses are owned by a person who owns medium or large businesses in other places. “Category C” taxpayers of Schedule “C” – identified as those businesses whose annual turnover does not exceed 100, 000 ETB – are subject to the presumptive income tax regime of standard assessment, which is based on type, size and location of the business.⁷² These taxpayers are relieved from the basic income tax law obligation of maintaining books and records due to the smallness of their size. Since these businesses do not maintain books and records or are not required to anyway, their income tax liability is assessed through indirect methods enunciated in the standard assessment rules and tables of

⁷² Income Tax Proclamation No. 286/2002, see Article 67

the Ethiopian income tax laws. In practice, their annual tax liability is determined primarily by estimation of daily sales, which are then used to estimate their taxable income and determine their tax liability in accordance with the standard tables of assessment.⁷³ Because the rules of assessment with respect to “Category C” taxpayers are different from the regular rules of assessment, the tax authorities have argued that the income of small businesses should not be aggregated with income of medium and/or large businesses even though all these businesses are owned by one sole proprietor.

This exception of small businesses from the rule of aggregation means that the individual proprietor who owns several businesses, some of which are in the small business category, will have to report the income from small businesses separately from the other businesses which are subject to the regular income tax rules. The extent to which the tax authorities can insist on presumptive taxation where a person carries on a category “C” business along with medium and large businesses is a controversial matter in practice, but the tax authorities have insisted in many cases on excepting category “C” businesses from the requirement of aggregation even if that defeats the aim of aggregation, which is to ensure at least intra-schedular equity among individuals with comparable amounts of taxable income in a year.

In one recent case, for example, *Lideta Sub-City Revenues Bureau v. Demissie Gebre*,⁷⁴ Demissie Gebre who owned a hotel and ran public transportation in the City submitted an aggregated income statement for purposes of tax assessment, but the Tax Authority rejected the aggregation on the ground that one of the businesses – namely, public transportation, was a

⁷³ See Zerihun Assegid, Presumptive Taxation of Small Businesses in Ethiopia; the tables are themselves presumably based on surveys of business profitability rates.

⁷⁴ Federal Court Cassation File No. 58620, Sene 02, 2003 E.C., unpublished, in Amharic

category “C” business and should not be aggregated with the larger business (the hotel).⁷⁵ The Tax Authority rejected the books and accounts submitted by Demissie in respect of his transportation business and assessed the tax according to the presumptive methods under which higher tax liabilities were charged for that transportation business. The Tax Authority stated in its submission to the courts that it would have accepted the aggregation if the income tax due based on the books and accounts submitted by Demissie was greater than that income tax under the presumptive methods. The case went up to the Cassation Division of the Federal Supreme Court, the highest judicial body in Ethiopia, but Demissie lost on appeal as well; the Supreme Court accepted the contention of the Tax Authority not to aggregate taxable income from multiple businesses if one of the businesses is a category C business.

Although the position of the tax authorities remains controversial (as there is no explicit exception against aggregation when one of the businesses involved is a Category C business), this exception is one source of discrimination among individuals who carry on multiple businesses. Since the income tax rates for individuals under Schedule “C” are progressive, they can result in significant differences in tax burdens among individual traders or business persons solely because one of the businesses happens to be a category “C” business.⁷⁶

⁷⁵ Public transportation is subject to a standard assessment based on seating capacity; see Income Tax Regulations No. 78/2002, Schedule 2

⁷⁶ Incidentally, there is some apparent inconsistency of approach between the Income Tax Proclamation and the VAT laws. The VAT laws authorize the tax authorities to aggregate the values of sales from several businesses for purposes of ascertaining whether a person meets the registration threshold. The VAT laws make no distinction between the sizes of different businesses. The VAT laws seem to require aggregation even if one of the businesses, taken alone, would be categorized as small. This insight of the VAT laws is not carried over into the income tax laws and as result even the ideal of “intra-schedular equity” is not honored due to the exceptions to aggregation when one of the businesses is a category C business; see Value Added Tax Proclamation No. 285/2002, Article 16(7)

b. The Un-traceability of Businesses by Related Persons

The current practice of aggregation is able to trace businesses that are carried on by one person directly. Although the Income Tax Proclamation contains sufficient authority to watch over businesses carried on by related persons, the tax authorities are so far severely constrained by administrative resources to pursue those individuals that carry on businesses through related parties, such as through spouses, children and parents.⁷⁷ It is therefore quite easy to get around the aggregation requirement by channeling businesses through related persons. In a country like Ethiopia, where there are still strong bonds of traditional family relationships, it becomes quite an easy matter for a person to carry on multiple businesses through relatives. Those contacted for interviews in this regard express the moral dilemma of going after the few suspected businesses operated through relationships when the tax authorities in general have not devised appropriate strategy to enforce the full rigor of the income tax on all businesses involved.⁷⁸ Tax officers may accidentally stumble upon business relations and may use this information to aggregate the income of those who are related, but they realize that this is fundamentally unjust as it leaves out hundreds, perhaps thousands of other businesses whose relationship is not known to the tax authorities.

The extent to which business owners use relationships to split their income (particularly to minimize their income taxes) is not known, but it is easy to see that this gap in the Ethiopian tax administration provides tremendous opportunity to those who are capable of channeling some of their business interests through relationships. In one case, *W/ro Etaferaw Wondimu v.*

⁷⁷ See Income Tax Proclamation No. 286/2002, Article 2(4), 2(5) and Article 29

⁷⁸ Interviews with Ato Dereje Mekonnen, ERCA, Addis Ketema Branch, May 15, 2012 and May 18, 2012; Ato Yohannes Gizaw, ERCA, Addis Ketema Branch, May 14, 2012

Akaki Qality Sub-City Small Business Taxpayers' Branch Office,⁷⁹ a taxpayer (Etaferaw Wondimu) successfully challenged attempts by an estimation committee to aggregate income from a hotel which the taxpayer owned with income from a pool house which she claimed her son owned. The Tax Appeal Commission treated the two businesses (a hotel and a pool house) as separately owned even though there was reason to suspect that both were effectively owned by her. There are legions of cases like this which escape the rule of aggregation.

c. Constitutional Hurdles to Aggregation of Income from Businesses Located in Several Regional States

The modality of constitutional tax assignment in Ethiopia also stands in the way of aggregation where a person carries on businesses in two or more Regional States in Ethiopia.⁸⁰ The Ethiopian Constitution assigns income tax powers on sole proprietor businesses to the Regional States.⁸¹ Sole proprietors who carry out businesses in two or more Regional States are not required to comply with the obligation stated in Article 70 simply because they have located their businesses in two or more Regional States. Each Regional State enforces income taxes with respect to businesses located in its territory in complete disregard of businesses operated by the same person in other Regional States.

There is no reliable data on how many individuals carry on multiple sole proprietor businesses in one Region let alone in several Regional States, but this problem is likely to become significant in adjacent states where it does not take much distance to carry on multiple

⁷⁹ Addis Ababa Tax Appeal Commission, Tax Appeal File No. 1454/04/783/04, Yekatit 15, 2004 e.C., in Amharic, unpublished

⁸⁰ See Taddese Lencho, *Income Tax Assignment under the Ethiopian Constitution*, pp. 31-51

⁸¹ The Constitution of Ethiopia, see Article 97(4)

businesses and fall under the jurisdiction of two or more regional states. There are five cities in Oromia Regional State surrounding the City of Addis Ababa within a short distance of less than five kilo meters, and it is quite easy for individuals to set aside the aggregation requirement by locating their businesses conveniently in two Regional States: Oromia and Addis Ababa City Administration. The same can be said of businesses in Hawassa (SNNPRS) and Shashamanne (a city in Oromia Regional State) –within a short distance of less than 20 KMs.

The Regional government tax officials are aware of the problem of aggregation of businesses that straddle two or more Regional States and there are reports of discussions on this issue in the intergovernmental forums but so far the solutions have yet to be found.⁸² One solution reportedly on the table is that the sole proprietors pay their income tax on the aggregate income in their place of principal business registration but it is difficult to see how that can be a solution in the face of opposition from those Regions where the businesses are not principally registered but are found significantly. For various administrative reasons, sole proprietors may wish to locate their principal or original business registration in the city of Addis Ababa but may operate their other businesses in adjacent regions like Oromia. It is difficult to see how the Regional State of Oromia will agree to any proposal that gives the primacy of income tax jurisdiction to Addis Ababa (Finfinne) unless the Federal Government somehow takes over the collection and distributes the proceeds from these sources as equitably as possible.

In any event, the problem of aggregation of multiple businesses in multiple regions remains to be a constitutional challenge in Ethiopia. The current Constitutional arrangement favors those

⁸² Interview with Obbo Lammessa Likki, Oromia Revenues Bureau, Finfinne, March 07, 2012

taxpayers that are able to locate their businesses in multiple Regional States and discriminates against those taxpayers that have located all of their business interests in one Regional State.

CHAPTER EIGHT

SCHEDULE “D” – TAXATION OF MISCELLANEOUS INCOME

I. Introduction

The current Schedule “D” was at one point a receptacle for a completely different source of income. In 1967, the income tax law of the time was revised to incorporate (for the first and last time, as it turned out) income from agricultural activities, which was added then as Schedule “D” of the main income tax system of Ethiopia.¹ But this incorporation of agricultural income taxation in the main body of the Ethiopian income tax system was short-lived. The agricultural income tax system was removed from the body of the income tax system less than ten years later in 1976 in the aftermath of the Ethiopian Revolution. Schedule “D” remained vacant for a while until the Government decided to fill it with entirely new sources of income in 1978 – sources which were aptly called “miscellaneous income.” The miscellaneous sources of income which became chargeable with tax after 1978 were either completely unknown or expressly exempted by the existing income tax system.²

Schedule “D” is intriguing on a number of levels for anyone familiar with the income tax structures of many other countries. Schedule “D” may appear to be designed as a schedule for final withholding taxes. Indeed many of the specific sources of income subject to tax under Schedule “D” of Ethiopian income tax system are subject to final withholding taxes. There are,

¹ The 1967 agricultural income tax law effected a brief incorporation of the agricultural income tax into the main body of the Ethiopian income tax system. This incorporation ended in 1976, when agricultural income taxes were once again taken out of the main income tax system and became autonomous regimes of income taxation in Ethiopia; see Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, pp. 108-113; see also Bekele Haileselassie, *Salient Features of Income Tax Laws*, pp. 46-64

² For example, dividends were known to be sources of income from the early times but they were expressly exempted from income tax until 1978, for dividends see below

however, some that are not subject to withholding taxes, which makes it difficult to label Schedule “D” of Ethiopian income tax as a final withholding tax schedule. At least two of the sources currently chargeable under Schedule “D” are not subject to withholding taxation. Capital gains taxes and windfall profits tax are self-assessment taxes.

Schedule “D” may also appear to be a tax on “income from capital.” Indeed, many of the sources chargeable under Schedule “D” may qualify as “income from capital.” Some of the sources of income chargeable with tax under Schedule “D” are typical sources of income from capital, namely, royalties, dividends, interest and capital gains. But, there are some sources that are difficult to fit into this category, e.g., winnings from games of chance and windfall profits.

Schedule “D” may be also considered as a schedule for charging the Ethiopian-source income of non-residents. But this is clearly not true. Apart from Article 32 of Schedule “D” which is explicitly intended for taxation of the income of non-residents, most of the final withholding taxes under Schedule “D” target both residents and non-residents. The withholding taxes on royalties, dividends and interest apply both upon residents and non-residents. Hence, while Schedule “D” includes many withholding taxes on non-residents, it is not intended solely for non-residents.

Schedule “D” is therefore at times a schedule for charging “income from capital,” in places for charging “income of non-residents” and in many cases for applying “final withholding taxation on certain sources of income.” Schedule “D” is all of these things and not all of these things. It is impossible to make one general statement that unites Schedule “D” at the moment. The other three schedules we have already considered in the previous chapters have certain unifying features and form one cohesive whole in terms of the income brackets, tax rates, assessment and

modes of tax collection. The income brackets, tax rates, assessments and modes of tax collection for all types of income subject to tax under Schedule “A” are one and the same rules, although there are minor differences here and there. The same can be said for Schedules “B” and “C” of Ethiopian income tax system. Although Schedule “D” is not as open-ended as its headings suggest (all its sources are enumerated exhaustively), it is clear that Schedule “D” was designed by the government to capture various sources of income not already captured under the other three schedules.

Part of the reason why Schedule “D” presents such an amorphous picture to us is that it was designed to capture multiple and disparate sources of income and serve as a vehicle of specific income tax policies at various times in recent history. The heading of Schedule “D” is in this respect at least apt: “Miscellaneous Income” in the past or “Other Income” now. When the current Schedule “D” was added to the schedular income tax system of Ethiopia in 1978, the original members of Schedule “D” “family” were four (royalties, income from technical services, winnings from games of chance, and dividends)³, but Schedule “D” has since then expanded its family to include “capital gains” (in 1994), “interest on bank deposits” (in 2001) “income from casual rental of property” (in 2002) and “windfall profits” (in 2010). By all accounts, if the schedular trajectory of the Ethiopian income tax system continues, Schedule “D” is going to be used as a basket for putting various sources of income not yet discovered to be taxable by the government.

³ The 1978 Income Tax Amendment Proclamation also mentioned “income from casual rental of property” but placed it under Schedule “C.” The 1978 Income Tax Proclamation simply states: “any person or organization who derives income from casual rental of property shall pay income tax according to Schedule “C”,” see Income Tax Amendment Proclamation No. 155/1978, Article 2(5)(d)

II. Defining the Scope of Schedule “D”

The scope of Schedule “D” is even harder to pin down than the other three schedules of the Ethiopian income tax system. As pointed out earlier, Schedule “D” is distinct from the other schedules in covering income tax sources which are not only diverse in origin but also the subject of differential tax rates (**for differential tax rates under Schedule “D,” see Table 8.1 below**). It is therefore impossible to write in general terms about the scope of Schedule “D.” Schedule “D” is intended to capture what, in other income tax systems, may be variously called “investment income” or “passive income” or “irregular income.” In one sense, the problems of Schedule “D” are the problems encountered in connection with the definition of the scope of the other schedules of the Ethiopian income tax system. The delimitation of the scope of Schedule “D” is compounded by the absence of definitions or detailed rules regarding the sources of income subject to tax under Schedule “D.” With the possible exception of “royalties,”⁴ and “income from technical services,”⁵ all of the sources chargeable under Schedule “D” largely remain undefined for income tax purposes.

In the Ethiopian legal system, certain concepts are left undefined in some pieces of legislation partly because these concepts are either well-defined in other laws of Ethiopia or well-known in general. A case in point is the concept of “dividend” whose definition is assumed to be left to Commercial Code of Ethiopia. The problem with this approach is that it is not known how controlling the meaning of these terms is or whether the definitions in other laws are relevant at all for purposes of income taxation. In cases involving payments for writing of modules, we saw in Chapter Five above how references to Ethiopian copyright laws for a while swayed the tax

⁴ Income Tax Proclamation No. 286/2002, see Article 31(3)

⁵ *Id.*, see Article 32

authorities in favor of characterizing these payments as “royalties,” but there are many cases in which appeals to other laws failed to sway the opinions of the tax authorities. In a recent controversy over the meaning of “dividends,” for example, a number of writers have opposed the treatment by the tax authorities of “undistributed profits” or “retained earnings” of companies as “dividends,” but the tax authorities have insisted that “retained earnings” are “dividends” as they are held in trust on behalf of shareholders.⁶ Both sides have sworn by the faithfulness of their arguments to the language of the Commercial Code, but both sides are locked in disagreement so far. These controversies about the meanings of certain concepts in Schedule “D” throw the whole exercise of defining the scope of Schedule “D” into doubts and uncertainties.

Table 8.1: Tax Rates and Modes of Assessment of Schedule “D” Income

No.	Type of income	Rate	Mode of Assessment
1	Royalties	5%	Final withholding
2	Income from technical services rendered abroad	10%	Final withholding
3	Income from games of chance	15%	Final withholding
4	Dividends	10%	Final withholding
5	Income from casual rental of property	15%	Self-assessment
6	Interest on bank deposit	5%	Final withholding

⁶ For dividends, see below

7	Capital gains tax on transfer of shares	30%	Self-assessment
8	Capital gains tax on transfer of buildings held for business	15%	Self-assessment
9	Windfall profits (open-ended)	Open-ended ⁷	Self-assessment

Source: Income Tax Proclamation No. 286/2002; Income Tax (Amendment) Proclamation 693/2010

The delineation of the scope of the other schedules has so far proceeded under the basic assumption that each source chargeable with tax under each of the other schedules (A, B and C) exhibits certain uniform characteristics which makes it easy to talk about the whole schedule as if it were one source. It should by now be apparent that this cannot be followed with respect to Schedule “D” sources of income. Schedule “D” charges disparate sources of income which are unified by little else than the fact that they are all incorporated in Schedule “D.” If we count all of the individual sources of income currently falling under Schedule “D,” we shall find that Schedule “D” contains eight different income taxes. Specifically, Schedule “D” alone is a receptacle for “royalties tax,” “foreign technical services income tax,” “chance winnings income tax,” “dividend tax,” “bank deposits interest tax,” “casual rental of property income tax,” “capital gains/investment property tax,” and most recently “windfall profits tax.”

Given its application to disparate income sources, Schedule “D” has proven itself to be flexible to accommodate new sources of income. The Government of Ethiopia has increasingly used Schedule “D” for charging new sources of income and expanding the frontiers of the schedular

⁷ The specific sources of income subject to windfall profits tax are to be determined through directives of the Ministry of Finance and Economic Development; the Ministry has so far charged profits by financial institutions gained from the sudden devaluation of Ethiopian currency (Birr) in 2010; for taxation of windfall profits, see below

structure of Ethiopian income tax system. Schedule “D” has therefore been used as a principal schedule for meeting one of the recent income tax policy goals of the Government of Ethiopia, namely, broadening the tax base of the Ethiopian tax system. If the schedular trajectory of the Ethiopian income tax system is maintained, it is expected that Schedule “D” will continue to serve as a receptacle for adding new sources of income in the future.

In view of the disparate membership of Schedule “D” incomes, it is appropriate to deal with individual sources of income currently chargeable with income tax under Schedule “D” and highlight the problems the enforcement of Schedule “D” poses on the equitability and administrability of the Ethiopian income tax system. We shall follow the order of the Income Tax Proclamation and proceed from “royalties” to the most recent addition to Schedule “D,” that of “windfall profits.”

III. Schedule “D” Income – Miscellaneous Income

a. Withholding Tax on Royalties – Article 31

i. The Legal Meaning of Royalties and the Scope of the Withholding Tax on Royalties

The term “royalties” (when used in the plural) is given to multiple interpretations in the literature. Two of the most widely accepted meanings of “royalties” are given by Black’s Law Dictionary:⁸

⁸ See Black’s Law Dictionary, 7th edition, 1999, s.v. “royalty,” pp. 1330-1331

- i) a payment made to an author or inventor for each copy of a work or an article sold under a copyright or patent;
- ii) a share of a product or profit from real property, reserved by the grantor of a mineral lease, in exchange for the lessee's right to mine or drill on the land.

Encyclopedia Britannica describes a “royalty” as “payment made to the owners of certain types of rights by those who are permitted by the owners to exercise the rights.”⁹ Those who own certain rights of property resort to the scheme of transferring the rights for economic exploitation of those rights because they themselves are usually not in an economic condition to fully exploit their rights to property. An author of a book, a playwright of a play, a musical composer, an artist and an inventor all need the resources of a publishing organization, or a theatrical management or a manufacturer to be able to gain some economic advantage from their artistic creation and intellectual work.¹⁰ When owners of intellectual property or mineral deposits make arrangements for the economic exploitation of their property by others, it is often in return for a payment of royalties.¹¹

While the contexts in which royalty payments are made are the same, it is easy to see that royalties may be made to a variety of owners. In general, “royalties” may be understood in three different but related senses.¹² The first and most familiar sense of “royalties” is as a payment for the use of a person's intellectual property, whether that intellectual property is a copyright, a

⁹ See Encyclopedia Britannica, s.v. “royalty,” p. 220

¹⁰ Id, p. 221

¹¹ Ibid

¹² See Cooper, Krever and Vann's Income Taxation, pp. 131-132; see Burns and Krever, Taxation of Income from Business and Investment, pp. 615-617

patent, a trademark, a know-how, or any other rights protected by intellectual property laws. In this sense, “royalties” refer to payments to an author for printing and selling her books, to a musician, singer, songwriter, or director for reproducing her music or playing her music, to an inventor using and/or reproducing her invention, etc.¹³

The second sense in which “royalties” might be used is in cases where an owner of an intellectual property agrees to sell the property in return for a lump-sum payment.¹⁴ In this second sense, “royalties” refer to the lump-sum payment for the sale of intellectual property rights. In those countries where the capital gains tax system is broad enough to cover the sale of intangible assets, this form of royalties is normally treated as a capital gain rather than as an ordinary income.¹⁵ In those countries where royalties are the subject of withholding taxation regardless of the form of payments, royalties are understood broadly to cover a lump-sum payment for the transfer of intellectual property as well. Apart from the special treatment of such payment under some income tax systems, the second meaning of “royalties” is not really different from the first meaning.

The third sense in which “royalties” might be used is in the context of extraction and/or exploitation of natural resources, like minerals and forests.¹⁶ In this sense, royalties is used to refer to payments made to an owner of the land from which the minerals are extracted or the forests are exploited.¹⁷ In those countries where the government exercises the exclusive authority (Ethiopia is a case in point) to grant the right to exploit natural resources, the grantees

¹³ See Burns and Krever, *Taxation of Income from Business and Investment*, p. 615; see *Federal Tax Course*, p. 425

¹⁴ See Burns and Krever, *Taxation of Income from Business and Investment*, p. 615

¹⁵ *Ibid*

¹⁶ *Id.*, p. 616

¹⁷ *Ibid*

of government concession are ordinarily required to pay royalties in return for the concession, in addition to their duty to pay income taxes over their profits from the exploitation of natural resources.¹⁸ In this context, royalties represent one source of income for the government.¹⁹

The structure of the income tax system has an obvious impact on the meaning, scope and treatment of “royalties” in the income tax system. In global income tax structures, “royalties” are normally considered to be one form of income, included in the income tax returns of an individual along with other forms of income, such as income from employment, income from business, and rental of property.²⁰ In schedular income tax systems, royalties are at times included among other forms of income or may be subject to final withholding taxes.²¹ Under Ethiopian income tax system, one form of “royalties” is chargeable with final withholding taxation under Schedule “D” of Ethiopian income tax laws.

The provision that charges “royalties” with withholding taxation is one of the very few provisions that also offer a definition for the source of income. Article 31 of the Income Tax Proclamation defines “royalties” as:

¹⁸ Indeed, Ethiopian Mining law defines “royalty” as a “payment to the government and the peoples’ who are the sole owners of the mineral resources to be made by the licensee for producing minerals from the ... site of minerals;” see Mining Operations Proclamation No. 678/2010, Article 2(32). In Ethiopia, the Federal Government collects royalties from large-scale mining companies, and Regional Governments collect royalties from small scale mining companies; see Constitution of the FDRE, Articles 97(8) and 98(3); for the Federal Government, see Mining Operations Proclamation No. 678/2010, Article 63

¹⁹ This source of government revenue is exempted from the income tax; see Income Tax Proclamation 286/2002 Article 30(2)

²⁰ See Federal Tax Course, p. 425; Cooper, Krever and Vann’s Income Taxation, p. 131

²¹ Under Cameroonian income tax system, for example, royalties are included in the personal income tax and not subject to withholding taxation; see Almeida, Cameroon – Individual Taxation, Section 1.5; under many income tax systems of Africa, however, royalties are often picked out for withholding taxation, which may be considered as final or as advance tax payments; see Income Tax Systems of Congo and Kenya, where royalties are subject to 20% and 5% withholding respectively in Hasnaoui, Congo (Demo. Rep.) – Individual Taxation, Section 1.5; Omondi, Kenya – Individual Taxation, Section 1.5

... a payment 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 cinematography films, and films or tapes for radio or television broadcasting, any patent, trade work, design or model, plan, secret formula or process, or for the use or for the right to use of any industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.²²

The definition tries to capture a wide range of intellectual property rights whose exploitation results in the payment of royalties. The definition, while useful, is, however, unlikely to settle the enormous diversity of issues that arise in connection with payments for literary, artistic or scientific works.

A cursory reading of the literature of mature income tax systems on this subject shows that the entertainment industry alone has spawned a wide range of contractual arrangements for the production and distribution of literary and artistic works, only some of which are said to have given rise to royalties.²³ In the United States, “contingent compensation” for services based on the success of films has been considered as income from employment, regardless of whether these types of compensation are called “royalties” in actual contracts.²⁴ Freelance columnists are considered as independent contractors if the newspaper has the option to accept or reject a column and the columnists are paid only upon acceptance of their writings.²⁵ In contrast, columnists are considered as employees if they “are paid fixed monthly retainers.”²⁶ Most of those who work in radio and television production and commercials (actors, narrators, singers, and musicians) are treated as employees “because of the level of direction and control to which

²² Income Tax Proclamation No. 286/2002, Article 31(3)

²³ For in-depth treatment of these issues, see Moore, *Taxation of the Entertainment Industry*

²⁴ *Id.*, p. 23

²⁵ *Id.*, p. 104

²⁶ *Ibid*

they are subject.”²⁷ In the music industry, recording artists are treated generally as “independent contractors” because of their substantial discretion over the manner and means by which they perform their services.²⁸ If there are several artists recording a song, however, some of the artists may be employees of the principal artist, subject to wage withholding.²⁹ The situation changes completely if all the artists are members of the band, which may be organized as a partnership; in that case, none of them will be employees of the payor.³⁰ Principal artists are also treated as independent contractors with respect to a promoter or venue of any live performances.³¹ Producers of music are mostly treated as independent contractors, not employees, as are songwriters, who “work on their own without any pre-existing contractual obligation.”³² These divergent conclusions with respect to various actors of the entertainment industry illustrate how difficult characterization of various payments can be.

In Ethiopian context, the scope of withholding taxation on “royalties” as used in the income tax law has not become a subject of widespread controversy largely because of the long-standing uncertainty over whether the taxation remained “suspended” and the lack of adequate attention to its enforcement by the tax authorities. While the definition of “royalties” will go a long way in settling the scope of the tax, the few controversies that have arisen in connection with the scope of “royalties” in connection with other sources of income shows that the income tax system relating to the taxation of “royalties” suffers as much from the lack of rules about scope as any of

²⁷ Id, p. 105

²⁸ Id, p. 279

²⁹ Ibid

³⁰ Ibid

³¹ Id, p. 279-280

³² Id, p. 280

the other sources of income. We shall review possible cases of conflicts and overlaps with the other sources of income in Ethiopia, by reference (whenever possible) to actual cases.

With Schedule “A” income tax, for example, we may be inclined to characterize a given income as income from employment when an employer pays an employee compensation for the use of intellectual property belonging to an employee. Since the tax rate for “royalties” is quite low compared to the tax rates for income from employment, it provides an incentive for employers and employees to structure their relationships in such a way that the income falls under Schedule “D” (royalties income tax) rather than under Schedule “A.” The cases involving the treatment of payments for preparation of educational modules in some places (**see Chapter Five above**) are illustrative of this kind of tax planning. University lecturers earn supplementary income from their respective universities and colleges by preparing instructional modules for regular and distance education. These modules are prepared upon the signing of special contracts between universities and individual instructors. The contracts specify the obligations and rights of the instructors, and the universities often make lump sum payments to instructors who produce the modules and other writing materials. Universities conclude these contracts often with their own academic employees and at times with external staff whose full-time employment is elsewhere.

The appropriate treatment of payments for modules preparation has led to acrimonious disputes between universities and instructors. Instructors believe that these payments are not income from employment and some universities are inclined to treat these as additional income from employment. In long-running disputes in the Amhara Regional State, instructors for a while swayed the opinions of the tax authorities in favor of characterizing payments for modules

preparation as “royalties.” The opinions of the tax authorities have been contradicted, however, by opinions issued later by the Ministry of Finance and Economic Development, which characterized the payments as “income from employment.”

With Schedule “C,” there is a question of in what context income from royalties received by businesses subject to Schedule “C” is subject to Schedule “D,” as a royalty and under Schedule “C,” as a business income. An example of possible conflict is the case of a publishing company obtaining substantial income stream from the granting of the right to use its intellectual property right (a copyright) to other persons and companies, or a film production company obtaining income both directly from the showing of its own films and of giving others the right to distribute and show its films in exchange for the payment of royalties, which may be calculated by the films shown in each case.

Another flashpoint for conflict is between royalties and income from technical services (**see below**), which is the subject of withholding taxation at twice the rate that of royalties. Ethiopian income tax law treats “royalties” differently from “income from technical services.” “Royalties” are subject to a final withholding tax rate of 5% while “income from technical services” is subject to 10% final withholding tax.³³ The differences in tax rates may induce some to structure their relationships as one giving rise to the payment of “royalties” rather than as payments for “technical services.” The income tax laws of Ethiopia do not provide adequate distinction between “royalties” and “income from technical services.”

The potential for conflict between royalties and payments for technical services is well understood elsewhere and has prompted the commentators of Model Double Taxation Treaties

³³ Income Tax Proclamation No. 286/2002, see Article 32

to identify areas of conflict and provide for rules of thumb for distinguishing the two cases. A Commentary on the UN Convention on Income and Capital, for example, notes that royalties may be confused with “payments for services” and gives a number of cases in which payments should be characterized as “payments for services” rather than as “royalties.” These cases include:³⁴

- Payments for after-sales services;
- Payments for services rendered by a seller to the purchaser under a warranty;
- Payments for pure technical assistance;
- Payments for a list of potential customers;
- Payments for an opinion given by an engineer, advocate or an accountant; and
- Payments for advice provided electronically, for electronic communications with technicians or for accessing, through computer networks, a trouble-shooting database, such as a database that provides users of software with non-confidential information in response to frequently asked questions or common problems that arise frequently.

The Commentary also gives cases in which “royalties” may overlap with “payments for the provision of technical assistance.” According to the Commentary, some contracts may cover both know-how (which is the subject of royalties) and the provision of technical assistance.³⁵ One example given in the Commentary is a franchise contract in which the franchisor agrees to impart his knowledge and experience to the franchisee in addition to providing the franchisee with a variety of technical assistance (sometimes financial assistance and supply of goods may

³⁴ United Nations Model Double Taxation between Developed and Developing Countries, p. 214

³⁵ Ibid p. 214

be included in the contract).³⁶ In this kind of situation, the Commentary recommends breaking down the elements of the contract:

On the basis of the information contained in the contract or by means of a reasonable apportionment, the whole amount of the stipulated consideration according to the various parts of what is being provided under the contract, and then to apply to each part of it so determined the taxation treatment proper thereto.³⁷

Under Ethiopian income tax law, we don't have comparable rules of differentiation, and the result is that some savvy taxpayers can very easily characterize the payments as "royalties" even though the substance of the contract shows that these payments are "payments for provision of technical assistance."³⁸ The obvious differences in the withholding tax rates give taxpayers every reason to resort to these tactics. The tax authorities have yet to come up with satisfactory rules of differentiation between the two types of income. Nor have the tax authorities paid much attention to how withholding agents treat various types of payments.³⁹

Ethiopia has signed double taxation treaties (DTTs) with two dozen countries.⁴⁰ In relation to royalties, many of the DTTs of Ethiopia contain a definition of royalties.⁴¹ The standard definition of royalties in these DTTs is:

³⁶ Id, pp. 214-215

³⁷ Ibid

³⁸ There is a running dispute with DSTV in connection with the provision of satellite services; DSTV has argued that the payments it has been receiving are "royalties" not "income from technical services." The tax authorities have argued that DSTV's services are in the nature of technical services and should therefore fall under Article 32. DSTV has so far made payments under Article 31, not Article 32; interview with Ato Girma Tafesse, ERCA, Branches Directorate, April 2, 2013.

³⁹ For the authorities' take on the meaning of "technical services," see below

⁴⁰ See Taddese Lencho, Country Surveys, Ethiopia – Corporate Taxation, Section 6.3.5

⁴¹ See, for example, Agreement between The Federal Democratic Republic of Ethiopia, and Tunisia, The Czech Republic, Saudi Arabia, Egypt, and UK and Northern Ireland, among others, for the Avoidance of Double Taxation and The Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, Article 12(3)

...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 or films or tapes used for television or radio broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.⁴²

Most of the DTTs also contain definitions for “professional services.”⁴³ One of the DTTs in particular is very helpful at least in distinguishing “royalties” from “income from technical services.” In the Ethio-Indian DTT, “royalties” and “fees for technical services” are treated in the same article, presumably because the two are so closely related and need to be distinguished. Having defined royalties as in the standard terms given in the quote above, the DTT between Ethiopia and India offers a definition for “fees for technical services” as “*consideration for managerial or technical or consultancy services, including the provision of services of technical or other personnel*”⁴⁴(italics supplied). The DTT between Ethiopia and India makes clear that payments made in connection with the transfer or assignment of intellectual property may be considered as “fees for technical services” if the payments are for “managerial or technical or consultancy services” rather than for the transfer or assignment of intellectual property itself. This DTT is authoritative only in respect to the parties covered by the Treaty, but it could have served as benchmark for how the tax authorities deal with similar cases. Unfortunately, the DTTs are not properly diffused in the tax administration of Ethiopia. Most of the tax treaties of Ethiopia are of symbolic diplomatic value. Apart from the substance of these

⁴² See Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the Republic of India for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Article 12(3)(a)

⁴³ The DTTs define “professional services” to include “independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, surgeons, dentists and accountants;” see the DTT between Ethiopia and India, Article 14(2); the DTT between Ethiopia and Egypt, Article 14(2).

⁴⁴ See DTT between Ethiopian and India, Article 12(3)(b)

treaties as instruments of avoiding double taxation between the contracting states, these treaties should have served as one source of interpretation of the domestic tax laws or at least should have inspired the authorities to revise domestic tax legislation to take account of these developments. As these treaties are a product of decades of experience in taxation, they should have served as at least one source of inspiration for how certain concepts are understood in the income tax system of Ethiopia.

**ii. The Withholding Taxation on Royalties in Practice:
Uncertainties and Disparities**

Taxation of royalty income was introduced first in 1978 when royalties were slapped with 40% tax rate.⁴⁵ This heavy taxation immediately provoked serious protests from the then small but vocal community of writers and playwrights. Writers argued that the tax was a final knell in the coffin of creative writing in Ethiopia.⁴⁶ Their protests eventually bore some results as the Council of Ministers decided in Tikimt 1975 E.C.(1983) to suspend the tax on royalties until appropriate studies were conducted to revise the tax on royalties.⁴⁷ The Council suspended the tax at the time citing the need to encourage creative writing and entrench the culture of reading and writing in the public in general and to ensure that publishers and theatres get adequate number of writings and plays.⁴⁸ This decision was communicated to the relevant withholding

⁴⁵ Income Tax (Amendment) Proclamation No. 155/1978, Article 2(7) (c) (now repealed)

⁴⁶ Writers and artists routinely complain about the high tax rates on the entertainment industry in general; one of these taxes was the high withholding income tax on royalties and other payments made to writers and artists in the entertainment industry; see, for example, interviews with Ato Wosenyeleh Abebe and Ato Teferi Alemu, Kokeb, 1st year No. 4, *Megabit* 4, 1985 E.C., pp. 37 and 39, in Amharic, pp. 37 and 39

⁴⁷ See the Provisional Military Government of Socialist Ethiopia, Office of the Chairman of the Council of Ministers, *Tikimt*, 3, 1975 E.C., in Amharic, unpublished

⁴⁸ *Ibid*

agents: theatre halls, cinema halls, Ministry of Culture and Sports, Associations of Ethiopian Musicians, writers, painters and playwrights and actors.⁴⁹

The decision of the Council of Ministers at the time was a suspension of the tax on royalties “until studies were conducted” but no studies were conducted (or they were not made public even if they were conducted) and the Government which took this decision to suspend was toppled by EPRDF in 1991. The new Government did not take any public measure to either exempt or reinstate the tax introduced in 1978, but the withholding agents in this regard simply followed the generous decision of the Council of Ministers of the previous Regime and decided not to withhold tax on payments made to writers, playwrights, actors, painters, musicians, etc. Ten years later in 1993 E.C. (2003), questions were again raised as to whether the tax on royalties was still suspended or in force.⁵⁰ The matter was once again presented to the Council of Ministers which decided that the tax on royalty payments remained suspended until further studies were conducted to reduce the high tax rate (40%).⁵¹

Meanwhile, the Income Tax Law which introduced the 40% income tax on royalties was repealed and replaced by the Income Tax Law of 2002. By slashing the withholding tax rates from that of 40% to 5%, the Income Tax Proclamation of 2002 appeared to have finally answered the concerns raised by writers in particular.⁵² The previous tax on royalties was suspended primarily on the ground that it was too high, and it seemed that the new income tax

⁴⁹ See the Provisional Military Government of Socialist Ethiopia, Ministry of Culture and Sports, undated, in Amharic, unpublished

⁵⁰ See The Federal Democratic Republic of Ethiopia, Ministry of Finance, *Tir* 01, 1993 E.C., in Amharic, unpublished

⁵¹ *Ibid*

⁵² See Income Tax Proclamation No. 286/2002, Article 31

law of 2002 addressed that issue. Of all the tax rate reductions at the time, royalties received the most generous tax break in the 2002 income tax laws.

This significant reduction in the tax rates did not remove the uncertainties surrounding the tax on royalties. A number of factors might be said to have contributed to this state of affairs. The suspension of withholding taxation on royalties created a sense among those involved that the suspension was in effect even after the 2002 Income Tax Proclamation responded to the concerns of writers and others that the withholding taxation was too high. The tax authorities did not aggressively enforce the new withholding taxes on royalties, and this allowed the withholding agents in this regard to continue behaving as if the tax on royalties were suspended.

Second, the application of the final withholding tax on royalties has also been affected by preponderance of other withholding income taxes. To the extent withholders comply with income tax laws, it was learnt that many of the payments that are ordinarily considered as royalties are currently the subject of 2% withholding under Schedule “C” or of withholding under Schedule “A.” We can illustrate this by reference to some places of entertainment which are ordinarily expected to withhold taxes on royalties.

Theatres and Cinema halls in Addis Ababa frequently make payments to writers, playwrights, producers and directors, among others, and these payments are usually contingent upon the proceeds of the theatre production. The proceeds of a play in theatres are distributed in accordance with pre-determined rules, issued in Directives which were more than two decades old.⁵³ The Internal Directives of the National Theatre and *Hager Fikir* Theatre (both in Addis

⁵³ See *Ye Itiyophiya Biherawi Teatre, Liyu Liyu Ye Fexera Maberetacha Kifiyawoch Memeriya, Yekatit 1982 E.C.*, in Amharic, unpublished

Ababa) have laid down rules for allocation of the proceeds from the production of plays, musical compositions, and various other performances. The Directives have fixed the percentage allocated for various contributors in the performance of the play, such as playwrights, directors/producers and actors in a play. With respect to plays, for example, the amounts payable (particularly to the playwrights) vary with the type of the play. According to these Directives, playwrights that write original plays, adaptations and translations are entitled to 30%, 25% and 20% respectively of the net proceeds of tickets sales from the performance of plays. Directors and actors receive 10% each from the net proceeds of ticket sales from the performance of plays. The withholding practices of two well-known theatre halls are given in the following table.

Table 8.2: Withholding Practices on Certain Payments in Two Public Theatre Halls in Addis Ababa

Recipient /s	Type of Work	Type of Contract	Allocation of Proceeds	Withholding under...	
				PUB Theatre 1	PUB Theatre 2
Playwright	Writing of an original play	Specific	30%	5% royalties tax	2% under Schedule "C," regardless of whether the playwright is already employed by the Company
Directors/producers	Directing/producing	specific	10%	Schedule "A," if already an employee, or 2% if contracted from outside	Withholding under Schedule "A" (in case an actor or technical assistant in a play is already employed by

					the company, the income is aggregated under Schedule "A")
Actors/ technical assistants in a play	Acting/ Support acting	Specific	10%	Schedule "A," if already an employee, or 2% if contracted from outside	Withholding under Schedule "A" (in case an actor or technical assistant in a play is already employed by the company, the income is aggregated under Schedule "A")
Theatre Hall	Managing theatrical performances	...	50%	N/A	N/A

Source: Internal Directives Issued by the Respective Theatre Halls, 1982 E.C., and interviews with finance staff (withholding agents) of the Halls.

As can be clearly seen from the table above, the withholding of taxation for the payments of royalties varies from one theatre hall to the other and the contributions of the various actors in the performance of plays. Playwrights are subject to 5% withholding tax in the PUB Theatre 1 while playwrights who contribute plays for PUB Theatre 2 are subject to 2% withholding under Schedule "C." Producers and directors who direct plays in PUB Theatre 2 are subject to withholding of tax under Schedule "A," regardless of whether these producers and directors are employees of PUB Theatre 2 or not. Producers and directors who direct plays in PUB Theatre 1 are subject to withholding of tax under Schedule "A," if they are already employees of PUB Theatre 1, and under Schedule "C" if they are brought from outside to direct and produce plays.

There are no rational explanations for these discrepant practices. It is the withholding agents, who, based on their own understanding of what the tax laws require, determine what withholding rates apply in each case. The tax authorities are largely content to see some withholding and do not seem to mind under which rules the withholding taxes are handled.

Those who have worked in the entertainment industry for a long time have confided that payments to the various “actors” of the entertainment industry are made without the deduction of the income tax. Entertainment and publishing companies, for example, make various kinds of payments to writers, producers, directors, actors and others involved in the production of books, music, films and dramas. The contracts with the writers, producers, directors, actors and others may vary from one entertainment company to the other. Some companies pay lump-sum fees regardless of the success of the production; others make the fees contingent upon the proceeds of the production. For example, a publishing company may agree to pay an author of a book a fixed fee for a fixed number of copies of the book before the book is published and sold. Another publishing company may make the payment of the fee contingent upon the sale of the books. Similar contractual arrangements exist in theatrical, musical and film productions.

The dilemma the entertainment companies often face in practice is whether to treat these fees as income from employment, or royalties or income from independent contract services. The least appealing (but perhaps the safest course of action as far the tax authorities are concerned) is to treat the fees as income from employment and withhold the income tax under the progressive income tax rates of Schedule “A.” Insiders of the industry say that this option is the least attractive to them as many of the “actors” of the entertainment industry would opt out of the contract if they were informed of the tax consequences.

There is also a general perception that the entertainment industry is already burdened with a number of taxes. Insiders cite the amusement tax law issued back in 1964 as a special tax that burdens the industry.⁵⁴ Coupled with the value added tax, which charges all goods and services with 15% tax rate, insiders claim that the entertainment industry is already being made to pay huge tax bills.⁵⁵ Hence, many of these companies risk not deducting the tax at all and suffer from the uncertainty in the future of the tax authorities going after them for failing to withhold the appropriate tax rates.

The withholding taxation on “royalties” has most of all been affected by the lack of attention from the tax authorities. Many of those interviewed for this paper have acknowledged that the withholding taxation is not being implemented and monitored in practice, largely because of the meager revenue expected from this source of taxation. The tax authorities have so far relied upon the voluntary compliance of withholding agents, who, as we have seen above, follow their own subjective interpretation of the rate of withholding expected of them.

b. Withholding Tax of Income from Technical Services rendered abroad

– Article 32

Like many sources currently chargeable under Schedule “D” of Ethiopian income tax system, tax on “income from technical services” was introduced for the first time in the 1978 income tax amendment to the then income tax laws of Ethiopia.⁵⁶ Since then, the tax on “income from technical services” has become a fixture of withholding taxation in Ethiopia, as it was

⁵⁴ See Municipality of Addis Ababa Amusement Tax Regulations, 1964; the amusement tax law of 1964 imposes 10% tax upon all tickets of admission to places of entertainment; see also Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, p. 148

⁵⁵ See interviews with Ato Wosenyeleh Abebe and Ato Teferi Alemu, *Kokeb*, 1st year No. 4, Megabit 4, 1985 E.C., pp. 37 and 39, in Amharic

⁵⁶ Income Tax (Amendment) Proclamation No. 155/1978, Article 2(7)(d)

maintained in successive income tax reforms of Ethiopia, including the current Income Tax Proclamation. The meaning as well as the tax rate of this tax has not changed since 1978. In terms of application or its targets, tax on income from technical services, along with tax on interest paid to foreign financial institutions, is the only two withholding taxes which apply to the income of non-residents only. Many of the other final withholding taxes under Schedule “D” apply to both residents and non-residents.⁵⁷ Final withholding taxes on royalties (**see above**), on income from games of chance, dividends, and interest (**see below**) all apply to both residents and non-residents. Withholding tax on “income from technical services” applies only when the “technical services” are rendered abroad for the benefit of residents in Ethiopia.⁵⁸

At the moment, what is definite about this source of income is that it is from the outset intended to capture, through withholding, income from services provided by individuals and companies from abroad that are not otherwise subject to Ethiopian income tax jurisdiction. In that sense, this tax is a final withholding tax upon the Ethiopian-source income of non-residents.⁵⁹ Article 32 of the Income Tax Proclamation makes it clear that where the recipient of a service provided abroad is a resident of Ethiopia, the payments to a non-resident technical service provider are subject to withholding of an income tax at the rate of 10%. It appears therefore that at least two conditions must obtain before Article 32 is set into motion. The first is that the person (an

⁵⁷ For the meaning of residence, see Income Tax Proclamation No. 286/2002, Article 5

⁵⁸ However, there are some uncertainties in practice because some experts have claimed that the tax authorities currently require withholding of this tax even when a technical expert has provided services or some of the services in Ethiopia; for example, one certified auditor claimed that the tax authorities require withholding tax on a geological surveyor who came to Ethiopia and did the survey on behalf of a Mining Exploration Company; interview with Ato Tibebe Mengistu, Tibebe Mengistu & Co, April 07, 2012

⁵⁹Article 32 is incidentally one of the very few provisions that do justice to the income tax concept of source by providing a proper definition to the concept of source under the Ethiopian income tax system. The concept of “source” for purposes of income taxation in Ethiopia is bungled by provisions (such as Article 6 of the Income Tax Proclamation No. 286/2002) that are content to call ‘sources’ by merely listing/enumerating the various sources of income that are chargeable with income tax in Ethiopia.

individual or a company) providing the service must be a non-resident person.⁶⁰ And secondly, the service itself must be provided abroad. The connecting factor to Ethiopian tax jurisdiction is that the recipient (or beneficiary) of the “technical services” is a resident of Ethiopia upon whom the obligation to withhold tax is imposed by the law.

Although what constitutes “technical services” is not sufficiently apparent from Article 32, the fact that this law is intended to capture income of non-residents from technical services to residents of Ethiopia makes the task of defining the scope of Article 32 considerably easier. If a resident of Ethiopia provides services to a resident of Ethiopia or for that matter a non-resident abroad, the income derived therefrom will not become the subject of Article 32. The resident who generates income from abroad is subject to Ethiopian income tax jurisdiction on her worldwide income,⁶¹ and the task is one of assigning the income under two possible candidates for taxation of such income – Schedule “A” (if the income is from employment) or Schedule “C” (if the income is from business or professional activities).

If a non-resident person provides technical services in Ethiopia (on a short-term assignment or visit to Ethiopia), the income derived therefrom is once again not the subject of Article 32. If the technical service is provided under contractual arrangements that might be characterized as one of “employment,” the income of the non-resident sojourner is subject to tax under Schedule “A” – subject to withholding by her employer. If the technical service is provided under conditions

⁶⁰ For definitions of residence for income tax purposes, see Income Tax Proclamation No. 286/2002, Articles 3, 4 and 5

⁶¹ Id, Articles 3 and 5

that might be characterized as one of a “permanent establishment,” the income of the permanent establishment is subject to tax under Schedule “C.”⁶²

The meaning and scope of Article 32 withholding tax suffers from ambiguities and uncertainties as much as many of the other sources of income in Ethiopia due in large part to the lack of adequate number of cases addressing its meaning and scope. No cases treating the meaning and scope of “technical services” and “income from technical services” have, to the best of the knowledge of the writer, made it to the Tax Appeal Commission and courts. But documents obtained from the tax authorities show that the authorities were drawn into defining the meaning and scope of Article 32 tax withholding in a number of cases. Most of the controversies revolve around the meaning and nature of “technical services” in Article 32 of the Income Tax Proclamation.

The tax authorities initially held the opinion that all payments made for services from abroad were the subject of withholding taxation under Article 32. In one of the cases, for example, having received information about Ethiopian resident companies, organizations and individuals making payments to foreign satellite TV providers, the Ministry of Finance and Economic Development issued a circular letter to Revenue Authorities to enforce Article 32 tax on all payments for satellite services.⁶³ But the disputes about the nature of these payments have not been resolved at the time of writing as the satellite providers have argued that the payments constitute royalties, rather than payments for technical services. DSTV, the South African digital satellite provider, for example, has insisted that the payments are royalties and should be the

⁶² Id, Articles 2(g) and 6(d)

⁶³ See Ministry of Finance and Economic Development, Letter written to the then Ministry of Revenues, 17/03/1996 E.C., in Amharic, unpublished

subject of 5% withholding under Article 31, rather than under Article 32, which imposes 10% withholding on payments for technical services.⁶⁴

In **DHL Ethiopia** case, ERCA and DHL Ethiopia (a logistics company) were involved in a dispute over whether DHL Ethiopia should withhold tax under Article 32 for payments it made its parent company for logistical assistance provided by the parent company abroad. ERCA at first argued that DHL Ethiopia's payments to its parent company for logistical assistance abroad constituted payments for technical services rendered abroad. ERCA was involved in similar disputes with **Red Fox Ethiopia**, a flower company, which made payments for logistical assistance by a company in Germany. ERCA argued that payments made by Red Fox Ethiopia to a company in Germany for logistical assistance in the sale of flowers in Europe constituted payments for technical services. Both these companies objected directly to ERCA, arguing primarily that the payments were not made for technical services as these terms were defined in Article 32 of the Income Tax Proclamation.

As these kinds of controversies became frequent, ERCA sought the legal opinion of the Ministry of Finance and Economic Development, which in a letter written in 2003 E.C. (2011) clarified the meaning of technical services, and in particular technological services. In its relevant part, the Letter reads:⁶⁵

በተለያዩ ሥነ-ፅሑፎች እንዲሁም ድረ-ገጾች የቴክኖሎጂ አገልግሎት ለሚለው ሀረግ ከተሰጠው ትርጉም መረዳት እንደሚቻለው የቴክኖሎጂ አገልግሎት ቴክኖሎጂን በመጠቀም የሚሰጥ አገልግሎት ሲሆን፤ ይህም የመረጃ ቴክኖሎጂን

⁶⁴ Interview with Ato Girma Tafesse, ERCA, Branches Directorate, April 2, 2013

⁶⁵ See Ministry of Finance and Economic Development, Letter to Ethiopian Revenues and Customs Authority, in Amharic, date blurred

በተለይም የቴክኒካል ድጋፍ፣ የኮሚፒውተር መረብ (computer networking) የመረጃ ሥርዓት አስተዳደር (systems administration) እና ተመሳሳይ ተግባራትን የሚያካትት ነው። የኢንተርኔት አገልግሎት ማለትም የድረ-ገፅ አገልግሎት (web hosting)፣ ኢሜይል እና የማህበራዊ ድረ-ገፅ መረብ (social networking websites) አገልግሎትም የመረጃ ቴክኖሎጂ አገልግሎት ውስጥ የሚወድቁ ናቸው።

ከዚህም በተጨማሪ የቴሌፎን፣ በተወሰነ የመገናኛ መንገድ የሚተላለፍ የቴሌቪዥን አገልግሎት፣ የዲጂታል ፎቶግራፍ፣ የግራፊክ ዲዛይን ውጤቶች፣ ኮቴክኖሎጂ ጥገና እና አስተዳደር ጋር የተያያዙ ተግባራት የቴክኖሎጂ አገልግሎት ተብለው ይወሰዳሉ።

የገቢ ግብር አዋጅ በሚረቀቅበት ወቅትም የቴክኖሎጂ አገልግሎት የሚለው ሀረግ ውስጥ ተካትተው በአዋጁ አንቀጽ 32(1) በተመለከተው መሠረት ከተከፋይ ሂሳብ ላይ ግብር ቀንሶ ገቢ የማድረግ ሥርዓት ተፈፃሚ እንዲሆንባቸው የታሰበው በእነዚህ የቴክኖሎጂ አገልግሎቶች ላይ ነው።

This reads:

It is readily understood from the various literatures and internet sources that technology services are services that involve technology, and include information technology, or information technology services, such as technical support, computer networking, computer systems administration, and other similar services. Other services that are included in technology services include internet services, such as web hosting, email, and social networking websites.

In addition, services that are not directly related to information technology, such as telephone and cable TV services, digital photography, graphic design, video production and services related to technology maintenance and administration are also considered as technological services.

The current income tax proclamation included technological services in Article 32 with the intent to apply withholding taxation from payments made for these kinds of technological services (author’s translation).

Having received these legal opinions from the Ministry of Finance and Economic Development, ERCA reversed its initial position against DHL Ethiopia and Red Fox Ethiopia. The Ministry of Finance and Economic Development restricted the meaning of “technical services” to technological services that have come about as a result of the advancements in information technology and left out a number of services which might be provided from abroad, although Article 32 itself defined “technical services” in the alternative as “*any kind of expert advice or technological service rendered*” (italics added).

It is by no means clear why some payments for “technological services” from abroad attract withholding taxation and others do not. If Article 32 were intended to be a withholding taxation upon the income of non-residents for services rendered abroad to Ethiopian resident companies, it should have been rendered broadly as to include all kinds of professional, managerial and technical services rendered outside Ethiopia. Otherwise, the form rather than the substance of the service is going to determine whether withholding taxation applies or not.

The restriction of the meaning of “technical services” to “technological services” by the Ministry of Finance and Economic Development is at variance with the meaning of “technical services” in some of the Double Taxation Treaties to which Ethiopia has been a party. The DTT between Ethiopia and India, for example, as we have already seen defines “fees for technical services” as “*consideration for managerial or technical or consultancy services, including the provision of services of technical or other personnel*” (italics added).⁶⁶ The scope of “technical services” in the Ethio-Indian DTT is clearly broader than that of the opinion of the Ministry of Finance and Economic Development in a letter quoted above. Unfortunately, DTTs are seldom used as references for understanding some of the terms of the income tax laws of Ethiopia, which must have accounted for the departure of the legal opinion of the Ministry from that of the DTT signed with India.⁶⁷

Although the language of Article 32 leaves little doubt about the location of the services, a number of tax officers and practitioners have argued for its application on technical services rendered for a brief period in Ethiopia. Article 32 qualifies “technical services” by their place of

⁶⁶ See Ministry of Finance and Economic Development, Double Taxation Treaty between India and Ethiopia, Article 12(3)(b), unpublished.

⁶⁷ Ironically, the narrow construction of “technical services” was made by the same Ministry that signed the DTT on behalf of the Ethiopian Government – the Ministry of Finance and Economic Development

rendition “*technical services rendered outside Ethiopia to resident persons in Ethiopia*” (italics added), indicating that Article 32 was intended for services provided abroad, not for services rendered in Ethiopia. The legal opinion of the Ministry of Finance and Economic Development, quoted above, seems to have accepted this, as all of the technological services listed down in the Letter required the provision of services from abroad using the devices of information technology. In spite of this, some of the tax officers and practitioners have argued that Article 32 might apply to cases in which a non-resident person comes to Ethiopia for the provision of technical services for a brief period of time. Some of the examples they have given include:

- Technical services to Ethiopian Telecommunications on the installation of fiber optics;
- Technical services to Ethiopian Electric and Power Corporation on installation of electrical wires and dams;
- Technical services to mining companies on exploration for minerals (e.g., geological surveys or exploratory surveys by a mining expert for a mining company);

Since the withholding practices in this regard are not properly monitored by the tax authorities, there is no certainty as to whether some withholding agents withhold taxes under Article 32 from payments made to non-residents for services provided in Ethiopia.

c. Withholding Tax on Income from Games of Chance – Article 33

Like many of the sources of income chargeable with income tax under Schedule “D,” the withholding tax on income from games of chance was introduced for the first time in 1978.⁶⁸ The tax rate was initially 10% and was raised to the current 15% by the Income Tax Law of 2002.

⁶⁸ See Income Tax (Amendment) Proclamation No. 155/1978 , Article 2(7)(b)

Like many of the incomes chargeable with tax under Schedule “D,” the tax on income from games of chance is a final withholding tax. The winner of games of chance is not required to include that income again as part of another income, for example, as part of business profits, even if the person who won the lottery is a business person.

The meaning as well as scope of Article 33 of the Income Tax Proclamation is not defined in the Proclamation. It was perhaps understood that games of chance are well-defined and well-regulated in another body of laws, namely laws relating to the regulation of the operation of lotteries in Ethiopia. The operation of games of chance was a government monopoly in Ethiopia from the very beginning and a number of laws have been issued over a number of years regulating the operation of games of chance.⁶⁹ The current law that regulates the operation of games of chance was issued in 2009. The National Lottery Administration (NLA), the government agency that runs, regulates and licenses games of chance in Ethiopia, uses this law as a source of legal authority for regulating the operation of games of chance as well as fulfilling its obligations under the Income Tax Proclamation.

The 2009 law does not offer a general definition for “games of chance” but it identifies the different forms of games of chance, which customarily go under the name of “lottery.”⁷⁰ The law defines lottery as “any game or activity in which the prize winner is determined by chance, drawing of lots or by any other means and includes tombola or raffle, lotto, toto, instant lottery,

⁶⁹ See a Proclamation to Provide for a National Lottery No. 183/1961, establishing state monopoly over the operation of the running of lotteries

⁷⁰ See National Lottery Administration Re-establishment Council of Ministers Regulation No. 160/2009,

number lottery, multiple prize lottery, promotional lottery, bingo, sport betting lottery and other similar activities.”⁷¹ The 2009 law also defines the forms of lottery as identified in that law.⁷²

Although lottery takes multiple forms, the winners of lottery take their winnings principally in two forms: in cash or in-kind. The winnings from games of chance like “money lottery,” “lotto,” “instant lottery,” “number lottery,” and “conventional bingo” are distributed to the winners in the form of cash. The winnings from games of chance like “tombola or raffle” are distributed in-kind (the most common winnings being a house, vehicles, TV sets, watches and computers). Winners of “promotional lotteries” may receive awards either in cash or in-kind or both.

The Government of Ethiopia closely regulates the operation of games of chance. Indeed, some forms of lottery activities in Ethiopia are exclusively preserved for the Government. Some may be undertaken privately, but those too are closely regulated and supervised by the Government through its lottery agency – National Lottery Administration (NLA).⁷³ Only the Government of Ethiopia can undertake “lotto,” “toto,” “instant lottery,” “number lottery,” “multiple lottery” and “modern bingo.”⁷⁴ “Tombola or raffle,” “sport betting lottery,” “conventional bingo,” and “promotional lottery” can be undertaken by private individuals and enterprises, with official permits from the NLA.⁷⁵ Conventional bingo places are operated in various places in Addis Ababa, and some big companies, like Coca-Cola and Pepsi-Cola, are frequently involved in promotional lotteries to attract consumers to their products. Games of chance are also played

⁷¹ Id, see Article 2(1)

⁷² Id, see Articles 2(3)-(12)

⁷³ No person is allowed to undertake any lottery activities without a permit from the NLA; any person who undertakes lottery activities without a permit is liable to penalties: a fine not less than 50, 000 ETB and not more than 100, 000 ETB and an imprisonment for not less than three years and not more than five years; id, see Articles 17(1) and 20(1)

⁷⁴ Id, see Article 12(1)

⁷⁵ Id, see Article 12(3)

commonly on TV, over the Radio and most recently on the internet. Indeed, games of chance are increasingly becoming ubiquitous in our daily lives. Mobile phones have now become important transmitters of games of chance and are used to entice customers to buy various products.⁷⁶ Even film posters try to entice viewers to watch recently released films through games of chance.⁷⁷

The withholding tax on income from games of chance is one of the most effectively collected taxes as a result of the Government being the principal withholding agent in respect of payments of winnings from games of chance in Ethiopia. The NLA undertakes most of the lottery activities itself and as such faithfully withholds the income tax due on such payments. Even on those lottery activities that are currently given to the private sector (e.g., conventional bingos and promotional lotteries), the NLA makes it a condition for licensing of these activities to withhold the income tax according to Article 33 of the Income Tax Proclamation. Conventional bingo places, for example, are required to withhold the 15% income tax from payments to winners as a condition of licensing and renewal of licenses.

The only aspect of withholding taxation on income from games of chance that has hit a snag in practice is winnings of games of chance that are paid in-kind. Chance winnings that are paid in-kind pose special problems for withholding of taxes. Winnings of tombola or raffle are exclusively paid in-kind and many promotional lotteries also pay winners in-kind benefits. These payments pose special problems of valuation and administrative challenges of enforcing the payments of taxes against winners. One obvious solution is to force winners to pay the tax

⁷⁶ A recent text message sent from the call center 8100 promises those who call the center the chance to win villas, condos, automobiles, laptops, tv, cell phones while supporting the Ethiopian Olympic team

⁷⁷ A film poster for the film “*Mekaniku*” or “the Mechanic” promises those who dial 831 Mekaniku a chance to win a car

due on in-kind awards before the winners are allowed to take their winnings. The problem with this solution is that the winners of in-kind benefits may not have the wherewithal to post cash payments needed to pay the taxes. The winners of these lotteries may come from all across the country as the amounts paid for participation in lottery games are quite negligible and may even be nil.

The tombola is run primarily by the NLA itself. Winners receive a variety of high as well as low-priced or valued assets ranging from villas, houses, cars, TV sets, watches to cell phones. The winners are determined from a pool of lottery ticket purchasers through public draws.⁷⁸ The winners, as any lottery is, may range over all income categories. It might be fairly easy to require well-to-do winners of tombola to pay the tax due from their own cash reserves. It is extremely difficult to enforce the tax against otherwise impecunious winners of tombola. The literal enforcement of the tax due might lead to unfair results, such as forcing the winners of the tombola to sell their winnings in order to settle the tax obligations to the government.

The National Lottery Administration has understood the unfairness of this obligation upon winners who may not be able to pay the tax and still keep their winnings. It has devised a system in which the Administration calculates the tax due as part of their winnings and pays the tax to the government on behalf of the winners.⁷⁹ This way out, while administratively commendable, makes it doubtful if the income tax as contemplated under Article 33 of the Income Tax Proclamation is really being paid by the taxpayers – namely the winners of tombola.

⁷⁸ National Lottery Administration Re-establishment Council of Ministers Regulation No. 160/2009, see Article 2(3)

⁷⁹ The National Lottery Administration covers all the incidental expenses associated with the awarding of in-kind payments to winners of tombola, such as the registration fees for houses and vehicles; interview with Tsehay Melaku, Legal Advisor, National Lottery Agency, April 03, 2012

A similar situation obtains with respect to in-kind awards by institutions other than the National Lottery Administration itself. A number of companies and other businesses carry out promotional activities through the so-called “promotional lottery.”⁸⁰ The most prominent are Coca Cola and Pepsi Cola, which, from time to time, induce customers to consume their products through various promotional lottery events, and promise the winners large prizes like cars and sometimes even houses. The winning numbers or codes are usually found embedded in the corks which the consumers of these products use to claim their prizes. They are undoubtedly a great source of surges in consumption of these products besides increasing the visibility of the companies and their products in the public. Once again, these promoters know that it would be unfair to some of the winners to pay the tax due on the winnings from their own pockets and choose to cover the tax bill themselves. The National Lottery Administration makes sure that the tax due to the government is paid by the promoters, but there is an internal understanding that the prizes in cash amounts (when in-kind benefits are converted into cash) include not just the basic value of the prizes but also the tax and other administrative expenses associated with the awarding of the prizes. Hence, if the value of a vehicle is 150, 000 ETB, it is understood that the value of the whole award is more than this basic price of the vehicle as to include the tax due, the commissions payable to the National Lottery Administration and all the incidental expenses of awarding the prizes.⁸¹

All these contrivances are created to get around the problem of enforcing the income tax against in-kind prize winners, but it is doubtful if the income tax has really reached its intended target, that is the prize-winners. The government may get to collect its revenues as effectively as it can

⁸⁰ National Lottery Administration Re-establishment Council of Ministers Regulation No. 160/2009, see Article 2(12)

⁸¹ Interview with Ato Tsehay Melaku, Legal Advisor, National Lottery Agency, April 03, 2012

get, but the jury is still out if the burden of the income tax is being borne by the recipients of lottery prizes or by the businesses that award these prizes. This practice also violates the principle of horizontal equity as those that win the prizes in cash are made to pay the income tax through withholding while those who win the prizes in-kind are relieved from the tax.

All of the tax that is currently collected from this source is collected by or through the National Lottery Administration (NLA). The enforceability of this withholding tax is as effective as the NLA itself. A number of games of chance emerge every day which make it increasingly difficult for the NLA to police them. Apart from the innumerable card games that are played in every nook and cranny, it is a matter of every day experience to come across games shows on TV, Radio and the Internet which award prizes of various sizes. The operators of these game shows may not even be aware that these prizes are subject to income tax under the income tax laws of Ethiopia. The advent of mobile telephones has also spawned a number of games that may be considered as lottery activities under the Establishment Regulation of NLA. One flyer (pamphlet) by 4AMT Mobile Technology, for example, promises a prize of 200 metre square villa in addition to access to current information (on news, weather, sports, films, etc) to those that simply dial 8282.⁸² There is no question that the awarding of the prize: the villa, should be subject to the 15% withholding tax, but that depends on how effective the NLA is in monitoring these kinds of activities.

⁸² Flyer by 4 AFRI, a Mobile Technology Company

d. Withholding Tax on Dividends – Article 34

Dividends were expressly exempted from income taxation until 1978.⁸³ The 1978 income tax amendment included dividends as one of the “miscellaneous” sources of income chargeable with a final withholding tax. The 1978 Income Tax Amendment law, which has gained some notoriety for its high tax rates, slapped corporate income with 50% tax rate and added 25% tax rates upon dividends.⁸⁴ The levying of dividend tax in addition to the high corporate tax at the time was seen as an attempt to discourage private capital.⁸⁵ This policy of using high tax rates to discourage private capital continued until the 1990s. The economic liberalization of the 1990s resulted in the reduction of both the corporate and dividend tax rates. The corporate tax and dividend tax rates were eventually brought down to the current 30% and 10% respectively.⁸⁶

Although both the corporate and dividend tax rates came considerably down in the post 1991 Ethiopia, the taxation of dividends in addition to the taxation of corporate income has attracted criticism from some quarters as economic double taxation.⁸⁷ While the Government of Ethiopia accepted the criticism that high corporate and dividend tax rates discourage private investment, it has so far shrugged off the criticisms of double taxation and decided to maintain both the separate tax on corporate income and the final withholding tax on dividends.⁸⁸ Aside from the question of whether it is sound economic policy to impose “additional” taxes on dividends, the

⁸³ Income Tax Proclamation No. 173/1961, Article 18(f)

⁸⁴ See Income Tax (Amendment) Proclamation No. 155/1978, Article 2(7(a))

⁸⁵ The 1978 income tax legislation came on the back of the adoption by the country of socialist ideology following the 1974 Ethiopian Revolution; see Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, p. 121

⁸⁶ See Income Tax (Amendment) Proclamation No. 107/1994

⁸⁷ Muzondo, Courneyea, Brooks and Elmi, *Ethiopia: Introduction of a VAT and a Presumptive Income Tax and Reform of the Income Tax*, p. 51

⁸⁸ The only exception in this regard is the Petroleum Income Tax of 1986 (as amended), in which dividends are exempted (presumably to encourage investment in this sector); see Taddese Lencho, *Towards Legislative History of Modern Taxes in Ethiopia*, pp. 124-125

withholding taxation on dividends in Ethiopia has been beset by a number of legal and practical problems. Perhaps, no other specific source of income has attracted as many questions about its meaning as the concept of “dividends.” In seeking answers to the meaning of “dividends,” it has become customary to cite two principal pieces of legislation – the Income Tax Proclamation itself and the Commercial Code of Ethiopia (of 1960). We shall examine the relevant provisions of both laws to understand the meaning and scope of withholding taxation on dividends before we proceed to investigating how dividend taxation is perceived in practice.

i. The Meaning and Scope of Dividends

1. The Commercial Code of 1960

The precise import of the Commercial Code provisions regulating the distribution of dividends for the application of withholding tax on dividends remains uncertain in practice. A few cases involving the taxation of dividends have cited the Commercial Code as an authoritative source for the meaning of dividends.⁸⁹ The purpose of the Commercial Code is decidedly different from that of the Income Tax Law, and while the Code remains relevant in understanding how dividends are distributed among shareholders, it cannot complete the intention of tax law to reach all sorts of distributions. The task of completing the inadequacies of the Commercial Code must be filled by the provisions of the income tax laws, which are far and few in between. In any case, since the Income Tax Proclamation is reticent on the meaning and scope of dividends, the Commercial Code has become a fall back provision in understanding the scope of application of the Income Tax Proclamation.

⁸⁹ See *Seferian Ethiopia PLC v. Federal Inland Revenue Authority (FIRA)*, Federal Tax Appeal Commission, File No. 562, Ginbot 1, 1998, E.C in Amharic, unpublished

The Commercial Code has a few provisions regulating the computation of net profits and distribution of these profits as dividends or transfer of them for reserves or increase of capital.⁹⁰ However, other than prohibiting the distribution of so-called “fictitious dividends,” the Commercial Code does not go into details about the various forms of distributions which constitute or do not constitute distribution of dividends by companies. It is not clear from the reading of the Commercial Code, for example, if the extension of loans or distribution of property or gifts of various kinds to shareholders can be assimilated into the distribution of dividends.

Apart from the prohibition of “fictitious dividends,” the only distribution that the Commercial Code regulates is the distribution of “residual surplus” upon dissolution of companies.⁹¹ In the event of dissolution of companies, the Code prescribes that all creditors (secured and unsecured) must be paid before any distribution of the proceeds is made to shareholders.⁹² Once all creditors are paid, the Code states that the “residual surplus” may be distributed according to the share of shareholders.⁹³ The Commercial Code does not say whether the distribution of “residual surplus” to shareholders constitutes “dividends,” or “return of capital” or “capital gains.” In practice, some within the tax authorities have used this provision and general

⁹⁰ Commercial Code of Ethiopia, see Articles 452-461 and Article 504

⁹¹ Id, see Article 501-504

⁹² Id, see Article 501

⁹³ Id, Article 504(1); the Code states that fully paid up shares enjoy full distribution according to the share while unpaid shares shall be deducted before any distribution is made to a shareholder; the Code also states that preferential shares enjoy preferential rights in the distribution of surplus during liquidation; see id, Article 504(2)

accounting rules to enforce the payment of dividends upon that part of the distribution of “residual surplus” that exceeds the “return” of the shareholder’s capital.⁹⁴

The Commercial Code does not compel companies to distribute net profits among shareholders. It states only that the balance of profits may, after transfer to legally required reserves, be distributed in accordance with the articles of association.⁹⁵ This implies that it is up to shareholders to specify in articles of association how net profits are distributed amongst them. The only restriction the Code imposes is that dividends may only be made out of net profits shown in the approved balance sheet – an injunction obviously intended to protect the interest of creditors and third parties in general.⁹⁶

Once the distribution of dividends is stated in the articles of association, Article 458 of the Commercial Code gives the discretion to the general meeting of shareholders to decide “the date and methods of payment of dividends.”⁹⁷ The tax authorities have generally shown themselves to be reluctant to cede discretionary powers to general meetings of shareholders. In their recent clamp-downs on what they considered to be tax avoiders, the tax authorities have been unable to accept that the withholding of dividend taxation is contingent upon the discretion of a body which has a lot at stake in declaring dividends – the general assembly of share companies and private limited companies.

⁹⁴ Interviews with Ato Yonas Argaw, ERCA, Tax Audit, April 27, 2012, Ato Girma Cherinet, ERCA, Tax Audit, May 23, 2012; Ato Tibebe Mengistu, Tibebe Mengistu & Co, April 07, 2012

⁹⁵ Commercial Code of Ethiopia, Article 456(2)

⁹⁶ Id, Article 458(1); distribution of “fictitious dividends” results in both civil and criminal liability

⁹⁷ Commercial Code of Ethiopia, Article 458(3)

2. The Income Tax Proclamation

The tax rules pertaining to dividend taxation are some of the sparsest of all the tax rules in the whole body of the Ethiopian income tax system. In the Income Tax Proclamation, there is only one provision devoted to the taxation of dividends – Article 34 of the Income Tax Proclamation. Article 34 states as a matter-of-fact that “*every person deriving income from dividends from share companies or withdrawals of profits from a private limited company shall be subject to tax at the rate of ten percent (10%)*(italics added).” The perfunctory manner in which the whole taxation of dividends is dashed off in the Income Tax Proclamation comes from the assumption either that the notion of dividends is not open to interpretation (which is obviously not the case) or that the concept of dividends is defined and described in other areas of Ethiopian law, most notably in the Commercial Code. This laconism of the Income Tax Proclamation has forced both the tax authorities and others involved in withholding of dividend taxation to have recourse to the provisions of the Commercial Code. Unfortunately, neither of those assumptions is true. The meaning and scope of dividends is open to widely and wildly divergent interpretations, and the Commercial Code does not give adequate answer to many of the questions that arise in connection with the taxation of dividends. The practice regarding the taxation of dividends has proven both assumptions wrong.

ii. Withholding Taxation of Dividends in Practice

The question of when taxes on dividends should be withheld by companies has divided opinions both within and outside the tax authorities. Some are of the opinion that as the law currently stands companies are free to keep the withholding of dividend tax at bay by simply not distributing dividends among shareholders. These individuals argue that companies are

obligated to withhold dividend taxes only when the general meeting of shareholders formally decides to distribute the net profits of companies in accordance with the provisions of the Commercial Code.⁹⁸ Until this decision is reached, thus runs this line of argument, no dividend is distributed and therefore no tax shall be withheld by the company concerned.

On the other hand, there are those who believe that it is possible to enforce the withholding of dividend taxation upon companies that have not formally declared dividends in accordance with the rules of the Commercial Code.⁹⁹ Those who hold this view believe that certain conditions trigger the withholding obligation of companies even in cases where there are no formal decisions made by the general assembly of shareholders. These conditions are: i) the company has put away some of the profits for the reserves required by law; ii) the articles of association contain a provision or provisions that impose upon companies the obligation to distribute the balance of the profits as dividends among shareholders; iii) the company has not taken any formal step to transfer the profits earned into the increase of its capital and thereby increased the share of shareholders accordingly; and iv) the company is not covered by law in Ethiopia that allows select companies to use their profits to increase its capital and in doing so are exempted from withholding of dividend taxation.

The latter line of argument has gained increasing popularity within the tax authorities and recent moves indicate that the authorities are determined to levy dividend taxation upon

⁹⁸ See Yohannes Woldegebriel, Dividend Tax Notice Illegal, *Fortune*, vol. 13, No. 664, January 20, 2013; Zafu Eyesuswork Zafu, Dividend Tax Law Mistakes Unforgivable, *Fortune*, vol. 13, No. 673, March 24, 2013

⁹⁹ See, in this regard, the Legal Opinion written by the Ministry of Finance and Economic Development on 27/11/2004 E.C.

undistributed profits of companies. In this regard, the authorities received some judicial support in a case which started the whole argument of what is ripe for dividend withholding taxation.

In *Seferian Ethiopia PLC v. FIRA*,¹⁰⁰ the audits of the Tax Authority led to the discovery that Seferian Co. (an importer and distributor of vans and trucks) kept its profits in its so-called “Retained Earnings Account” for the years 1991-1996 E.C (1998-2003). The authorities found that Seferian failed to take formal steps either to distribute these profits among its shareholders or use the earnings to increase its capital. Federal Inland Revenue Authority (FIRA, the predecessor of ERCA), argued that Seferian owed dividend taxes on its retained earnings even though its general shareholders’ meeting never decided to declare these as dividends. The Company not surprisingly objected, arguing that dividend taxes were not due until the general meeting of shareholders decided to declare its profits as dividends.

The case went to the Tax Appeal Commission which agreed with the position of the Tax Authority that dividend taxes were due on retained earnings even if no formal decisions were taken by the general meetings of the shareholders of Seferian Company. The Commission found that Seferian Company did not formally transfer the retained earnings to increase its capital in accordance with Articles 535 and 536 (455 and 456?) of the Commercial Code. From this fact, the Tax Appeal Commission concluded that Seferian was therefore holding the profits in trust for its shareholders. The Commission ruled that Seferian owed a dividend tax on its retained earnings as long as it did not take formal steps to use these earnings to increase its capital. The agreement of the Tax Appeal Commission with the position of the FIRA in Seferian Co. case boosted the confidence of the tax authorities in their efforts to pursue those companies that

¹⁰⁰ *Seferian Ethiopia PLC v. Federal Inland Revenue Authority (FIRA)*, Federal Tax Appeal Commission, File No. 562, *Ginbot* 1, 1998, in Amharic, unpublished

thought they could hold off withholding taxation of dividends by placing their undistributed profits in their retained earnings accounts.

Another high profile case is the case against Oil Libya (Ethiopia). The Tax Authorities initiated a case against Oil Libya (Ethiopia) Ltd. after obtaining a leaked information that the transfer of shares from its predecessor – Shell (Ethiopia) Ltd., to Oil Libya (Ethiopia) Ltd. was grossly understated for the purpose (the tax authorities suspected) of avoiding the capital gains tax due on the transfer of shares.¹⁰¹ In 2008, Shell (Ethiopia) Ltd., which was operating in Ethiopia since the 1950s, decided to transfer all of its operations in Ethiopia to Oil Libya and left the “downstream market.” Shell (Ethiopia) Ltd. paid some amount in capital gains at the time of the transfer but leaked information led to the investigation that the actual amount of transfer was much higher than that publicly declared. After conducting its investigation, the Tax Authority started proceedings for the payment of capital gains taxes and dividend taxes upon undistributed profits against the transferee of Shell Ethiopia Ltd – Oil Libya. The Tax Authority argued that Shell Ethiopia should have paid dividend taxes on its accumulated earnings and Oil Libya owed the obligation as it has acquired the interest of Shell Ethiopia Ltd. Oil Libya took its case to the Review Committee but the Review Committee concurred with the Tax Authority and ordered Oil Libya to pay both capital gains taxes and dividend taxes as claimed by the Tax Authority. The dispute could not go beyond the Review Committee as Oil Libya was allegedly unable to post the 50% payment condition for appealing to the Tax Appeal Commission.

The Oil Libya case, as the Seferian Ethiopia Ltd. case before it, illustrates the increasingly popular position within the tax authorities that dividend taxes should be enforced against

¹⁰¹ See Mahlet Mesfin, Tax Authority Claims 210m Br. In Back Taxes from Libya Oil (sic), *Fortune*, vol. 12, No. 574, May 1, 2011

companies that keep retained earnings even though the general assemblies of companies never formally decided to distribute these as dividends. Buoyed by the successes in Seferian Co. and other cases, the Authority has been preparing the groundwork for going after companies it believed were not complying with the withholding of dividend taxation. In December 2012, ERCA began a massive campaign of collecting unpaid tax arrears and sent assessment notifications to hundreds of share and private limited companies for the payment of unpaid dividend taxes (along with interest and penalties).¹⁰² This action of the Authority stirred a storm of controversy and consternation within the business community. In a display of collective action, the representatives of the business community, through the Addis Ababa and Ethiopian Chambers of Commerce and Sectoral Association, demanded a forum with the heads of the ERCA in a bid to persuade ERCA to rethink its position on taxation of dividends.¹⁰³ In a meeting held on January 19, 2013, they were told in no uncertain terms about the firm position of ERCA with regard to the collection of unpaid dividends over the last how-so-ever many years.¹⁰⁴ The only point upon which ERCA showed some softening of stance was in the payment of interest and penalties, which the Authority agreed to rescind, admitting that the Authority contributed to the general state of delinquency in this regard by not enforcing dividend taxation against these companies.

¹⁰² See Muluken Yewonwossen, ERCA to Collect Tax Arrears from Undistributed Dividend, December 17, 2012; Mahlet Mesfin, ERCA seeks Dividend Tax Whether Retaining Earnings or Not, *Fortune*, vol. 13, No. 659, December 16, 2012

¹⁰³ See Tax Authorities to Explain Demand on Dividend Tax, in *Retrospect*, *Fortune*, vol. 13, No. 664, January 17, 2013

¹⁰⁴ See Melkam Aschalew, ERCA Determined to go Back in Time to Claim Dividend Tax, *Fortune*, vol. 13, No. 664, January 20, 2013; Muluken Yewondwossen, Undistributed Dividend Tax applies, *Capital*, January 21, 2013

The Authority received a massive boost in its position from the Ministry of Finance and Economic Development which penned a legal opinion that supported ERCA's position. In a letter written to ERCA, the Ministry of Finance and Economic Development opined that dividend tax was due on undistributed profits of share and private limited companies even though the general meeting of the shareholders never met and decided to distribute dividends.¹⁰⁵ In its operative paragraphs, the said Letter reads:

... ምላሽ የሚሻው ዓቢይ ጉዳይ በአክሲዮን ትርፍ ድርሻ ላይ የሚከፈለው ግብር ትርፋ ባለአክሲዮኖች ዘንድ እስከሚደርስ ሊጠበቅ ይገባል ወይስ አይገባም; የሚለው ጥያቄ ነው። ከዚህ ቀደም ተመሳሳይ የመከራከርያ ነጥብ እየተነሳ በአፈፃፀም ችግር ሲያጋጥም በመቆየቱ በሥራ ላይ ያለው የገቢ ግብር አዋጅ በሚረቀቅበት ወቅት (ገቢ) ለሚለው ቃል የተሰጠው ትርጉም ሁሉን የሚያካትት እንዲሆን ተደርገል:: በዚህም መሰረት በአዋጁ አንቀጽ 2/10/ ለገቢ በተሰጠው ትርጉም ለግብር ከፋይ በስሙ የተያዘለትን ጥቅም ሁሉ እንደሚጨምር ተደርገል::

በንግድ ህጉ አንቀጽ 458(1) እንደተመለከተው የትርፍ ድርሻ የሚከፈለው በፀደቀው የሂሳብ ሚዛን ውስጥ ከተገለፀው የተጣራ ትርፍ ላይ ነው። በመሆኑም የተጣራው ትርፍ እንደታወቀ ባለአክሲዮኖች በማህበሩ መመስረቻ ደንብ በተመለከተው የአክሲዮን ድልድል ልክ ከትርፉ የመካፈል ሙብት ይኖራቸዋል:: በንግድ ህጉ አንቀጽ 458(3) የትርፍ ድርሳ የሚከፈልበትን ቀንና ዓይነት የሚወስነው በጠቅላላ ጉባዔው መሆኑ መመልከቱ ይታወቃል:: ይሁን እንጂ የጠቅላላ ጉባዔው የሚወስነው የትርፉ ድርሻ የሚከፈልበትን ቀንና ዓይነት እንጂ የትርፉን ድርሻ አይደለም::

...

...

የማህበሩ የተጣራ ትርፍ እንደታወቀ ባለአክሲዮኖች በማህበሩ ውስጥ ባለቸው አክሲዮን መጠን ከትርፉ የመካፈል ሙብት ስለሚኖራቸው ማህበሩ ከዚህ ገቢ ላይ ግብሩን ቀንሶ ገቢ ማድረግ ይኖርበታል::

...

ስለዚህ የአክሲዮን ማህበራት እና ሃላፊነታቸው የተወሰነ የግል ማህበራት ትርፉ ለአባላቱ መከፋፈሉን ሳይጠበቁ ለባለአክሲዮኖች ተከፋይ ከሆነው የአክሲዮን ድርሻ ላይ ተገቢውን ግብር ቀንሰው ለግብር አስገቢው ባለስልጣን ገቢ ማድረግ እንዳለባቸው እንገልጻለን::¹⁰⁶

This reads:

¹⁰⁵ The Federal Democratic Republic of Ethiopia, Ministry of Finance and Economic Development, Legal Opinion Letter Written to Ethiopian Revenues and Customs Authority, 27/11/2004 E.C., in Amharic, unpublished

¹⁰⁶ The Federal Democratic Republic of Ethiopia, Ministry of Finance and Economic Development, Legal Opinion Letter Written to Ethiopian Revenues and Customs Authority, 27/11/2004 E.C., in Amharic, unpublished

... the issue that requires an answer is whether the withholding tax on dividends should wait until the dividends are distributed to shareholders? As the same issue created problems in the enforcement of the [income] tax in the past, we tried to address and resolve the issue during the drafting of the current income tax law (in 2002) by defining income in the broadest sense possible. Accordingly, the definition of “income” in Article 2(10) [of the Income Tax Proclamation] was made to include income credited in the name of the taxpayer.

As indicated in Article 458(1) of the Commercial Code [of Ethiopia], dividends are to be paid only from the net profits as shown in the approved balance sheet [of a company]. Once the net profits are ascertained, the shareholders shall have the right to the distribution of dividends in accordance with the rules of Articles of Association [of the company]. It is to be noted that Article 458(3) of the Commercial Code authorizes the general assembly [of shareholders] to determine the manner and time of payments of dividends to shareholders. The general assembly, however, is authorized only to determine the manner and time of payment of dividends, and not the amount of dividends to be paid.

... since the shareholders of a company have the right to the distribution of dividends once the net profits of the company are known, the company has the obligation to withhold the [dividend] tax from the [net] profits and transmit the same to the [authority].

....

....

Thus, it is incumbent upon share companies and private limited companies to withhold dividend taxes and transmit the proceeds to the tax authorities without waiting for the actual distribution of dividends to the shareholders (author’s translation).

The Letter of the Ministry of Finance relieved ERCA from having to show any distributions to shareholders and what is more from even waiting until companies take some formal steps to declare and distribute dividends to shareholders.

Not surprisingly, this position of the authorities has not gone down well with members of the business community, many of whom have continued to hold on to the view that no dividends are payable to shareholders until the general assemblies of shareholders meet and decide to distribute the net profits of a company. Some critics of the move have argued that shareholders have not received dividends until the general assemblies have decided to declare dividends.

Critics have rejected the idea that the undistributed profits of companies are even income within the meaning of the Income Tax Proclamation.¹⁰⁷ One critic described the Authority's move as "expecting an employee to pay income tax while they (sic) did not yet received (sic) salary."¹⁰⁸

Another critic of the move wrote:

The opinion of MoFED [Ministry of Finance and Economic Development], (sic) thus disparages any legal significance of the phrases under 'article 34' of the Income Tax Proclamation, which act as a (sic) precedent to the payment of dividend tax.

...

Contrary to the opinion given by the MoFED[Ministry of Finance and Economic Development], the general meeting of a company, in accordance with article 419 – sub-article one of the Commercial Code, "shall approve or reject the accounts for the past financial year... decide, where necessary, on the allocation and distribution of profits and on all question arising out of the accounts of the past financial year." Therefore, the power of the general meetings of each company is not limited merely to time and method of payment of dividends, as asserted by the MoFED's opinion.¹⁰⁹

Some of the companies, which received assessment notifications from the Authority, have vowed to challenge this move of the Authority, but since the Tax Appeal Commission and the Federal Supreme Court ruled in favor of the Authority in similar cases against Seferian Co., it is less likely that they will be able to receive favorable decisions in the near future.

iii. Major Problems in the Effective Withholding Taxation of Dividends in Ethiopia

From the analysis of the laws and the survey of the practice, it is easy to see that the withholding taxation on dividends has been fraught with a number of problems. The inadequacy of the rules

¹⁰⁷ In this regard, see Zafu Eyesuswork Zafu, Dividend Tax Law Mistakes Unforgivable, *Fortune*, vol. 13, No. 673, March 24, 2013; see also Editorial, *Fortune*, New Dividend Tax Interpretation Unlawful, Unfair, vol. 13, No. 665, January 27, 2013

¹⁰⁸ An auditor of an import company, quoted in Mahlet Mesfin, ERCA Seeks Dividend Tax Whether Retaining Earnings or Not, *Fortune*, vol. 13, No. 659, December 16, 2012

¹⁰⁹ Yohannes Woldegebriel, Dividend Tax Notice Illegal, *Fortune*, vol. 13, No. 664, January 20, 2013

coupled with the questionable practices of the tax authorities in the enforcement of withholding taxation on dividends have all created problems which are simmering at the time of writing. We shall examine some of these problems below.

1. Lack of Detailed Provisions in the Income Tax Law on the Meaning and Scope of Dividends

The chief blame for lack of effective implementation of dividend taxation in Ethiopia must go to the laws themselves. The income tax rules charging dividends with withholding taxation are some of the sparsest and loneliest of all the provisions in the whole of Ethiopian income tax laws. The Income Tax Proclamation devotes one provision to the taxation of dividends – Article 34. In order to understand how spare the Income Tax Proclamation is, it is necessary to quote sub-Article (1) of Article 34 in full:

Every person deriving income from dividends from a share company or withdrawals of profits from a private limited company shall be subject to tax at the rate of ten percent (10%).

This provision appears to take it for granted that the concepts of “dividends” and “withdrawals of profits” are clear or as it is often the custom, will be clarified by reference to other laws, such as the Commercial Code, in which it was presumed adequate definitions are available. In the definition section of the Income Tax Proclamation, where a number of concepts used in the Income Tax Proclamation are defined, we don’t find a definition for “dividends” and “withdrawals of profits.” Many tax practitioners have argued that this is the root of problems in practice, as the absence of adequate rules defining concepts like dividends allows many companies to easily avoid the payment of income tax on dividends by characterizing their

distributions in many other ways that are not called dividends.¹¹⁰ The Commercial Code, upon which the understanding of the concept of dividends is probably predicated, does not have detailed provisions regulating the different forms of distributions that are assimilated in many other income tax systems with the concept of “dividends” (so-called “deemed dividends”) and treated as such.

The result of these sparse regulations in the Income Tax Proclamation is that the integrity of the whole infrastructure of dividend taxation in practice has depended upon the precarious voluntary declaration by companies of dividends. This, needless to say, discriminates against those widely held public companies that have little choice in declaring dividends in public and massively favors privately held private limited companies that have been able in practice to avoid paying dividend taxes by channeling their distributions to their members through other ways.

The need for detailed definitions capable of capturing multiple forms of distributions is not in doubt if the intention of the government is to impose withholding obligations on all types of distributions that are in substance dividends. The practice of enforcing withholding obligations upon various forms of distributions is so limited thus far the tax authorities are not anywhere near raising these questions against companies that choose to distribute benefits in various ways without calling these benefits dividends for share companies or withdrawals of profits for private limited companies. After years of neglect, the tax authorities have gone to the other extreme of calling “undistributed profits” of companies “dividends” – which is as worrying a development as the neglect of various forms of distribution by companies in the past.

¹¹⁰ Interviews with Ato Girma Cherinet, ERCA, Tax Audit, May 23, 2012; Ato Yonas Argaw, ERCA, Tax Audit, April 27, 2012

There are many solutions to the current dearth of rules regulating the concept of dividends in Ethiopia, but it is necessary to state one obvious solution: provide for rules that define and list the various types of distributions and regulate the tax consequences of these distributions. It is clear that the Commercial Code does not fill the gaps left by the Income Tax Proclamation in this regard and it is necessary for the Income Tax Proclamation and subsidiary tax legislations to step in and regulate the various forms of distributions and the consequences of these distributions upon income tax withholding.

In looking for definitions, the double taxation treaties (DTTs) of Ethiopia can be used as starting references. Ethiopia has signed tax treaties with a number of countries.¹¹¹ Many of the DTTs of Ethiopia define the concept of “dividends.” These treaties have virtually identical definitions for “dividends.” One of the treaties (with Algeria), for example, defines “dividends” as:

The term “dividends” as used in this [treaty] means income from shares, 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.¹¹²

This definition provides a broader template for Ethiopian tax authorities to capture the various forms of distributions by companies. It has not been customary in practice to cite the text of tax treaties in Ethiopia or even referring to tax treaties for purposes of understanding related concepts in the income tax laws, but it is perhaps necessary in the future to use these definitions as models for domestic tax purposes as well. There are also detailed commentaries prepared by

¹¹¹ For the DTTs signed by Ethiopia, see Taddese Lencho, Country Survey, Ethiopia: Corporate Taxation, updated up to March 1, 2013

¹¹² See, for example, Convention between the Governments of the Federal Democratic Republic of Ethiopia and the Peoples’ Democratic Republic of Algeria for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital, Article 10(3); most of the other Conventions contain similar definitions.

both the UN and the OECD to explain the model tax treaties of the UN and OECD and these can be used as templates for preparing detailed provisions regulating the taxation of various distributions by companies.¹¹³ There is really no shortage of templates from which the definition of “dividends” can be taken. A cursory reading of the income tax laws of some African countries shows that detailed provisions are a way to go when it comes to the taxation of dividends once a choice is made to impose withholding taxes on dividends. The Ugandan Income Tax Act of 1997, for example, can be taken as a perfect example of how detailed provisions can be made in order to capture the various forms of distributions by companies.¹¹⁴ Ethiopia must either exempt “dividends” completely or go all the way like many of the African countries.

¹¹³ See United Nations Model Double Taxation Convention between Developed and Developing Countries, pp. 176ff

¹¹⁴ Under the Ugandan Income Tax Act (1997), “dividend” includes –

- (i) where a company issues debentures or redeemable preference shares to a shareholder –
 - (A) in respect of which the shareholder gave no consideration, an amount equal to the greater of the nominal or redeemable value of the debentures or shares; or
 - (B) in respect of which the shareholder gave consideration which is less than the greater of the nominal or redeemable value, an amount equal to the excess;
- (ii) any distribution upon redemption or cancellation of a share, or made in the course of liquidation, in excess of the nominal value of the share redeemed, cancelled, or subject to liquidation;
- (iii) in the case of a partial return of capital, any payment made in excess of the amount by which the nominal value of the shares was reduced;
- (iv) in the case of a reconstruction of a company, any payment made in respect of the shares in the company in excess of the nominal value of the shares before the reconstruction; or

2. The Avoidance of Dividend Taxation by many Companies

The absence of detailed rules governing the taxation of dividends is a perfect recipe for tax avoidance. It is extremely easy to avoid payment of dividend taxation in Ethiopia. All that companies need to do is desist from declaring dividends. That is exactly what many of the private limited companies did – hold off declaring dividends for as long as they could manage and they were able to keep the withholding obligations at bay. In the past, the only opportunity for the tax authorities of capturing some tax in this regard is when the companies are liquidated and a need arises to distribute the assets among the members of companies upon liquidation.

Like all the legal loopholes that create opportunities for tax avoidance, these opportunities for avoidance were not available to all companies. Companies with widely dispersed shareholding were under pressure to declare and distribute dividends from time to time and had to withhold the dividend taxes from distributions of dividends. Companies that were tightly held by a few shareholders, particularly the private limited companies, on the contrary, were able to hold off dividend taxation by simply not declaring dividends. There are no researches on how many of these companies were motivated by tax consideration for not declaring dividends, but the tax authorities have for a long time suspected that taxation constituted the primary reason for their actions (rather inactions). It is also quite legitimate to suspect back-door and

-
- (v) the amount of any loan, the amount of any payment for an asset or services, the value of any asset or services provided, or the amount of any debt obligation released, by a company to, or in favour of, a shareholder of the company or an associate of a shareholder to the extent to which the transaction is, in substance, a distribution of profits,

but does not include a distribution made by a building society; see The Income Tax Act of 1997 (as amended up to 2005),

surreptitious distributions of dividends as there are no financial controls in place to monitor the movement of economic benefits from these companies to their shareholders. Ethiopian income tax rules do not regulate various types of distributions from companies to shareholders and as a result have opened a way for companies to distribute various kinds of economic benefits to their shareholders without calling these distributions dividends. There are no rules for characterizing certain distributions like loans to shareholders, in-kind benefits as dividends. It is quite possible that many companies were using these loopholes in the laws to smuggle benefits to shareholders without attracting dividend taxation.

ERCA has acknowledged that the withholding taxation of dividends is susceptible to massive tax avoidance schemes by companies. An internal Memo of ERCA blames the challenges faced in the collection of dividend taxes on a number of factors.¹¹⁵ The Memo deplores the practice of enforcing dividend taxes only when companies formally decide to declare dividends and urges the tax authorities to enforce dividend taxation against companies that retain earnings without any legitimate reason. The Memo states that this practice has encouraged numberless companies to avoid payment of dividend tax by merely showing their profits in their so-called “Retained Earnings Account” and accuses companies of distributing their earnings to their members through numerous backdoor deals. Since there is no formal scheme for verifying whether what is stated to be in the “Retained Earnings Account” is actually available in the accounts of the company, the Memo notes with regret that it is extremely easy for companies to simply pretend to be putting their profits in their “Retained Earnings Account” without keeping the money in that account. The Memo rues the fact that the Government has lost millions of

¹¹⁵ See Ethiopian Revenues and Customs Authority, **Internal Memo: ERCA, 22/05/2004** Re: Implementation of Dividend Tax, in Amharic, unpublished

dollars in tax revenues as the companies that are allowed to put their profits in their “Retained Earnings Account” never actually pay the tax on undistributed profits. According to the Memo, some of these companies are dissolved or go out of business without paying the dividend tax which should have been collected in the past.

The Memo acknowledges that there are loopholes in the law that allow many companies to avoid paying dividend tax but it also blames the complacency within the tax authorities and the lack of attention so far for collection of dividend taxes from companies. To reverse the dismal record of revenue collection from this source, the Memo recommends a number of steps:¹¹⁶

- i) Directives or regulations be issued to fix a maximum period for which profits may remain undistributed;
- ii) The Tax Authorities force companies to comply with the provisions of their memorandums of associations;
- iii) The Tax Authorities ascertain that the money that is recorded as retained earnings actually is available in the accounts of the Company as recorded in the accounts or is being distributed indirectly to shareholders; and
- iv) In general, the Tax Authorities should conduct proper studies to issue regulations and directives to curtail the level of tax evasion and tax avoidance in this regard.

¹¹⁶ Ethiopian Revenues and Customs Authority, **Internal Memo:** ERCA, 22/05/2004 Re: Implementation of Dividend Tax, in Amharic, unpublished

3. Lack of Precise Rules Defining Entities subject to Dividend Taxation

The question of entities that are subject to withholding taxation for distribution of dividends is not an aspect of the definition of dividends, but it requires a separate treatment as the Income Tax Proclamation is even more problematic in its supposed approach to the entities that are currently subject to withholding obligations on dividends and withdrawals of profits. The only reason why this has not become a problem so far is that the authorities have not yet been aware of its existence. In one respect, the Income Tax Proclamation provision charging dividends with withholding taxation (Article 34) is sufficiently clear. We know that two kinds of entities which are well defined in the Commercial Code are subject to withholding obligations under Article 34. These are share companies and private limited companies.¹¹⁷ In practice, these and only entities organized as cooperative societies are required to withhold the taxation on dividends distributed to their members.¹¹⁸

In another sense, the Income Tax Proclamation can be taken to have bungled the issue by not adequately identifying the entities that are subject to both the corporate and dividend taxation. The early sections of the Proclamation give the sense that corporate and dividend taxation apply not just to companies but also to other entities that are assimilated to companies. Article 2(2) of the Proclamation defines “bodies” (translation: entities subject to entity taxation) so as to cover

¹¹⁷ For share companies and private limited companies, see Commercial Code of Ethiopia (1960), Articles 304-509 and Article 510-543

¹¹⁸ See Cooperative Societies Proclamation No. 147/1998, Article 31; it is, however, to be noted that the exemption of cooperative societies from the corporate tax is not an acceptance of the partnership treatment of certain business organizations but an official exemption of cooperatives by the government in order to encourage cooperatives. The title of the provision that exempts cooperatives is thus aptly couched as “Government Assistance.”

entities other than the two forms of companies in Ethiopia (i.e., share companies and private limited companies). The list of entities that are subject to corporate (entity) and presumably dividend taxation, according to Article 2(2) of the Proclamation, includes not just companies, but also “registered partnerships,” entities “formed under foreign law resembling” companies or registered partnerships in Ethiopia, and public enterprises or public financial agencies.

And Article 6 of the Income Tax Proclamation appears to be intent on expanding the reach of dividend taxation to “registered partnerships” as it lists “profit shares paid by a resident registered partnership” as one of the sources of income specifically chargeable by the Income Tax Proclamation.¹¹⁹ The problem is that “registered partnerships” are not recognized as one of the six entities recognized by the Commercial Code of Ethiopia. The Commercial Code recognizes six different types of business organizations: ordinary partnerships, general partnerships, joint ventures, limited partnerships, share companies and private limited companies.¹²⁰ The first four are generally categorized as “partnerships” while the last two are generally called “companies.” There are three entities that go by the name of partnerships – namely, ordinary, general and limited partnerships, but there is no “registered partnership” by that name. Under the Commercial Code, all forms of partnerships should be registered to be recognized as entities (it is a condition precedent to legal personality under the Code). All partnerships are therefore registered partnerships, but, since that is the case, the use of an adjective “registered” is superfluous as far as the Commercial Code is concerned.

¹¹⁹ Income Tax Proclamation No. 286/2002, see Article 6(i)

¹²⁰ Commercial Code of Ethiopia, see Article 212

Some members of the tax authorities have argued that the entity “registered partnership” in the Proclamation refers to all forms of partnerships.¹²¹ This position will put all forms of business partnerships in the same tax dock as the two forms of companies under the Commercial Code of Ethiopia. The Income Tax Proclamation, however, is not as bracing to this line of argument, as the tax authorities might have liked. In the provision that charges dividends with withholding taxation, the scope of the tax is narrowed down to the two companies recognized by the Commercial Code of Ethiopia. Article 34 (1), as repeatedly quoted above, mentions only dividends distributed by a share company or profits from private limited company as chargeable with dividend taxation. It remains a mystery as to why the early provisions of the Income Tax Proclamation (Articles 2(2) and 6(i)) mention “registered partnerships” as potential objects of corporate and dividend taxation but fail to complete the pursuit in the provision that actual matters when it comes to taxation – i.e., Article 34.¹²²

4. The Cascading Effects of Dividend Taxation on Some Dividend Distributions

Many income tax systems provide a relief for inter-corporate dividends from the tax in order to avoid the cascading effect of the tax upon dividends distributed to corporate shareholders.¹²³ Without this relief, the indiscriminate taxation of all dividends results in double, and perhaps triple, taxation when the dividends are distributed to corporate shareholders which will distribute the same dividends as dividends to their shareholders. A simple example will illustrate the problem. If Company A distributes dividends to two of its shareholders, one a

¹²¹ See Weynaalem W/Senbet, *Taxation of Partnerships and Partners under Ethiopian Law*, p. 35

¹²² Puzzled by these questions, I have called this a case of “misimplantation” of foreign terminologies that are lost in translation in the Ethiopian legal context; see Taddese Lencho, *Legal Transplantation and Mis-Implantation: Evidence from the Tax Reforms of 2002*, a monograph, unpublished, 2010

¹²³ See Ault and Arnold, *Comparative Income Taxation*, pp. 358-362

natural person and the other a company, Company A should withhold the tax on dividends distributed to both the individual shareholder and the company shareholder. The company shareholder includes the dividend distributed to it by Company A in its profits and distributes the dividend among its shareholders. The company shareholder is again required to withhold the dividend tax from its distributions to its shareholders as if no dividends were previously withheld. In the absence of inter-corporate dividend exemption, the distribution of dividends to the corporate shareholder attracts dividend tax withholding twice in this example, leading to the problem of double and at times triple taxation of the same income. Many income tax systems have realized that this is unfair against corporate shareholders and provided for exemptions from dividend tax of dividends distributed to corporate shareholders.¹²⁴

Ethiopian Income tax laws do not have provisions that exempt companies from withholding obligations when they distribute dividends to corporate shareholders. As such, companies are required to withhold the tax on dividends against corporate shareholders as well as individual/natural person shareholders. The perfunctory way in which the taxation of dividends is treated in the Income Tax Proclamation has once again left a major gap in the treatment of inter-corporate or inter-company dividend distributions. In the absence of rules that exempt dividends distributed to other companies from withholding taxation, the existing rules of dividend taxation could have been creatively interpreted to prevent the cascading effects of current withholding taxation on dividends.

¹²⁴ See Ault and Arnold, *Comparative Income Taxation*, pp. 358-362

The Income Tax Proclamation provides that the withholding on dividend distributions is final.¹²⁵ This is in practice understood to mean that the companies that receive dividend after tax are not required to include the dividends among their business profits under Schedule “C.”¹²⁶ In the absence of clear rules exempting inter-corporate dividend distribution, this provision should have been creatively deployed to exempt distributions to corporate shareholders for the intent of the provision is that the same income base should not be subject to tax twice or more simply because of the accident of the recipient being a corporate shareholder. In practice, the distribution of dividends is subject to mechanical withholding of taxation regardless of whether the recipient of the dividend is an individual shareholder or a company.

e. Taxation of Income from Casual Rental of Property – Article 35

Income taxation of casual rental of property (which is chargeable under Article 35, Schedule “D” of Ethiopian income tax law) is one of the least known sources of tax in the Ethiopian income tax system.¹²⁷ The first mention of this source of income as a taxable income was in the 1978 Income Tax Amendment law, in which it was specified as income chargeable along with business income under Schedule “C.”¹²⁸ It was taken out of Schedule “C” and became chargeable with tax under Schedule “D” in the Income Tax Proclamation of 2002. Many tax officers and seasoned tax practitioners admit to having never come across anybody reporting income and paying tax under Article 35. Much of the evidence about Article 35 tax is anecdotal and contradictory, as many tax officers and practitioners continue to speculate about the meaning and nature of Article 35 income tax in the face of complete lack of encounter with the reporting of income and

¹²⁵ Income Tax Proclamation No. 286/2002, see Article 34(3)

¹²⁶ See Lila Desta, *Taxation of Corporate Distributions in Ethiopia*, p. 41

¹²⁷ See Estifanos Denbu, *Taxation of Income from Rental of Buildings under Schedule “B,”* pp. 13-14

¹²⁸ See Income Tax Amendment Proclamation No. 155/ 1978, Article 2(5)(d)

paying of tax under Article 35. Casual rental of both movable and immovable property is not really an uncommon practice in the Ethiopian economy, but for reasons to be explored below, this type of activity has seldom been reported under Article 35 of the Income Tax Proclamation. The uncertainty about the language of Article 35 and the lack of adequate reporting of the tax in practice have created lots of ambiguities about the meaning and scope of Article 35.

As can be readily seen from the reading of the preceding chapters, Article 35 is not the only provision of the Ethiopian income tax that charges income from rental of property. A number of Ethiopian income tax schedules compete over the taxation of income from rental of property. Income from rental of buildings is taxable under Schedule “B”; income from rental or lease of business as a property is taxable under Schedule “C;” income from rental of property as an “integral” part of the business (e.g. equipment leasing) is the subject of Schedule “C” and income from casual rental of property is taxable under Schedule “D” – Article 35. The competing claims of multiple income tax schedules of Ethiopia over income from rental of property raise a question of when income from rental of property becomes chargeable with tax under Article 35, rather than, say, Schedule “B” – which is the main charging provision for income from rental of property. In coming to terms with the meaning and scope of Article 35, it is necessary to start from the language of Article 35 itself:

Every person deriving income from the casual rental of property (including any land, building, or movable asset) not related to a business activity taxable under Article 17 shall tax on the annual gross income at the rate of fifteen percent (15%). This tax is a final tax in lieu of a net income tax.

From the language of Article 35, it appears that the tax on casual rental of property applies to cases in which an otherwise Schedule “C” taxpayer engages in rental of property outside its regular line of business. In a sense, Article 35 requires two conditions for its application. For

whatever it is worth, Article 35 makes clear that the person reporting this income for tax purposes is otherwise a Schedule “C” taxpayer. If a person that is otherwise not involved in business on regular basis is involved and derives income from casual rental of private property, it appears that this person is not required to report income from casual rental of property under Article 35.

The second requirement for the application of Article 35 is that the rental must be casual, although how casual the rental must be to qualify for reporting under Article 35 is not clear. A person involved in the activity of rental of property on a regular basis should report that income under Schedule “B” of Ethiopian income tax if the object of the rental or lease is a building. A person involved in the activity of rental of property on a regular basis should report the income from that activity under Schedule “C” of Ethiopian income tax if the object of the rental is any other property (movable property – equipments, vehicles, tools, implements, furniture, or machinery).¹²⁹ A person involved in an activity other than rental of property must report income under Article 35 when the person is involved in a “casual” rental of business property. A close reading of the language of Article 35 along with other related provisions of the Ethiopian income tax laws yields these interpretations.

The language of Article 35 restricts the application of this tax to Schedule “C” taxpayers that rent business property casually. Nonetheless, the tax authorities have in practice received frequent demands by some non-Schedule “C” taxpayers to pay tax under Article 35. Persons who rent their houses casually, for example, have asked to pay tax under Article 35, taking the cues

¹²⁹ Rental of equipments, machineries and vehicles is listed as one of the businesses in standard assessment tables, showing that these kinds of rentals are treated as businesses under Schedule “C” of the Ethiopian income tax system.

obviously from the language of Article 35. These frequent questions prompted the tax authorities to weigh in on the scope of Article 35 vis-à-vis Schedule “B” in particular – the only official statement from authorities regarding the meaning and scope of Article 35. In a Circular Letter issued in 2004, the Ministry of Revenues (the predecessor of ERCA) sought to define the scope of Article 35 tax by the purposes for which property is rented and finally determined that Article 35 is not applicable to rental of buildings for residential purposes, no matter how short term or casual the rental may be. The relevant portions of the Letter read:

ቤት (በተለይም የመኖርያ ቤት) በማከራየት ንግድ ላይ የተሠማሩ ሰዎች ቤቱን የምናከራየው አልፎ አልፎ ስለሆነ ግብር መክፈል ያለብን በአንቀጽ 35 መሠረት ነው የሚል ጥያቄ ያቀርባሉ።

በማናቸውም ሁኔታ ከተከራየ ቤት በሚገኝ ቤት ላይ ግብር የሚከፈለው በሠንጠረዥ «ለ» መሠረት መሆኑ በአዋጁ አንቀጽ 14 ተመልክቷል። ይህ መሠረታዊ ድንጋጌ እንደተጠበቀ ሆኖ አልፎ አልፎ ቤት ለሚያከራዩ ሰዎች ክፍያ የሚፈፀም ሰው ከተከፋዩ ሂሳብ ላይ 15 ቀን ገቢ ማድረግ እንዳለበት አንቀጽ 35 እና 54 (1) ተደንግጋል።

በመሆኑም የአዋጁ አንቀጽ 35 ከሌሎች መካከል፤ አዳራሽ እና ሌሎች ተቃዋሚ አልፎ አልፎ በማከራየት ገቢ የሚያገኙትን እንጂ ቤት በማከራየት ሥራ ላይ የተሠማሩትን የሚጨምር አይደለም።

This reads:

Persons who rent buildings (particularly residential buildings) often ask to pay tax under Article 35 on their income from occasional rental of buildings.

It is stipulated under Article 14 of the Income Tax Proclamation that income from rental of buildings in any manner shall be subject to income tax under Schedule “B.” It is also stipulated that, notwithstanding this basic provision of the Income Tax Proclamation, any person who makes payments to those who lease their property on a casual basis shall deduct 15% from the lease payments [and transmit the same to the Government].

Accordingly, Article 35 covers casual leases of property for purposes other than residential purposes, such as hiring of halls and does not include those persons who rent buildings [even casually].

The Letter quoted above asserts the primacy of Schedule “B” over Article 35 in respect of rental of buildings for residential purposes, no matter how short-term the rental might be. It is not clear why the Letter excluded rental of buildings for residential purposes from the scope of Article 35, but it can be surmised that the tax authorities wanted to apply uniform set of rules

upon the rental of buildings, whether the buildings were rented occasionally or regularly. Be that as it may, the Letter cannot escape from the criticism of being idiosyncratic as it is equally plausible to argue that occasional rentals of buildings fall under Article 35. Indeed, Article 35 cites buildings as one of the examples of properties the rental of which would trigger the application of Article 35.¹³⁰ As for the primacy Schedule “B” over rental of buildings for “residence,” we have seen in Chapter Six above that Schedule “B” applies to rental of buildings for any purposes, including residence, commerce and office work.

The Letter quoted above is also interesting on another count. In the process of apparently clarifying the scope of Article 35 vis-à-vis Schedule “B,” the Letter sanctifies one mode of collection for Article 35 tax – something which is not clear from the reading of Article 35 itself. The Letter suggests that Article 35 tax is collected through withholding by persons making payments for casual rental of property (for special occasions). Thus, if Company A rents a hall for a conference from Company B, Company A (the payor) is expected to withhold 15% from rental payment and transmit the same to the tax authorities. Company B, whose income is subject to withholding tax under Article 35, is neither required to include this income in its other income nor expected to file tax returns in respect of its income from casual rental of property.

The line of reasoning taken in the Letter quoted above is consistent with the nature of most of the miscellaneous incomes chargeable with tax under Schedule “D.” Royalties, income from technical services, income from games of chance, dividends and interest on deposit accounts are all subject to final withholding tax by the payors. Unlike Article 31 (tax on royalties), Article 32

¹³⁰ See the phrase “casual rental of property (including any land, building, or movable asset)” in Income Tax Proclamation No. 286/2002, Article 35

(tax on income from technical services rendered abroad), Article 33 (tax on income from games of chance), Article 34 (tax on dividends), Article 36 (tax on interest on deposit accounts), Article 35 is silent about how and by whom the income and the tax is reported. The Letter quoted above suggests that Article 35 is akin to these other final withholding taxes under Schedule “D.”

The Letter quoted above was specific in nature, meant to address one particular issue coming frequently from one group of taxpayers – namely, occasional or casual renters of buildings for residential purposes. As a result, the Letter left many issues unresolved. The meaning and scope of Article 35 is compounded by lack of adequate practice dealing with Article 35 cases. For lack of court cases addressing Article 35, we have to turn to the opinions of a number of tax officers and tax practitioners, whose views about Article 35 (though interesting) is shaped more by their perceptions than their actual encounters with Article 35 tax in practice. Here is a partial list of the responses from tax officers and practitioners who have admitted never to have come across Article 35 cases:

- Occasional or intermittent rental of both immovable and movable property;
- Occasional rental of movable property;
- Occasional rental of equipment, furniture, machinery, tools and implements by businesses that report their regular income under Schedule “C”;
- Occasional rental of private property like private vehicles/automobiles for special occasions like wedding festivities, birthday parties, etc;

- Occasional rental of tents, furniture and utensils by community organizations like *Edirs*;¹³¹
- Rental of guest houses.

These divergent responses about the scope of Article 35 are mere speculations but they are symptomatic of how little understood Article 35 tax is in practice. One issue that divides opinions (in spite of the fairly clear language of Article 35), for example, is whether Article 35 applies only to Schedule “C” taxpayers or to other taxpayers that are not otherwise subject to tax under Schedule “C.” Some tax officers and practitioners have stuck to the clear language of Article 35 and asserted that Article 35 apply to Schedule “C” taxpayers who occasionally lease property outside their regular line of business. Examples in this regard include cases in which a construction company leases construction equipment to others in lean times, or a transportation company leases its vehicles to others for a short period of time. This line of reasoning stems from the phrase in Article 35, which reads “income from the *casual rental of property (including any land, building, or movable asset) not related to a business activity taxable under Article 17*” (italics added).

There are also a significant number of tax officers who have argued that Article 35 should apply to any persons or organizations involved in casual rental of property regardless of whether these persons or organizations are engaged in business chargeable with income tax under Article 35.¹³² These tax officers have mentioned community organizations (like *Edirs*), government

¹³¹ *Edir* is an Amharic name for a traditional self-help community organization intended to help members financially and psychologically in times of bereavement.

¹³² In this connection, the 1978 Income Tax Amendment Law used language that embraced all persons and organizations deriving income from casual rental of property; Article 2(5)(d) of that Proclamation stated: “Any person or organization who derives income from casual rental of property shall pay income tax;” the qualification of the taxpayers to Schedule “C” taxpayers came later; see Income Tax Amendment Proclamation No. 155/1978.

organizations, schools, hospitals as some of those contemplated by Article 35 of the Income Tax Proclamation. According to these officers, community organizations like *Edirs* should report their income and pay tax under Article 35 whenever they rent tents, furniture and utensils; and government organizations, schools and hospitals should report their income and pay tax under Article 35 whenever they lease their buildings for special occasions like graduation and birth day parties, weddings and conferences.

Another issue that divides opinion is the modality of collection of Article 35 tax. The Circular Letter from the Ministry of Revenues quoted above suggests that Article 35 is a final withholding tax like most of the taxes mentioned in Schedule “D” of the Ethiopian income tax system. The collection of Article 35 is not clear from the language of the Proclamation itself – a matter which partly accounts for the division within the tax authorities as to how the tax is to be collected.

Many tax officers and practitioners believe that Article 35 is a self-assessment tax, to be reported by persons and organizations that lease their properties on a casual basis. These officers and practitioners cite the ambiguous language of Article 35 for their authority– “*Every person deriving income from the casual rental of property ... not related to a business activity taxable under Article 17 [Schedule “C”] shall pay tax on the annual gross income at the rate of fifteen percent (15%)*” (italics added). Anyone who reads the quoted phrases will conclude first that the person who pays Article 35 tax is the person “deriving income” (and not the person paying the rents) and second that Article 35 is an annual tax on “gross income” from casual rental of property. The literal language of Article 35 leads to an inescapable conclusion that Article 35 is a self-assessment tax, and not a withholding tax. The Letter issued by the Ministry of Revenue (quoted above) therefore clearly departs from the language of Article 35.

Those who believe Article 35 is a withholding tax, and not a self-assessment tax, cite the placement of Article 35 in Schedule “D” in support of their views. Article 35 is placed along with many final withholding taxes under Schedule “D.” Income taxes on royalties, income from technical services, income from games of chance, dividends, and interest on bank deposits are all collected by withholding agents, not the recipients of the income. The placement of Article 35 alongside these withholding taxes must have accounted for the view that Article 35 is as much a withholding tax as any of these taxes. It must, however, be noted that Schedule “D” income taxes are not comprised solely of “withholding taxes.” Some of the taxes included in Schedule “D” are self-assessment taxes – capital gains taxes and the tax on windfall profits (thus far) are self-assessment taxes. But the dominant feature of Schedule “D” is that it is a withholding tax schedule. The Letter of the Ministry of Revenues (cited above) must have been informed by this nature of Schedule “D” when it characterized Article 35 as a final withholding tax, to be collected by the payors of rental income, rather than the recipients of the income.

Those members of the tax administration who believe that Article 35 is a self-assessment tax are convinced that this fact is in part responsible for the rarity of reporting of this type of income in practice. They argue that those businesses that derive income from casual rental of property report the income (if they ever) as part of their business income, not separately, as seems to be required by Article 35 of the Income Tax Proclamation. They note that businesses are in the habit of reporting such income under headings like “other income” or “miscellaneous income” of the business under Schedule “C.” According to them, the objective of taxing “income from casual rental of property” separately from “business income” has not been successful in practice because most accountants and auditors that prepare financial accounts for businesses opt to report this type of income as “business income” under Schedule “C.” Given the higher tax rates

of Schedule “C,” the accountants and auditors may also have seen this as forestalling any future attempts by the tax authorities from characterizing the income as one falling under Schedule “C.”

The practice of including “income from casual rental of property” as part of the “business income” under Schedule “C” contrary to the language of Article 35 and the acquiescence of the tax authorities in this practice is perhaps an acknowledgment of the sheer absurdity of splitting the income of business into “business income” (subject to tax under Schedule “C”) and “income from casual rental of property” (subject to tax under Schedule “D” – Article 35). Whether this practice has won over both parties as a matter of its logical plausibility or is a result of some practical coincidence, it exposes some of the serious gaps in the structural organization of the Ethiopian income tax system. It also opens the income tax system to tax planning opportunities for businesses to place their “income from casual rental of property” either as part of the business income under Schedule “C” or separately under Schedule “D,” depending on which course of reporting yields lower tax burdens for the business.

In any event, it is now agreed that the reporting of the income under Article 35 (withholding or otherwise) is rare in practice. The tax authorities have admitted as much in a Directive which grants 100% waiver (tax amnesty) to those who report this type of income.¹³³ The Directive gives a 100% waiver from administrative penalties to those businesses that voluntarily declare their annual income from casual rental of property unrelated to the rest of their business.

¹³³ Ministry of Revenues, Directive to Waive Tax and Customs Penalties No. 5/1996 E.C., in Amharic, unpublished, Article 5(3)

በአዋጅ ቁጥር 286/94 አንቀጽ 35 እንደተመለከተው ግብር ከሚከፈልበት የንግድ ሥራ እንቅስቃሴ ጋር በማይገናኝ አካታን ንብረት አልፎ አልፎ በማከራየት ገቢ ያገኘ ሰው በዚህ ዓይነት ያገኘውን የዓመት ጠቅላላ ገቢ ራሱ አሳውቆ ግብሩን የከፈለ ወይም የግብር ውሳኔ ማስታወቂያ በደረሰው በ30 (ሦላሳ) ቀናት ውስጥ ፍሬግብሩን ከፍሎ ከተገኘ፤

This reads:

Any person who derives income from casual rental of property unrelated to [her] business and voluntarily declares such income or agrees to pay the tax within 30 days of receiving assessment notification... shall receive a 100% waiver of the penalty due for the delay on the declaration of such income (author’s translation).

It can be surmised that the Authorities gave such generous waiver largely because of the fact that few (if any) taxpayers involved reported such income in accordance with Article 35 of the Income Tax Proclamation. Unfortunately, the Directive does not shed much light on this source of income and left the Proclamation with as much uncertainty as before.

f. Withholding Tax on Interest from Bank Deposits – Article 36

The withholding tax on interest from bank deposits can only be understood from the perspective of Ethiopia’s approach to interest income prior to 2001 income tax reforms – the first time withholding tax on interest on deposit accounts was introduced. Income from interest generated by businesses was the subject of “business income” taxation from the early times but one type of interest was exempted specifically by law – interest derived by persons from bank deposits.¹³⁴ The exemption of interest on bank deposits was justified by a policy of encouraging people to save in Ethiopia’s fledgling banking sector.¹³⁵

In addition to exempting “interest on bank deposits,” Ethiopia’s income tax laws have for a long time imposed special restrictions upon the deductibility of “interest” as expense – perhaps as an

¹³⁴ See Income Tax Proclamation No. 173/1961, Article 18(e); see also Article 12(a) of the same Proclamation which mentions “interest” as the subject of Schedule “C” income taxation.

¹³⁵ See, for example, Muzondo, Courneyea, Brooks and Amina, Ethiopia: Introduction of a VAT and Presumptive Income Tax and Reform of the Income Tax, p. 48

anti-avoidance measure. For a long time, businesses subject to income tax under Schedule “C” were allowed to deduct interest as expense only if they raised loans from recognized financial institutions.¹³⁶ Businesses that raised loans from foreign financial institutions were subjected to the additional duty of withholding tax from the interest paid to non-resident financial institutions in order to deduct the interest paid to foreign financial institutions as business expense under Schedule “C.”¹³⁷ The Income Tax laws of Ethiopia supported both saving in the financial institutions and borrowing from financial institutions by exempting the former and providing deductions for interest paid only on the latter.

The exemptions for “interest on bank deposits” as well as the restrictions on deduction of interest as business expenses drew criticisms from those who believed that the income tax policy should be neutral to various sources of income and allow deduction for all kinds of business expenses.¹³⁸ Critics of the exemption charged that the exemption was selective, discriminatory and distortionary.¹³⁹ They charged that this privilege discriminated against non-preferred sectors (non-banking sectors) as interest derived from loans to businesses by businesses was to be included in the taxable business income and be subject to tax under Schedule “C.”¹⁴⁰

The Government of Ethiopia partially¹⁴¹ relented on exemption of “interest on bank deposits” by introducing a final withholding tax first in the 2001 income tax amendment¹⁴² and maintaining that in the 2002 Income Tax Proclamation. But the Government insisted on its policy of

¹³⁶ See Income Tax Proclamation No. 173/1961, Article 17

¹³⁷ Income Tax Regulations No. 258/1962, Article 21(b) (ii),

¹³⁸ Muzondo, Courneyea, Brooks and Amina, Ethiopia: Introduction of a VAT and Presumptive Income Tax and Reform of the Income Tax, p. 48

¹³⁹ Ibid

¹⁴⁰ Ibid

¹⁴¹ Partially, because the withholding tax on interest is still very low compared to other withholding taxes

¹⁴² The withholding tax on “deposit interest income” was first introduced in the Income Tax Amendment Proclamation of 2001; see Income Tax (Amendment) Proclamation No. 227/2001, Article 40(d)

restricting the deductibility of “interest” as a business expense. The Income Tax Regulations of 2002 maintained the old restriction upon the deductibility of interest – namely, that interest would be deductible to Schedule “C” businesses only if the loan were raised from recognized financial institutions. Interest paid to recognized foreign financial institutions is subject to the additional duty of a Schedule “C” borrower withholding 10% final withholding tax from the interest paid.¹⁴³

Under the current structural arrangements of the Ethiopian income tax system, interest, as an income is the subject of taxation under three distinct situations. The first is the interest accruing from deposit accounts, which is the subject of withholding taxation at the rate of 5% under Article 36 of the Income Tax Proclamation. The second form of interest is an interest paid to non-resident financial institutions recognized by the National Bank of Ethiopia as lending institutions. This form of interest is subject to a 10% final withholding tax rate.¹⁴⁴ The withholding tax on interest paid to non-resident financial institutions is conditional. If the Ethiopian resident payor of interest (the borrower) wishes to deduct the interest as a business expense, it must fulfill the obligations of withholding 10% from the interest paid to a non-resident financial institution. If the Ethiopian resident payor of interest chooses not to seek deduction of the interest as a business expense, it appears that it does not have the obligation to withhold 10% from the interest paid to a non-resident financial institution. A non-resident financial institution can derive interest from loans to Ethiopian resident business and the 10% withholding tax does not attach as long as the Ethiopian borrower has agreed not to claim a deduction of the interest from its gross income under Schedule “C.”

¹⁴³ Income Tax Proclamation No. 173/1961, Article 17

¹⁴⁴ Income Tax Regulations No. 78/2002, see Article 10

The third instance in which interest becomes a subject of taxation is when it is received by a Schedule “C” taxpayer from loans to others as part of its business. Banks and other financial institutions derive a significant portion of their income in the form of interest. Some business involved in the leasing of equipments under hire-purchase, finance lease or operational lease agreements also derive income from interest as their lease or sale of equipments is often accompanied by extension of loan. Many other businesses are also involved in lending to other businesses in exchange for payment of interest. These types of interest are to be reported as business income under Schedule “C” of the Ethiopian income tax system. The following table shows the taxation of interest under different scenarios.

Table 8.3: Taxation of various types of interest income

Type/source of interest income	Tax Rate	Schedule of Income Tax
Interest on deposit accounts	5%	Schedule “D”
Interest derived from business loans and interest derived by financial institutions	Progressive if the earner is a sole proprietor or 30% flat rate if the earner is a company	Schedule “C”
Interest derived by non-resident financial institutions	10% final withholding if the payor chooses to deduct the interest as an expense or 0% if the payor chooses not to claim deduction of the interest as an expense	Not designated
Interest derived by private individuals from private loans	Not taxable	Not taxable

As can be clearly seen from the schematic table above, interest income is the subject of variable tax rates depending on the source of interest and the recipient of interest income. Ethiopian income tax policy (to the extent that policy can be derived from the language of the law) is one of extending incentives to people who deposit and save their money in recognized financial institutions and of discouraging inter-business or inter-company loans through higher tax rates and denial of deductions.

Companies subject to income tax under Schedule “C” are punished on both ends should they choose to borrow from other companies that are not financial institutions. Companies that derive interest from inter-company loans are required to include the interest in their business income, which is subject to 30% tax, but the companies that pay these kinds of interest are not entitled to deduct the interest as an expense unless the lending company is a recognized financial institution. This restriction, needless to say, is very discriminatory. It discourages (and is probably intended to discourage) inter-company loans and forces those companies that have excess liquid money to put their money in the banks for fear of the higher tax rate on interest from business loans.

While Ethiopian Government relaxed its policy of total exemption of “interest on bank deposits” in its income tax reforms of 2001 and 2002, it has yet to respond to the critics’ charge that current income tax policy of Ethiopia on deduction of interest expense is discriminatory against those taxpayers who raise loans from businesses others than lending institutions. Those businesses that rely upon interest derived from business loans are therefore subject to the double jeopardy of having to include their interest income in a business income (with higher tax

rates) and of being denied deductions for interest paid on loans raised from other businesses.¹⁴⁵ The rules are so starkly stacked against these kinds of loan transactions that the message is very clear. Taxpayers must opt for a deposit of their money with financial lending institutions if they are to receive favorable treatment for the interest accruing therefrom and raise money only from financial institutions if they seek to obtain deductions for interest expense on loans. As rightly noted by the critics, this policy is evidently discriminatory and creates lots of distortions on the choices businesses make when they seek to place their money or raise money from others.

Since the rules are so overwhelmingly favorable to loans from and deposits in financial institutions, they might encourage taxpayers to channel their loans through financial lending institutions just to benefit from the reduced tax rates on interest income and the deduction of interest expenses from financial lending institutions. In effect, the current rules heavily favor those taxpayers that are able to strike a deal with financial institutions and discriminate against those businesses that are unable to raise loans from financial institutions. Those taxpayers that are big enough to strike special relationships with financial lending institutions will certainly come out favorably in income tax terms compared to other businesses that are not so well connected with financial institutions. Some members of the tax authorities have downplayed the effect of this discrimination in practice as it is unlikely for many businesses to hold saving deposit accounts in the banks.¹⁴⁶ They assert that most businesses prefer to have running current accounts which do not bear interest.

¹⁴⁵ Many within the tax authorities believe that it is not the business of businesses other than financial institutions to lend money and derive interest

¹⁴⁶ Interviews with Ato Girma Tafesse, ERCA, Branches Directorate, May 09, 2012; Ato Girma Balcha, ERCA, Large Taxpayers' Office, August 20, 2012

The use of withholding taxation of interest can be justified by the desire of the government to use withholding as a scheme for capturing hard-to-tax income and obtaining a reliable cash flow as income is earned. If that were the interest of the government, the scope of the provision that charges interest needs to be broadened as to capture all types of interest, as that term is conventionally known. A standard definition of interest in the literature is that of “compensation earned by a creditor for the use of his or her money during the period of the loan.”¹⁴⁷ It is very clear that the scope of “interest” in Article 36 is far narrower than the standard definition of interest in the literature.

g. Taxation of Capital Gains from Transfer of Investment Property –

Article 37

The idea of taxing gains from the transfer of capital, which raged in the rest of the world for a long time, did not reach Ethiopia until a special income tax law charging gains from the transfer of some types of capital assets was issued in 1994.¹⁴⁸ If gains from the transfer of capital assets were at all the subject of income taxation before 1994, they were considered as part of the business profits of taxpayers subject to income taxation under Schedule “C.” Non-business or private capital gains were excluded from the income tax more by omission than specific exemption prior to 1994.

The introduction of the first tax on gains from transfer of capital in 1994 was justified interestingly by appeals to tax equity. The 1994 capital gains tax law stated that “levying tax on all gainful activities in the [Ethiopian] economy” would enhance the equitability of the tax

¹⁴⁷ Burns and Kreyer, *Taxation of Income from Business and Investment*, p. 615, foot notes 79 and 80

¹⁴⁸ The first law to mention taxation of gains from the transfer of capital was the 1994 proclamation for the payment of tax on gains from capital; see *Payment of Tax on Gains from Capital Proclamation No. 108/1994*

system.¹⁴⁹ The 1994 capital gains tax law selected three types of capital assets as chargeable with the tax upon transfer: shares, bonds and urban houses.¹⁵⁰ The 1994 tax law bore all the signs of a capital gains tax law as the tax was to be levied upon the difference between the sales price and the original cost of these assets adjusted for inflation.¹⁵¹ The tax rate was 30% for all the assets specified and the capital gains tax applied regardless of whether the asset was held by an individual or a business or a company.¹⁵²

Structurally, the 1994 capital gains tax law was issued as a special tax law separate from the main income tax system, but many rules of the main income tax law of the time were made applicable by cross-references as the 1994 law itself contained only a few charging provisions, leaving the administrative and procedural matters of tax enforcement to the main income tax law at the time. Although capital gains taxation was not placed in any of the schedules at the time, it was for all purposes and intents considered part of the main income tax system of Ethiopia. The 2002 Income Tax Proclamation completed the full incorporation of the capital gains tax system in the main body of the income tax system by designating capital gains as one of the miscellaneous sources of income chargeable with tax under Schedule “D.”

The 2002 Income Tax Proclamation included capital gains in Schedule “D” – a schedule which has increasingly been used in recent income tax reforms of Ethiopia for incorporating new sources of income. The 2002 Income Tax Proclamation continued the expansive trend established by the 1994 capital gains tax law, but it shrank the capital assets that are to be

¹⁴⁹ See Payment of Tax on Gains from Capital Proclamation No. 108/1994

¹⁵⁰ *Id.*, Article 3

¹⁵¹ *Id.*, Article 5

¹⁵² Muzondo, Courneyea, Brooks and Amina, *Ethiopia: Introduction of a VAT and Presumptive Income Tax and Reform of the Income Tax*, p. 52

subject to capital gains tax upon transfer to: i) buildings held for business and ii) shares.¹⁵³ Gains from the transfer of buildings held for residence, which had previously been subject to capital gains tax under the 1994, were now exempted by the 2002 Income Tax Proclamation.¹⁵⁴ This has the effect of exempting the transfer of all non-business capital assets from taxation under the current schedular system of income taxation in Ethiopia.

Although capital gains are mentioned in name only under Schedule “D,” it is important to remember that the current income tax regime of Ethiopia applies tax upon the transfer of capital assets under two different income tax regimes or schedules. The transfer of capital business assets other than buildings is subject to ordinary income tax under Schedule “C.”¹⁵⁵ The tax treatment of the transfer of capital assets under various scenarios is shown in table 9.4 below.

Table 8.4: Treatment of Gains from the Transfer of Capital Assets under the Current Income Tax Regime of Ethiopia

Type of Capital Asset	Treatment as	Schedule of the Income Tax	Tax Rate
Shares/stocks	Capital gain	D	30%
Buildings held in business	Capital gain	D	15%
Buildings held for residence	Exempted	NA	NA
Other business capital assets (e.g. vehicles, machinery)	Ordinary Schedule “C” income	C	30% if the transferor is a company; progressive if the

¹⁵³ Income Tax Proclamation No. 286/2002, see Article 37(1)

¹⁵⁴ Id, see Article 37(2)

¹⁵⁵ Id, see Article 24

			transferor is a sole proprietor
Non business capital assets (e.g., private vehicles)	Not taxable	NA	NA

The transfer of assets, which are currently specified in the Ethiopian income law as subject to depreciation, are treated under Schedule “C” except when the asset transferred is a building.¹⁵⁶ The transfer of business capital assets like vehicles, machinery, tools and implements as well as furniture held by businesses results in business income tax, if their transfer realizes income. The transfer of business capital assets like vehicles, machinery, tools and implements is treated as subject to the depreciation provisions when their transfer results in a loss.¹⁵⁷ Only one of the business capital assets – that is, buildings – is taken out of the business income tax schedule (C) and treated as a capital gains and loss matter when it is sold, exchanged or transferred in any manner. This means that a building which is treated as a Schedule “C” matter for depreciation purposes is transformed into a capital gains and loss matter when it is transferred by the business.

This special transformation of a building from a capital expenditure (for depreciation purposes) under Schedule “C” into a capital gains or loss matter under Schedule “D” leads to some arbitrage of the rules under these two schedules, resulting in (perhaps unintended) tax benefits for some taxpayers. For example, corporate taxpayers under Schedule “C” may opt to receive depreciation allowance under Schedule “C” and then transfer the building and pay tax at much lower tax rates (15%) under Schedule “D.” Other things remaining the same, therefore,

¹⁵⁶ Id, see Articles 23 and 24

¹⁵⁷ Id, see Articles 23(7) (8) and (9)

companies that are aware of the tax benefits will hold onto a building until it is fully depreciated (to take advantage of the 30% benefit of deductions) and then sell it to take advantage of the lower capital gains tax rate (15%). Whether the tax reformers were aware of the tax planning opportunities was doubtful, but it remains to be the case that the lower tax rate upon the transfer of buildings has resulted in tax benefits for those companies that own significant number of buildings in their business. As shall be seen below, due to problems of valuation, the transferors of buildings may be able to avoid capital gains tax significantly while taking advantage of the higher corporate tax rate under Schedule “C.”

i. The Taxation of Capital Gains in Practice

The taxation of capital gains is now close two decades old, but the practice of capital gains taxation has at best been circumstantial. All respondents agree that the capital gains provisions of the Ethiopian income tax system are open to massive tax avoidance schemes. These avoidance schemes are not even sophisticated enough to elude the naked eyes of those in the tax administration, but the authorities appear powerless to do anything about them.

The taxation of building transfers is plagued by the absence of detailed rules governing the valuation of buildings for capital gains tax purposes.¹⁵⁸ The value of the building is at the moment the voluntary price of the building agreed upon by the parties to the contract.¹⁵⁹ The parties conveniently agree the price of the building to be so close to the historical cost of the building so as to avoid paying capital gains tax. The tax authorities know that the value of

¹⁵⁸ Interviews with Ato Mekonnen Ayele, Legal Advisor to Director of ERCA, March 28, 2012, Ato Girma Tafesse, ERCA Branches Directorate, May 29, 2012, Ato Abreha Wubet, ERCA Branches Directorate, May 29, 2012 and Ato Girma Cherinet, ERCA, Tax Audit, May 23, 2012

¹⁵⁹ Ibid

buildings almost always appreciate but they are often helpless to do anything about it in the absence of rules that empower them to override the price fixed by the parties. A directive issued to implement the capital gains tax provisions permits the tax authorities to resort to other ways of determining the value of the assets where the assets are transferred through donations, and the authorities of course do not hesitate to use other methods of valuation when the contract is one of donation. Indeed, some ill-informed transferors of buildings bring their contract of donation under the misguided assumption that the value of the property would be zero (therefore entails no capital gains taxes), but upon being informed that this gives the authorities the power to use indirect methods of valuation, they revert to a contract for consideration in which the value of the property is fixed very close to the historical cost of the property to avoid capital gains taxation. In effect, the parties rescind their original contract of donation and replace it by a contract of sale when they learn that they are better off structuring the transfer as one of sale rather than of donation to keep the power of the tax authorities at bay. The tax administrators admit to being powerless to do anything even in the face of clear intentions to avoid capital gains tax.

The situation is similarly dismal with respect to transfer of shares. Most respondents agree that the biggest handicap to the implementation of capital gains tax upon shares is the absence of stock markets in Ethiopia. A common practice in share transfer transactions is one of transferring shares at their par value to ensure that capital gains taxes do not attach to the transfer at all. The actual value of the transfer of shares is often concealed (and successfully as that) from the tax authorities. Some tax administrators and auditors have at times reacted by trying to estimate the value of shares by reference to the retained earnings of the companies whose shares are being traded among parties. Some tax administrators argue that these

practices are justified by the reasonable expectation that the transferor is transferring her right to the retained earnings of the company and the unlikely scenario that the transferor is transferring shares without any consideration. The auditors examine the financial accounts of the company and collect information about the earnings which were not distributed as dividends. They then assume that the shares represent a portion of those retained earnings. This practice is very controversial and has not even secured the consensus of all the tax administrators involved. The legal basis for it is even more tenuous. The provisions of the Ethiopian income tax laws do not authorize the authorities to resort to extracting the value of shares from the retained earnings. The authorities have developed these presumptive rules of valuation in a desperate attempt to prevent parties from avoiding paying the capital gains tax by under-pricing the value of shares. These practices are successful only because the tax authorities are powerful to enforce their own side of the interpretation of the law and also because the actions of the authorities are rarely challenged in courts.

The position of the tax authorities, taken purely from the vantage point of the law, is very controversial, but at least one court has supported the move by the tax authorities to estimate and derive the value of shares from the retained earnings of the company whose shares are being transferred. In *ERCA v. Matador Addis Tyre PLC*,¹⁶⁰ ERCA set aside the transfer of shares at par value and assessed that the former shareholder owed capital gains taxes, deriving the gains from the retained earnings of the Company whose shares were transferred. Horizon Plantations Ethiopia PLC, a company owned by the Ethiopian tycoon Mohammed Ali Al Amoudi, acquired 69pc of Matador's shares from Matador AS, a Slovak company which itself acquired the shares from the Ethiopian Government in 2004 when a joint venture agreement

¹⁶⁰ *ERCA v. Matador Addis Tyre*, Federal App/File/No. 66470, Federal Supreme Court, *Sene* 06 2003 E.C., in Amharic, unpublished

was signed in which the Ethiopian Government retained 31pc of the ownership of the company.¹⁶¹ ERCA examined the accounts of Matador Addis and found that the company retained earnings for several years and the shareholders transferred the shares in the Company without receiving any distributions. ERCA derived the value of the shares not from the agreement of the parties but from the retained earnings and sent the shareholders a tax assessment notification. The shareholders objected to this assessment and appealed to the Review Committee. The Committee agreed in principle with the position of ERCA but reduced the amount of capital gains taxes due. The shareholders appealed to the Tax Appeal Commission which took the position that capital gains could not be derived from retained earnings and insisted that share prices were fixed by the agreement of the parties. The matter finally went to the Federal Supreme Court which agreed with the position of ERCA that capital gains could be derived from the retained earnings of the company and should be used for the assessment of the capital gains tax.

This is very recent decision and could signal a sea change in the way capital gains are thought of up to now. It also confers significant powers upon ERCA to revise the agreement of the parties whenever it has the evidence that the company whose shares are transferred has retained earnings. However, since the decision of the Federal Supreme Court possess no precedential value, the positions are liable to be reversed in future decisions until the Cassation Division of the Federal Supreme Court hands down a decision that has some precedential value. It will nonetheless bolster ERCA's recent tendencies to extend its successes in individual cases to similar other cases at the national level.

¹⁶¹ See Tamirat G. Giorgis, Al-Amoudi's Horizon Acquires Matador-ATC's 69pc for \$18m, Addis Fortune, vol. 11, No. 562, February 06, 2011

The recent attempts by ERCA to derive the value of shares from the retained earnings of companies are fraught with a number of problems. The agreement of the Federal Supreme Court notwithstanding, there is no legal basis for ERCA's powers to override the agreement of the parties and impose its own idiosyncratic computation of capital gains upon the parties. None of the income tax laws confer a specific power upon ERCA to reject the agreement of the parties and specifically to derive the value of shares from the retained earnings of the company whose shares are being transferred. The fact that the absence of rules has allowed parties to easily avoid the payment of capital gains taxes is no ground for imposing a special form of derivation of capital gains, i.e., from the retained earnings of companies.

Some of the positions of ERCA in this regard are also contradictory. We have seen above (in connection with dividends) cases in which ERCA attempted to collect dividend taxes from companies that retained dividends for years (**see above**). These cases illustrate that ERCA is trying to collect taxes from the same source: retained earnings. The jury is still out on how ERCA can sometimes draw upon retained earnings as the basis for computation of dividend taxes, which are after all taxes upon distributed dividends, and capital gains taxes, which are taxes upon the appreciation of capital.

In *Seferian Co.* case, ERCA assessed dividend taxes on the basis of the retained earnings of that company (**see above**). In *Matador Addis* case, ERCA assessed capital gains taxes on the basis of the retained earnings of Matador Addis. Since *Seferian Co.* preceded *Matador Addis* in time, one would have expected ERCA to use *Seferian Co.* as a benchmark for collecting dividend taxes upon undistributed retained earnings of *Matador Addis*, but for some mysterious reason, ERCA did not choose to follow that path. Instead, ERCA took a position (which found agreement with the Supreme Court) that capital gains could be derived from retained earnings even though

the parties agreed to transfer shares at par value. These positions of ERCA are inconsistent, although one might argue that its positions in Matador Addis were motivated by the desire to impose taxes upon transferors of shares.¹⁶²

In any event, it is agreed by many respondents that capital gains taxes are not being collected from transactions potentially attracting capital gains taxes under the law.¹⁶³ It is also agreed by all the parties and conceded by the tax authorities that the basic rationale for the introduction of capital gains taxes into the Ethiopian income tax system, viz., the broadening of the tax base and increasing the equitability of the tax system, has not been successful. The major reasons for the failure of the capital gains taxation, as garnered from various sources, are the following:

- i) The absence of detailed provisions in the law that help in countering tax avoidance schemes by parties to transfer of assets;
- ii) The absence of a stock market from which the objective value of shares may be derived;
- iii) The fact that the tax authorities lack legal power to apply presumptive methods of valuation when they suspect that the value of the transfer does not reflect the market value of the assets transferred.

h. Windfall Profits Tax – 2010 Income Tax Amendment Proclamation

Windfall profits are the latest addition to the repertoire of Ethiopian income tax system. Windfall profits became the target of the Ethiopian income tax system as a result of a particular incident. The Government was only led to the introduction of a special income tax (special in

¹⁶² ERCA's ulterior motive to generate more revenues through capital gains taxes (which are currently 30% compared to dividends, which are 10%) could not be ruled out.

¹⁶³ Official revenue figures are not disaggregated by sources and it is impossible to know how much is being collected from capital gains sources at the moment

every sense) after it learnt that its sudden devaluation of the Ethiopian currency (Birr) back in 2010 yielded windfall profits for banks and other financial institutions holding significant amounts of foreign currency at the time of the devaluation.¹⁶⁴ Not to be upstaged in its game, the Government issued a windfall profits tax law after the devaluation of the Ethiopian currency and sought to recapture whatever windfall profits the banking sector was able to garner as a result of the devaluation.

The manner in which the Government at the time sought to recapture the windfall profits of the banking sector was perhaps unprecedented in the history of income taxation in Ethiopia. The first legislative measure of the Government was to pass a Proclamation which added “windfall profits” to the catalogue of sources chargeable with income tax under the main Ethiopian income tax system.¹⁶⁵ But this first measure made no mention of the fact that the Government was drawn into issuing a new tax legislation as a result of the windfalls gained by the banking sector as a result of the sudden devaluation of the Birr by the National Bank of Ethiopia. The Government opened the way for that by providing a broad definition of “windfall profits” and then conferring enormous powers upon the Ministry of Finance and Economic Development of defining and designating cases in which windfall profits” may be said to arise. In the amendment Proclamation, “windfall profits” are defined in an open-ended language as:

... profit obtained by any person as a result of a change (sic) occurred (sic) in local or international economic or political situations without its (sic) own efforts.

Taking the cues from the Proclamation, the Ministry of Finance and Economic Development issued a Directive which designated the “windfall gains” from the devaluation of the Birr three

¹⁶⁴ Taddese Lencho, *The Ethiopian Tax System: Excesses and Gaps*, p. 339

¹⁶⁵ See a Proclamation to Amend the Income Tax Proclamation No. 693/2010

months before the Directive as “windfall profits” and slapped them with 75% tax rate.¹⁶⁶ This was not all. The Directive also stated that banks that made “windfall profits” from the devaluation of the Birr in June 2010 would be required to add the remaining/residual income in their annual income under Schedule “C” (profit tax) and charge it with the 30% corporate tax under Schedule “C.” In effect, the overall aim of the windfall tax laws was to recapture the whole of the windfall profits from the banking sector which found itself with the opportunity of gaining lots of profits as a result of the action of the Ethiopian Government.

The windfall profits tax of 2010 was unprecedented for a number of reasons. First, at least with respect to the windfall profits from the devaluation of the currency, the tax was a one-off applying to a specific incident. Second, again with respect to windfall profits from the devaluation of the currency, the tax law was unrepentantly retroactive.¹⁶⁷ Third, the windfall profits tax law gave unprecedented powers to the Ministry of Finance and Economic Development to designate cases as well as the rates for windfall profits in the future –raising some serious issues of tax legality.¹⁶⁸

Since the windfall profits tax of 2010 was open-ended, it is up to the Ministry of Finance and Economic Development to expand the specific cases in which windfall profits are merited. The Ministry of Finance and Economic Development has so far acted in only one instance (that of windfalls from devaluation of currency), and it is impossible to speculate in what directions the Ministry may expand the reach of windfall profits taxation in Ethiopia. It may be that the windfall profits taxation had run its course with the full recovery by the Government of all the

¹⁶⁶ Federal Democratic Republic of Ethiopia, Ministry of Finance and Economic Development, Directive to Determine Tax on Windfall Profits obtained by Banks No. 29/2003 E.C., in Amharic, unpublished

¹⁶⁷ For possible questions of legality, see Taddese Lencho, *The Ethiopian Tax System: Excesses and Gaps*, p. 339

¹⁶⁸ *Ibid*

profits gained from its devaluation of the Ethiopian currency back in 2010. But at least legislatively it is quite possible for the Ministry of Finance and Economic Development to continue to expand the frontiers of Ethiopian income tax system through the vistas opened by the Windfall Profit tax law of 2010.¹⁶⁹ The only constraint on the part of the Ministry is to convince the public whether the new profits qualify as “windfalls” in a semantic sense.

IV. Tax Rate Differentials under Schedule “D”

The existence of a separate schedule for final withholding taxation upon some sources of income is wholly understandable given the administrative limitations of the Ethiopian tax system.¹⁷⁰ Ethiopia is not alone in employing final withholding taxes on some types of income. A number of African countries employ final withholding taxes on some types of income, the most common of which are interest, dividends and royalties.¹⁷¹ While the use of final withholding taxes is justified on administrative grounds, the application of wildly disparate tax rates on various sources of income subject to final withholding taxation under Schedule “D” is something that has been hard to justify. The withholding tax rates (many of which are final) range from 5% for “royalties” and “interest on bank deposits” to 75% for “windfall profits from the devaluation of ETB” in 2010 (the latest addition to Schedule “D” income).

¹⁶⁹ There were rumors extending the windfall profit tax regime to fuel distribution companies that stood to benefit from sudden revisions of fuel tariffs; see Mahlet Mesfin, Taxman to Probe Potential Windfall Profits to Petroleum Distributors, *Fortune*, vol. 13, No. 633, June 17, 2012.

¹⁷⁰ As Richard Bird writes “all payments from corporations to individuals for the use of movable capital – whether labeled “interest,” “dividends,” or “royalties” – should be subject to withholding, *preferably at a significant uniform rate*,”(italics added); see Bird, *Tax Policy & Economic Development*, p. 104

¹⁷¹ See Namubiru, *Uganda – Individual Taxation*, Section 1.5; Bill Page, *Tanzania – Individual Taxation*, Section 1.5; Kennedy Munyandi, *Zambia – Individual Taxation*, Section 1.5

These tax rate differentials have never been publicly justified through clearly articulated tax policy statements from the governments, but the differentials appear to reflect some subjective sentiments regarding the different sources of income. Interviews with those involved in the tax reform process confirm these subjective sentiments.¹⁷² While the discussions leading up to the revision of the income taxes in 2002 were not unfortunately well-documented, discussions with those involved in the process reveal that the tax rate differentials were the product of the subjective assessments of public officials about the different sources of income currently subject to tax under Schedule “D.” Historical factors also seemed to have played some role in the decisions regarding the specific withholding tax rates upon some sources of income. It is, for example, recalled that royalties were the subject of a high withholding tax rate since 1978 income tax reforms. We have seen above how this high tax rates provoked public protests particularly from the highly vocal writers’ community and how these protests eventually forced the governments (both the previous and current governments) to suspend the high tax on “royalties” (at least on royalties payments by publishers, theatres and cinemas) until “studies were conducted and lower tax rates were proposed.”¹⁷³ It is in the midst of this period of suspension that income tax reforms of 2002 came about, and “whether the studies were conducted” or not, the income tax reforms slashed the withholding tax rates upon “royalties” by a whopping 35%. The controversies that accompanied the imposition of 40% of withholding taxes upon “royalties” affected the current tax rates, and the lower tax rates are in response to the public outcry after the 40% tax rates of the 1978 income tax law.

¹⁷² Interviews with Ato Wasihun Abate, Legal Advisor to Minister of Finance and Economic Development, July 13, 2012; Ato Reta Alemayehu, former legal advisor of ERCA, November 10, 2010, Ato W/Gebriel Naizghi, former deputy director of ERCA, June 23, 2011

¹⁷³ See, royalties, above

The withholding taxation upon “interest” was a product of the previous stance of the government under prior income tax laws, to exempt “interest” paid by banks, and the argument particularly from the technical missions of the IMF that such exemptions were discriminatory and distortionary.¹⁷⁴ Although the government tax reformers were convinced that this was discriminatory, they continued to believe that the lower tax rate upon “interest from bank deposit” would encourage saving in the country.¹⁷⁵ In other words, they viewed the lower tax rates as incentive schemes, which is not surprising in view of the way they saw the income tax not just as a tax law but as an incentive scheme for certain kinds of investment.

The story of the withholding tax upon “income from games of chance” also confirms that the tax rates differentials reflected more about the subjective sentiments of the tax reformers than about some firm conviction about tax policies. It is again to be recalled that the original withholding tax rate upon “income from games of chance” was 10%.¹⁷⁶ This tax rate served as final tax rate until 2002, when the tax rate was slightly raised to 15%. Those who were involved in the discussions of the tax reforms of 2002 recall that the tax rates were raised after some members argued that the recipients had not sweated for this source of income and therefore a higher tax rate (higher than 10% at least) was justified, but they did not raise the tax rate higher than 15% because they feared that it might discourage people from buying lottery tickets.¹⁷⁷ Their fear was justified in view of the fact that revenues from lottery tickets constituted one important source of revenue for the [Federal] Government.

¹⁷⁴ See Muzondo, Courneyea, Brooks and Amina, Ethiopia: Introduction of a VAT and Presumptive Income Tax and Reform of the Income Tax, p. 48

¹⁷⁵ Ato Wasihun Abate, Legal Advisor to the Minister of Finance and Economic Development, July 13, 2012; Ato Reta Alemayehu, former legal advisor of ERCA, November 10, 2011

¹⁷⁶ See a Proclamation to Amend the Income Tax No. 155/1978

¹⁷⁷ Interviews with Ato Reta Alemayehu, former legal advisor of ERCA, November 10, 2011, and Ato Wasihun Abate, Legal Advisor to the Minister of Finance and Economic Development, July 13, 2012

While the tax rate differentials were at least informally justified by appeals to public policies of encouraging certain types of investment income, they are bound to discriminate among different sources of income and create opportunities for tax planning. The tax rate differentials between “royalties” (subject to 5% withholding tax) and “income from technical services” (subject to 10% withholding tax) will create incentives for businesses to characterize borderline payments as “royalties” rather than as “income from technical services.” Similar opportunities may present themselves in respect of other sources of income subject to tax under Schedule “D” of Ethiopian income tax.

The most serious charge against the tax rate differentials, however, is one of neutrality towards various sources of income and equitable treatment of taxpayers that derive income these various sources. The widely divergent tax rates applicable to various sources of income are not justified at all by the policy of encouraging certain types of income. Since the tax rates are the product of subjective assessments of tax reformers at one point of tax reform process, it is highly doubtful if these differentials are the result of serious deliberations of Ethiopian tax policy or the product of subjective imaginations of some public officials at the time of tax reforms. Whatever the truth may be, it is now incontestable that the structure and organization of Schedule “D” income tax is a source of so much administrative complication in practice as well as of inequity among various categories of taxpayers.

CHAPTER NINE

CONCLUSION AND RECOMMENDATIONS

I. Conclusion

The Ethiopian income tax system has always been defined by its schedular structure since the modern income taxes were introduced in the 1940s. Given the severe administrative limitations of Ethiopian tax administration for much of the modern history of taxation in Ethiopia, no one could have begrudged Ethiopia's choice of a schedular income tax structure over its counterpart. Over the course of six decades, the schedular organization of the income taxes has reigned supreme, its suitability uncontested largely because it is taken as self-evident that the schedular income tax structure is the only structure that Ethiopia can afford.

The main income tax system of Ethiopia is organized around the four schedules, designated by letters A, B, C and D, each with its own domain defined by sources: income from employment, income from rental of buildings, income from business and professional, vocational occupations, and income from miscellaneous sources respectively. The schedules might sound like mere alphabetical labels designating various sources of income, but it will soon become evident that the schedules determine not just the various sources that are chargeable with income tax but also the methods of computation, the breadth of taxable bases, the income brackets and tax rates, methods of assessment and eventually the burden of income tax liability.

The income tax schedules are the lens through which the Ethiopian income tax system reads, characterizes and determines whether a certain income is taxable at all, when, how and at what rates. With all their imperfections, the income tax schedules have been used to allocate income

tax burdens among employees, lessors of buildings and other types of property, businesses, professionals, earners of miscellaneous income like royalties and dividends. The critical question asked in this dissertation is whether the schedules are fair to all the different categories of income earners. If employees, lessors, business persons and professionals, shareholders, property owners and others are to ask themselves the fundamental question of whether they are treated equitably or fairly in a conventional sense, the answer would be emphatically no.

In order to discover that the Ethiopian income tax system discriminates among taxpayers, it is not at all necessary to engage in inter-schedular comparisons of how Schedule “A” taxpayers fare vis-à-vis that of Schedule “B” or Schedule “C” or Schedule “D”. Taxpayers subject to the same schedule are often the subject of discrimination. Employees who work for the same employer are made to bear the full brunt of the progressive income tax system, while some employees who work for two or more employers are able to split their income and thus escape the higher taxes resulting from the operation of progressive income tax rates. Identical services are characterized as “employment” in some places and “independent contract services” in others. Employees with better bargaining abilities are able to strike a more generous concession from some employers to characterize their services as “independent contract services” rather than as “employments,” whereas the less fortunate ones are condemned to practices that characterize their services as one of “employment,” the full weight of a progressive income tax bearing down upon their aggregate income from employment.

Income tax burdens are affected by fortuitous circumstances like for whom employees work. Addis Ababa is the political capital of Africa, a host to many regional and international organizations and quite a sizeable number of embassies and consulates. A large number of

employees work for these organizations. By all accounts, these employees are some of the highest paid employees in the country, perhaps the highest. The income tax law which is enforced conscientiously against employees with less than a hundred dollars a year has found itself struggling against employees making more than a thousand dollars a month. These are the paradoxes of income taxation in Ethiopia.

The stories of discrimination among the same category of taxpayers can be continued *ad nauseam* for all the other schedules of the Ethiopian income tax system. The differences in income tax burdens among the various schedules of the Ethiopian income tax system are even worse. Most of the chapters of this dissertation were devoted to explicating and exposing the various forms of structural discrimination that litter the main income tax system of Ethiopia. Some of the discriminations are inherent in the very structure and architecture of a schedular income tax system. It is known, for example, that the denial of deduction of employment related expenses for employees will result in some discrimination against employees' vis-à-vis other income earners, particularly if this is not offset by some preferences for employees in other ways. The denial of employee expenses is accepted in many income tax systems as the price of a schedular income tax structure, indeed of even the global income tax structures with in-built bias against employment-related expenses.

Apart from the usual side effects of a schedular income tax structure, the Ethiopian income tax system is filled with numerous cases of discrimination for reasons that are peculiar to the operation of the Ethiopian income tax system. While the schedular system of taxation is responsible for many cases of discrimination, it is also true to say that circumstances peculiar to the Ethiopian income tax system have aggravated the cases of discrimination on the ground. We

can only, once again, mention a few of these circumstances. The discriminatory treatment of employees of all income categories is aggravated by the requirement of aggregation of income from employment and application of a progressive income tax structure on the one hand and the absence of aggregation when the income is characterized as arising from sources falling under other schedules. An employee, who, for various reasons recounted in one of the chapters of this dissertation, is unable to characterize specific income generated in connection with employment as “income from independent contract of services” or sources other than from “employment,” will have to bear the full brunt of the progressive income tax rate under Schedule “A.” On the contrary, an employee, who manages to characterize the income as one from “independent contract of services” (which falls under Schedule “C”) will immediately receive enormous tax benefits.

Of all the income tax schedules, no schedule probably illustrates the peculiarity of the Ethiopian income tax system as Schedule “B” – easily the most idiosyncratic in the whole income tax system of Ethiopia. The very existence of Schedule “B” as a separate schedule is responsible partly for discrimination, but the peculiar ways in which the scope of Schedule “B” is interpreted in practice are responsible for most of the discriminatory treatments associated with the implementation of Schedule “B”. The income tax system of Ethiopia splinters income from rental of property into several forms, giving some to Schedule “B,” some to Schedule “C” and some to Schedule “D,” in the process creating lots of uncertainties about the meaning and scope of Schedule “B” vis-à-vis Schedules “C” and “D.” It is not always clear where one schedule ends and the other begins.

One of the devices in use in the Ethiopian income tax system is the use of withholding taxation as final taxes. Ethiopia is not alone in using withholding taxation as final determination of tax liability on certain sources of income. Many other countries employ withholding taxation against some sources of income conventionally known as “income from capital” or “investment income.” The very operation of final withholding taxes leads necessarily to some kind of discrimination, which is often tolerated in various tax systems on grounds of administrative simplicity of final withholding taxation. But the Ethiopian income tax system has certain peculiarities which exacerbate this kind of discrimination. First, the final withholding tax rates are wildly divergent, which, over and above being sources of discrimination by their very operation, also give some taxpayers undue advantages by allowing them to structure their affairs in such a way that their income would fall under a category subject to lower rate. To give one example in this regard, the absence of clear set of rules defining and distinguishing “royalties” from “income from technical services”(both of which are subject to final withholding taxation) coupled with divergent withholding tax rates (5% for royalties and 10% for income from technical services) gives certain taxpayers an advantage in the sense that it is easy to characterize certain payments as royalties rather than as income from technical services. The differences are even starker when the bifurcation involved is between royalties and income from employment.

It is often maintained that schedular income tax structures are overall easier to administer than global income tax structures. Indeed, many theorists have dissuaded developing countries from pursuing global income tax structures precisely on this ground of global income tax structures being such expensive tax structures for poorly resourced tax administrations of developing countries. Ethiopia has never had soul-searching questions raised about its income tax structure since the introduction of the modern income tax in 1944. Over the course of six decades,

Ethiopia kept faith with the schedular income tax system (never even thought about seriously abandoning the schedular income tax structure ever since) largely because of the administrative expedience of the schedular income tax structure over its counterpart.

The schedular income tax structure of Ethiopia has gone on unchallenged for more than six decades largely on account of its administrative simplicity. It may therefore come as a surprise that questions are now being raised about its administrative simplicity. The administrative simplicity of a schedular income tax system is often glibly accepted on faith rather than some solid evidence on the ground. On closer examination, the invincible aura of the schedular income tax structure of Ethiopia can be questioned even on grounds of its perceived administrative simplicity. This should not, of course, be read as questioning the schedular system of income taxation as a whole. There are as many schedular income tax structures as there are countries in the world subscribing to the schedular system of income taxation. The Ethiopian income tax system may belong to the family of schedular income tax structures, but there are many aspects that set it apart from other structures as there are common features.

Once again, it is discovered that the administrative problems recounted in previous chapters are mostly of Ethiopian income tax system's own making. In addressing the dilemmas withholding agents face in trying to distinguish income from employment from that of income from "independent contract of services," for example, the tax authorities have been forced to write tens, perhaps hundreds of guidance letters to withholding agents as the questions arise, but, in spite of their numerous efforts to date, the tax authorities have not been able to put the nagging questions to rest by providing guidance that is uniformly applied by all withholding agents throughout the country. Many withholding agents have also found themselves in conflict with

employees (most notably with teachers of higher education institutions) over the appropriate withholding rates. Other tax systems have faced similar problems. The Ethiopian situation is exacerbated by factors perhaps peculiar to the Ethiopian tax administration, such as the absence of an administrative scheme in place to find uniform solutions to recurrent or recurring problems of tax administration.

With respect to the administration of Schedule “B” income tax, we have seen how the peculiar ways in which the meaning and scope of Schedule “B” is understood in practice complicated the administration of this tax both for members of the tax administration and the taxpayers involved. Businesses involved in real estate activities have at times been forced to maintain separate books and records for income sources falling under Schedule “B” and income sources falling under Schedule “C”. Some real estate companies (those that are involved in a hybrid business of renting and selling real estate or in a hybrid business of renting and non-real estate activities) are required under the current organization of income taxation in Ethiopia to maintain separate books and records to comply with their obligations under the Ethiopian income tax system. Coupled with additional duties imposed upon them as withholding agents (e.g., as employers), these types of businesses are subjected to tax compliance regimes whose existence rests on questionable foundation.

II. Recommendations

Each problem recounted in this dissertation calls for its own solutions, but that reduces the whole business of recommendations into placing solutions alongside the problems without the context of what each recommendations entails. What is needed in the context of the Ethiopian income tax system is a systematic approach to income tax reform – something which it lacked

for much of its modern history. A systematic approach to the reform of the Ethiopian income tax system calls for two sets of solutions. The first set of solutions works within the system and perfects (a strong word?) the schedular system without radically altering the organization of the income tax system of Ethiopia. The second set of solutions looks beyond the schedular income tax structure and draws from the comparative studies of other income tax systems to propose various possible solutions for the Ethiopian income tax system.

First a few caveats about the recommendations. If anyone can take a lesson from the comparative experience of tax reforms in many parts of the world, it is this: that there is no silver bullet that puts all the problems of income taxation to rest. It will also be seen that the second set of solutions – jettisoning the Ethiopian schedular income tax system for another – is rounded off with qualifications, because the solutions are not easy solutions to recommend boldly for the Ethiopian income tax system. It is, for example, easy to dash off a solution like recommending the flat tax for Ethiopia, but one must resist the temptation of falling in love with a system whose details are not yet fully worked out. There are also many practical considerations that militate against an easy solution like that. In any case, it is instructive to be open to all the options out there but to read these with a grain of salt until extensive researches are conducted and details are worked out.

Another caveat to look out for in income tax reforms of any country is the ogre of complexity. Income tax systems that have tried to achieve tax equity by closing down the loopholes have often run into the den of complexity. It is therefore fair to ask the question of whether the Ethiopian income tax system can afford to be complex while straining its resources to be equitable. With every attempt on the part of the lawmakers to improve the certainty of the rules,

there is a corresponding piling up of the rules, adding layers after layers of complexity for average taxpayers. This is perhaps the inevitable price to pay for ensuring tax equity.

Nonetheless, complexity need not be exaggerated in Ethiopian context. Fear of complexity has seldom held the Ethiopian income tax system back from resolving its equity deficits. We can cite a number of cases in which simple inaction, inertia or sheer indifference towards those discriminated against resulted in the lack of the necessary rules out there to avoid discrimination among various categories of income taxpayers. It is not fear of complexity that prevented Ethiopian tax administration from providing adequate guidance for distinguishing cases of employment from those of self-employment. It is not fear of complexity that produced discriminatory treatments that arise from the operation of Schedule “B” vis-à-vis the other schedules of Ethiopian income tax. It is not fear of complexity that left many of the key concepts in Schedule “D” income tax either undefined or poorly defined. There are many instances in which the Ethiopian tax administration neither attempted to overcome problems of discrimination nor spared income taxpayers from the specter of complexity.

In other instances, fear of complexity provides a vague backdrop to some of the discriminatory treatments that have been recounted throughout this dissertation. But it can be maintained that in many instances the fear of complexity is exaggerated to justify the *status quo* and wallow in inaction. For example, it is often claimed that the finality of the withholding tax for employees is justified by the simplicity of withholding taxation. This is indeed true if withholding taxation is considered final for all cases. The Ethiopian income tax system employs non-final withholding taxes in certain situations. Income taxes are withheld on imports and from payments for supplies of goods and services. These are not final, and indeed are creditable against the final tax

due at the end of every tax year. An income tax administration that accepts some withholding taxes as non-final even though these come with administrative complications cannot be said to be afraid of complexity.

No matter how hard we try to downplay the specter of complexity that rears its head in attempts to close down loopholes, however, we must own that complexity is a real threat. If Ethiopia is going to continue to rely upon income taxes as one of the principal sources of tax revenues, it is going to have to make allowances for and cope with the complexities of a modern income tax system. A certain dosage of complexity is necessary to maintain an equitable tax system. It is hoped that with incremental improvements on equity front, the Ethiopian tax administration, aided by obvious advances in information technology and innovations in tax administration, can cope with the demands of complexity and live up to its promises of equity.

a. Reforming the System within the System

The first task is to reform the income tax structure of Ethiopia within the system – namely, to close down the loopholes, to write subsidiary pieces of legislation wherever these are necessary, to eliminate the discriminatory tax rates, to end unjustified preferences for some types of income, to remove the income tax schedules that have in practice proven track records as sources of inequity and discrimination, to streamline the income tax schedules, and to extend the insights of aggregation of income regardless of the source of income and to introduce a self-assessment income tax regime for all individuals when these individuals happen to generate income from multiple sources, to introduce the administrative infrastructure that can cope with the changing culture of income tax assessment, and so on.

Reforming the income tax system within the system can be carried out on a number of fronts, which can be expressed as:

- Broadening the income tax base;
- Closing down the loopholes;
- Eliminating tax rate differentials and harmonizing the income tax brackets and
- Streamlining the income tax schedules

We shall work out the details of these recommendations below.

i. Broadening the Income Tax Bases

“Broadening the tax base” has become one of the pillars of tax policy objectives of Ethiopia in recent times. Broadening the tax base has featured in various Government policy documents along with the important goals of raising revenues and stimulating economic growth. The Government may have seized on this goal as part of its all out measure to raise as much revenues as it can manage, but the incidental benefits of broadening the income tax base as equity maximizer are quite as important as the revenue yields. The Government of Ethiopia has taken a number of measures to improve the tax base of the Ethiopian tax system in general. In the area of income taxes, the introduction of the capital gains taxes in 1994 and the inclusion of withholding taxation of “interest on bank deposits” in 2001 and most recently the introduction of windfall profits tax, were all touted as part of the agenda of broadening the income tax base of the Ethiopian income tax system. Notwithstanding these recent attempts at broadening the income tax base, it is easy to see that the Ethiopian income tax system is not as broad as it should be. It is now clear that the Ethiopian income tax system is not able to capture some of the

well-known sources of income. The reasons why the Ethiopian income tax system has not been able to capture all sources of income can be traced to two factors:

1. The patchiness of the income tax rules;
2. The absence of schedule/s for charging undesignated sources of income.

If the income tax system of Ethiopia is to be made as broad as the expansive definition of “income” in the Income Tax Proclamation suggests, it is important to tackle these two problems of the Ethiopian income tax system.

1. Taking Care of The Patchiness of the Income Tax Rules

Anyone who spends sometime reading the income tax laws of Ethiopia cannot fail to notice the patchiness of the Ethiopian income tax system. This is because the Ethiopian income tax system is more a product of accretion of individual sources as they were discovered to be sources by the authorities than of a well-thought out system at one point of income tax reform. This patchwork of various income tax sources was stitched together through piecemeal accretion of newer sources of income at various times of income tax reforms.

The piecemeal approach to income tax reforms produced lots of incongruities, which are at times manifested by an offhand mention of certain sources of income without the accompanying details required for their taxation. Certain sources of income are mentioned in the Income Tax Proclamation and sometimes in the Regulations as chargeable sources, but the provisions are not followed by the necessary legal infrastructures for capturing these sources of income. The 2002 Income Tax Proclamation, in particular, is riddled with these types of incongruities. Article 6 of the 2002 Income Tax Proclamation enumerates many specific types of income as

chargeable with income taxation under the Proclamation. Many of those in the list are mere reiterations of the sources of income chargeable with tax under the four income tax schedules of the 2002 Income Tax Proclamation. But there are some in the list that are a source of bewilderment because Article 6 is the last Article that mentions these sources of income, making it difficult to charge these sources of income in practice.

One of the sources that Article 6 of the 2002 Income Tax Proclamation mentions is “profit shares paid by resident registered partnerships.”¹ The mention of this source was apparently intended to tax profits distributed to partners of one “type” of partnership – the registered partnership. Unfortunately, this is not followed by specific rules that charge these “profit shares” with tax in the operating parts of the Proclamation and the Regulations. The provision that charges “dividends” fails to include “profit shares” distributed to partners of registered partnerships. We are as a result left wondering if the income of partners from partnerships is subject to withholding income taxation at all.²

There are other lists in Article 6 of the Income Tax Proclamation of 2002 that are puzzling as sources, because, once again, these sources are not matched by operating rules for their taxation. One of these is “the income of entertainers, musicians or sportspersons from personal

¹ See Income Tax Proclamation No. 286/2002, Article 6 (i)

² The root cause of the problem is that Ethiopian income tax laws are vague in general about the treatment of partnerships and the income of partners. There are some hints in some provisions of the current income tax laws that partnerships are treated (like in most of the rest of the world) as transparent entities; See for example, Article 2(2) of the Income Tax Proclamation which has a definition for “association of persons” (an apparent reference to partnership) with the objective of (one is led to assume) of treating partnerships as transparent entities. Unfortunately, the income tax laws have failed to provide for rules that ensure that the income of partnerships is disregarded and the income of partners is subject to income instead. As a result, partnerships are subject to the corporate tax as entities and the partners are not subject to income tax for distributions of partnership profits.

activities.”³ The income of entertainers, musicians or sportspersons often appears as a separate income source category in double tax treaties.⁴ The double tax treaties mention this category of income in order to apportion jurisdiction over the income of entertainers, musicians or sportspersons between countries of residence and countries of source. This is understandable because entertainers, musicians or sportspersons often cross borders and generate income from other countries, creating conflicts of jurisdiction over the taxation of their income.⁵

The mention of the income of entertainers, musicians or sportspersons in Article 6 of the Proclamation creates the false impression that the Ethiopian income tax system has special schemes for taxation of the income of entertainers, musicians or sportspersons, particularly for non-resident entertainers, musicians or sportspersons. Ethiopian income tax system does not have any special schemes for taxation of the income of entertainers, musicians or sportspersons. If the Ethiopian source income of non-resident entertainers, musicians or sportspersons is subject to tax in Ethiopia, it is through the interpretation of the existing schedules of the Ethiopian income tax system. In order to impose taxes on the Ethiopian source income of entertainers, musicians or sportspersons, it is, for example, necessary to characterize the Ethiopian income of non-resident entertainers, musicians or sportspersons as either “income from employment” (Schedule “A”), “income from independent contract of services” (Schedule “C”) or perhaps as “royalties” (Schedule “D”, Article 31), just to mention a few of the possible placements. Otherwise, the income of non-resident entertainers, musicians or sportsperson is unlikely to be taxed in Ethiopia. The mention of certain sources of income as subject to tax but

³ Income Tax Proclamation No. 286/2002, see Article 6(c)

⁴ See, for example, Double Taxation Treaties between Ethiopia and Sudan, Article 18; between Ethiopia and Egypt, Article 17.

⁵ See Vegh (ed.), OECD Model Tax Convention on Income and on Capital, Condensed Version, pp. 218-222

the failure to accompany these with operative rules creates a tantalizing prospect of taxation of these sources of income but in end the Income Tax Proclamation disappoints due to the absence of rules to complete the taxation of these sources of income.

All it takes to rectify this glaring gap in the income tax laws is to match the listing of various sources of income with corresponding charging provisions in the operative parts of the income tax laws. The income tax laws should complete the charging of some kinds of income that were mentioned at the beginning of the Income Tax Proclamation but mysteriously left out in the charging provisions of the Ethiopian income tax laws. For example, if the intent was to charge “profit shares distributed by registered partnerships,” the provisions relating to the taxation of dividends should clearly indicate that “profit shares” are also chargeable with withholding taxation. Similarly, if the intent of the law was to tax the income of entertainers, sportspersons, etc, the charging provisions should ensure that these sources of income are subject to a specific tax rate, possibly a withholding one.

2. Developing a Schedule for charging “undesigned” incomes

The all-encompassing definition of “income” in the Income Tax Proclamation would have given some credence to the comprehensiveness of the Ethiopian income tax system had it been followed by income tax schedules capable of capturing all sources of income. In this regard, the old income tax laws of Ethiopia provided a better template. The 1961 Income Tax Proclamation, for example, phrased the language of Schedule “C” (business income tax) so broadly as to capture all sorts of undesigned incomes.⁶ While Schedule “C” income tax might be considered

⁶ Schedule “C” was theoretically designed to apply to “income from businesses, from professional and vocational occupations, from the exploitation of woods and forests for lumbering purposes, from interest

as unsuitable for charging undesignated forms of income, the old income tax laws at least made some attempts to capture all sorts of income consistent with the expansive definition of income. This kind of “catch-all” language was omitted in subsequent income tax laws and now it is clear that any income that is not specifically mentioned in schedules of the Ethiopian income tax (or in the autonomous income tax laws for agriculture and mining) will remain un-taxable solely because none of the schedules is intended to capture undesignated forms of income.

From the experience of other countries and the encounter of Ethiopian income tax administration, we can cite a number of income sources that are currently un-taxable because there are simply no charging provisions for these sources. The case involving *Shell Ethiopia Ltd* (see Chapter Four) is a perfect illustration of how an income that is not captured by one of the schedules of the Ethiopian income tax system easily falls through the cracks and escapes taxation. In that case, the tax authorities were unable to convince the courts that “interest accruing on a provident fund” held in the name of employees of Shell Ethiopia was income from employment. The tax authorities also tried to press home the idea that the interest was “income” according to the definition then operating, which was as expansive as it is today. The courts were in agreement on that score but the tax authorities were unable to place the “interest” under the existing schedules of the Ethiopian income tax and thus failed in their bids to charge the interest with tax. The absence of a catchall schedule in the Ethiopian income tax legislation allowed the “interest” in Shell Ethiopia Ltd. case to fall through the cracks. That case proved that the expansive definition of “income” was no use without the income tax schedules in Ethiopia.

and *from all other sources not elsewhere mentioned...* (italics added); see Article 4(c) and 12(a) of Income Tax Proclamation No. 173/1961, Negarit Gazeta, 20th year, No. 13 (now repealed)

Many other sources of income for which the authorities are unable to find schedules will remain un-taxable under the current organization of the Ethiopian income tax system. A recent encounter of the authorities in this regard involves the scholarship income some graduate students at Mekelle University were receiving from a fund set up in cooperation agreement with the Norwegian Government. In a Letter issued on Tahsas 01, 2003 E.C. (2009), the Ministry of Finance and Economic Development opined that the scholarship money was not taxable under Ethiopian law not because it was expressly exempted by law but because the Ministry was unable to find a place for this income under any one of the existing schedules.⁷ The strengths of the arguments of the Ministry notwithstanding, we can see how the absence of a catchall schedule in the Ethiopian income tax system allows certain forms of income to fall through the cracks.

Another source of income actually struck so close home to the authorities that it left them scratching their heads.⁸ As a strategy for combating tax evasion, the Income Tax Proclamation authorizes a payment of up to 20% of an amount recovered for informants and whistleblowers against tax evasion.⁹ The tax authorities have subsequently issued a number of directives specifying the amount and conditions under which informants and whistleblowers are rewarded by the authorities.¹⁰ Some whistleblowers have struck big in some cases. A certain individual who informed the authorities of another person smuggling gold out of Ethiopia was rewarded

⁷ Ministry of Finance and Economic Development, Letter to Ethiopian Revenues and Customs Authority, 21/08/2003 E.C., in Amharic, unpublished

⁸ This was mentioned to me by Ato Eshetu Atlaw, ERCA, Civil Division Directorate, August 28, 2012

⁹ Income Tax Proclamation No. 286/2002, Article 84(1)

¹⁰ See Federal Inland Revenue Authority, Directive for Rewarding Informants, Hamle 1 1996 E.C., in Amharic, unpublished; Ministry of Revenues, Directive to Provide for Reward of Outstanding Performance No. 30/1998, in Amharic, unpublished; Ministry of Revenues, Directive to Provide for Reward of Outstanding Employees No. 31/1998, in Amharic, unpublished

2.5 million ETB in 2010.¹¹ ERCA reported that it paid a total of 53.5 million ETB in rewards to various informants and whistleblowers in 2010/2011 fiscal year alone.¹² There is no question that rewards like these qualify as “income” within the definition of income in Article 2(10) of the Income Tax Proclamation, but the authorities are unable to tax this type of income due to lack of provisions and schedules that capture all sorts of income.

Some of the sources given as examples above can probably be mentioned in name and be treated as separate category while others can be seen as part of the sources that are already part of the canon of income taxation in Ethiopia. In any case, it is necessary to mention all the sources that are known to be sources of income both in Ethiopia and outside Ethiopia. As for those sources that are not yet known, the solution is to designate one of the schedules for catching all sources that are not already mentioned as chargeable with tax under any of the other schedules of the Ethiopian income tax system.¹³ Some of the sources of income that are known to be taxable in the rest of the world include annuities, life insurance proceeds, income arising from cancellation of indebtedness, alimony and maintenance payments, subsidies and even gifts and bequests. It is possible that once these sources are contemplated as chargeable sources, the Government might decide to exempt some of these sources, but the exemptions should be expressly granted by law and not be the result of omissions.

¹¹ See Mahlet Mesfin, ERCA gets around 400 million Br. Back due to tip-offs from informants, *Fortune*, vol. 11, No. 547, October 24, 2010

¹² See Mahlet Mesfin, Tax Authority Shells Out Millions for Tips, *Fortune*, vol. 12, No. 595, September 2011.

¹³ An example in this regard is that of the UK schedular income tax system, which has a schedule devoted to “annual profits and gains not falling under any of the other Schedules” – appropriately called a “Sweeping-up” provision. The Schedule that plays this role in the UK is Schedule “D” Case VI. This Schedule is used in the UK to charge “income from settlements,” “profits and gains from furnished lettings, securities transactions, post-cessation receipts and the transfers of assets abroad;” see Olowofeyku, Kirkbride and Butler, *Revenue Law*, p. 274

ii. Closing down the Loopholes of the Ethiopian Income Tax System

Recounting the loopholes of the Ethiopian income tax system can fill multiple chapters in and of itself. Most of the chapters of this dissertation are devoted to the task of just recounting these loopholes. The loopholes exist both at the macro and micro-level. At the macro-level, we encounter uncertainties in the realm of tax policies. This uncertainty about Ethiopian tax policy has been responsible for all sorts of discriminations between various categories of income taxpayers. Despite all the valiant efforts to extract policies from various documents of the government, it is sadly the case that Ethiopian tax policy remains fragmentary, conjectural and largely unarticulated.

The micro-level loopholes of the Ethiopian income tax system are too numerous to recount here. Most of the loopholes of the Ethiopian income tax system are attributable to ill-defined schedules, which are responsible for many disputes in practice and for numerous cases of discrimination among various categories of income taxpayers. The scope of Schedule “A” is not well defined vis-à-vis that of Schedule “C” or Schedule “D”; as that of Schedule “B” as against Schedule “C” or Schedule “D”. Some of these problems come with the territory of having a schedular income tax system in place, but most of them are clearly the fault of the Ethiopian income tax system. It is true, for example, other income tax systems, including the global income tax systems, have struggled with delimiting the boundaries of “employment” against that of “self-employment.” But the Ethiopian problem in this regard is more acute than what other countries have experienced largely on account of practices peculiar to the Ethiopian tax administration. The Income Tax Proclamation has failed to provide adequate guidance to withholding agents for distinguishing cases of “employment” from cases of “self-employment,”

and in their attempts to provide some guidance to withholding agents, the tax authorities have in fact worsened the situation on the ground. Similarly, the problems associated with the delimitation of the scope of Schedule “B” vis-à-vis that of Schedules “C” and “D” are problems peculiar to how the Ethiopian income tax structure is organized and how that structure is administered on the ground.

Leaving the detailed issues and recommendations to respective chapters, some of the major recommendations for each of the schedules of the Ethiopian income tax system are outlined below.

Schedule “A”

On the Question of Employment vs. Self-Employment

- The authorities should issue directives that are consistent with the legislative intent of the Proclamation. The Directives should provide withholding agents (employers) with clear indicators of elements of employment (direction and control). The directives should be uniformly applied by all withholding agents.

On the Treatment of Employment Fringe-Benefits

- The Council of Ministers should fulfill its responsibility of issuing regulations that fix valuation schemes for certain employment fringe benefits (e.g., company cars) so that in-kind benefits are subjected to the income tax as their cash counterparts.

On Aggregation of Income from Multiple Employments

- The authorities should enforce the requirement of aggregation of income from multiple employments and not leave these matters to the discretion of certain employers.

On Employee Self-Assessment Obligations

- The income tax rules for employee self-assessment should be revised so that employees are given clear and easy-to-follow procedures for fulfilling their self-assessment obligations. For example, the income tax rules should contain an annual reporting system by employees instead of the current rules which appear to require reporting every month, following the accounting systems of employment income tax withholding.

On Employees of Exempt Organizations

- It is difficult to enforce withholding obligations against embassies and other international organizations enjoying diplomatic immunities. In view of this, it is important to devise a self-assessment scheme that is both easy for the employees to comply with and efficient for the tax administration to collect the taxes due.

Schedule “B”

- If the authorities are convinced that Schedule “B” should be maintained, it is important to streamline the substance of Schedule “B” so that Schedule “B” serves as a schedule for taxing the rental of income of lessors that lease buildings not as a regular activity (business) but do it to supplement their income (owners of residential homes who lease

their buildings informally). The rental of buildings as a business should be the subject of Schedule “C,” like any other business.

- Future tax reforms should remove all fortuitous differences between schedules that have been responsible for unjustified discrimination among various sources of income. To the extent possible, all expenses incurred in connection with the generation of income under Schedule “B” should be deductible.
- The constitutional issues that arise in connection with the jurisdiction over Schedule “B” should be resolved through constitutional amendments.

Schedule “C”

- Since Ethiopian tax system seldom relies upon case law, it is necessary for the tax authorities to write into the law elements that constitute what are known elsewhere as “badges of trade.” These elements of trade should be broad enough to attract all profit-making activities that currently lie outside the business income tax regime, either because of the inattention of the authorities or the ambiguity of the laws.
- The fiscal jurisdiction issues that arise in connection with the aggregation of the income of sole proprietor businesses from multiple businesses situated in several regional states should be resolved, if need be through the amendment of the Constitution so that aggregation occurs not just against those taxpayers that derive income in one regional state but also against those that derive income from several regional states.

Schedule “D”

Withholding Taxation on Royalties

- The authorities should work to dispel all uncertainties surrounding the withholding taxation on “royalties” and enforce the rules as set out in the Proclamation.
- The authorities should also issue subsidiary rules to remove the ambiguities surrounding the meaning of “royalties” vis-à-vis “income from employment” and “income from independent contract of services” so that the discriminatory treatments of similar forms of income in practice will come to an end.

Withholding Taxation on Income from Technical Services Rendered Abroad

- If this tax is intended to capture the tax due on income of non-residents from services rendered to Ethiopian residents, the meaning of technical services should not be limited to the narrow sense of technical services but should be extended to all kinds of services rendered outside Ethiopia to Ethiopian residents.

Withholding Taxation on Income from Games of Chance

- The income tax laws should keep pace with the fast changing world of games of chance and introduce self-assessment obligations upon all those persons that derive income from any games of chance.
- The income tax laws should also devise ways of reaching the in-kind benefits won in games of chance, and not just the cash benefits as is currently the case.

Withholding Taxation on Dividends

- The income tax laws should provide for detailed definition of dividends so that all forms of corporate distributions short of return of capital are captured by the withholding taxation of dividends. To the extent possible, the income tax laws should provide for all the rules needed to tax dividends, and not depend upon the Commercial Code, as has traditionally been the case.¹⁴
- The income tax laws should avoid the cascading effects of dividend taxation under the current system by exempting inter-corporate dividend distributions from withholding taxation.

Taxation of Income from Casual Rental of Property

- To the extent Article 35 tax is necessary, it should be to capture the occasional income of those persons or institutions that are not already in the tax roll.
- In addition, Article 35 must be explicit about its collection. To enhance its efficiency, Article 35 tax should be collected by payors when those payors are large and organized enough to act as reliable withholding agents (e.g., government agencies, large business organizations). As for those that generate occasional income from rental of property to individuals and others not accessible as withholding agents, the earners themselves

¹⁴ Taxation of corporate income, including dividends, requires special policy attention. Ethiopia must at some point come to decision whether it wishes to continue with the current system of the classical approach to corporate taxation (which treats corporations (companies) as separate taxable entities over and above the tax due on dividends) or shift to some of the proposed solutions to the charges of double taxation (imputation systems, partial or full integration systems, etc.); see Ault and Arnold, *Comparative Income Taxation*, pp. 331-448

should be subject to self-assessment regime in order to equalize those that are subject to withholding taxation and those that are subject to self-assessment.

Withholding Taxation on Interest from Bank Deposits

- The income tax rules should eliminate the discriminatory treatments of various types of interest and institute withholding obligations on all interest payments, regardless of whether interest is accruing on bank deposits or not.
- The income tax rules should also lift the moratorium on the deduction of interest paid to creditors other than financial institutions recognized by the National Bank of Ethiopia.

Capital Gains Taxes

- Adequate systems of valuations should be put in place to ensure that all capital gains are taxed in accordance with the intent of the law.
- In view of the fact that capital gains are irregular sources of income, the tax rates should remain separate and lower than the tax rates on other sources of income. Lowering the tax rates takes away the temptation for avoiding the tax by understating the amount of the gain and other sorts of avoidance.

Taxation of Windfall Profits

- All the essential elements of windfall profits should be set down in the Income Tax Proclamation. The MoFED should not possess the excessive power it has now to define and designate windfall profits and the tax rates as it sees fit. Windfall profits may be

limited to economic circumstances that create favorable conditions for generation of windfall gains, but these must be sufficiently outlined in the Proclamation itself.

- If windfall profits are conceived as temporary taxes that come and go, the main Income Tax Proclamation is not the proper place for them. Temporary taxes should be issued by special laws as required.

iii. Harmonizing the Income Brackets and Tax Rates of the Schedules of Ethiopian Income Tax System

The income brackets and tax rate structures of the three principal schedules of the Ethiopian income tax system (A, B, and C) were formally harmonized after the income tax reforms of 2002. These reforms came after the Ethiopian income tax system was criticized for not having uniform income brackets and tax rates among the various sources of income. The income brackets and tax rates of the three schedules are outwardly uniform. But in this move to answer the critics, it seemed that Schedule “D” was exempted from the policy of having uniform income brackets and tax rate structures. Schedule “D” – applying, as it does, upon miscellaneous sources of income – does not even pretend to have a uniform rate of taxation for the various sources of income chargeable to tax under it. We have also seen in Chapter Four above how the application of the income brackets and tax rate structures resulted in discriminatory treatment of persons with the same amount of income, demonstrating that the discriminatory treatments persisted in spite of the apparent harmonization of the income tax brackets and rates of the income tax schedules.

Harmonization of the income brackets and tax rates has a number of virtues to recommend it. First, it ends the discrimination of persons based on the accident of the source of income and improves the overall equitability and neutrality of the Ethiopian income tax system. Second, it takes away the temptation for tax planning among various categories of taxpayers and improves the efficiency of the income tax system of Ethiopia in general. Third, it reduces the number of disputes that arise as a result of efforts on the parts of taxpayers to characterize their income as falling under a more favorable income tax schedule and of that of the tax administration to place the income under a higher-taxed schedule or category.

As noted repeatedly before, the income tax reforms of 2002 tried to harmonize the income brackets and tax rates of three schedules – A, B, and C. However, the harmonization efforts of 2002 have not gone far enough to complete the project harmonization. Harmonization will require taking a number of measures.

The first measure is to eliminate the subtle discriminatory treatments that persist in spite of the efforts at harmonization. One of the points of discrimination in this regard is the application of the simple PAYE scheme in place for Schedule “A” taxpayers. This scheme wrongly assumes that the monthly income of an employee is steady throughout the year and fails to take account of income fluctuations resulting from raises in income or loss of remunerative employment in the course of a year. The future income tax laws of Ethiopia should allow employees to seek adjustments at the end of every tax year, just as business persons are required to pay tax only for the amount of income they generated in the year.

The second measure is to apply uniform rates of withholding taxation on Schedule “D” incomes. The wildly divergent income tax rates under Schedule “D” should be eliminated and replaced by

more or less uniform rate of withholding tax on “royalties,” “dividends,” “interest” and others. In view of the non-recurrence of certain types of income currently chargeable with tax under Schedule “D” (e.g., income from games of chance and gains from the transfer of capital (capital gains)), there is reason to apply a more generous tax rate upon capital gains and perhaps a higher-than-normal tax rates upon income from games of chance. The current policies of generous tax rates upon income from games of chance and a higher than normal tax rates upon gains from the transfer of shares should therefore be reversed and replaced by a higher tax rate upon income from games of chance and lower than the ordinary tax rates upon the transfer of shares.

The third measure in harmonization is to introduce inter-schedular aggregation of income. The inter-schedular aggregation rule should be seen as part of the overall attempt to eliminate discrimination among various sources of income. Persons who generate income from sources falling under multiple schedules should be subject to a self-assessment regime in which these persons are required to report their total income in a year and pay the appropriate tax due under the progressive income tax rate structures. The total income of these persons should include “income from capital” subject to withholding taxation under Schedule “D”. Withholding taxes under Schedule “D” should not be considered as “final taxes” for residents of Ethiopia. They should be included in the income of individuals at the end of every tax year, with tax credits for taxes withheld at source just as the 2% taxes withheld from supplies of goods and services and the 3% taxes withheld from imports of goods are considered as advance taxes under the current rules of the Ethiopian income tax system. Many other tax systems have similar withholding taxation schemes but they do not necessarily treat the withholding as final against residents. The withholding taxes should be considered as final only against non-residents.

The harmonization of schedules should make exceptions for some irregular sources of income like income from games of chance and gains from the transfer of capital (capital gains). Many other countries have separate rules of taxation for capital gains. Non-recurrent sources of income like “income from games of chance” and “windfall profits” cannot be treated like recurrent sources of income like “income from employment” or “income from business” or “income from rental of property.” As an exception to the general rule of harmonization of the income tax system, therefore, future income tax reforms of Ethiopia should devise special rules and schemes for taxation of irregular income, most notably capital gains, income from games of chance and windfall profits.

iv. Streamlining the Income Tax Schedules

Another front of income tax reform will take the form of streamlining the income tax schedules, which will involve medium-level reorganization of the Ethiopian income tax system, without abandoning the fundamentals of the schedular income tax structure. Taking account of the complications that arise from the implementation of the income tax schedules, streamlining the income tax schedules will look to reorganization of the schedules as a solution to these complications. The main focus of streamlining is on the organization of the schedules to achieve the overall aims of the Ethiopian income tax system: mainly the two objectives of ensuring equity and administrability.

In streamlining the income tax schedules, there are certain schedules and categories that will have to be considered for axing and merging with the other schedules of the Ethiopian income tax system. The prime candidate for this is Schedule “B”. As a result of lack of adequate rules regulating the taxation of “income from rental of buildings,” Schedule “B” has been haunted by a

number of unanswered questions and issues in its implementation. Overall, the existence of a separate schedule (with its own rules on definition of taxable income, deductions, assessment, etc.) for taxation of income from rental of buildings is one of the least convincing cases even in the context of the schedular system of income taxation in Ethiopia. Apart from informal leasing activities of home owners in Ethiopia, many of the other activities that are currently treated under Schedule “B” (e.g., rental activities by real estate companies) can be handled and subsumed under the business income tax schedule (C), thus avoiding some of the compulsory splits of income apparently required by the current schedular arrangement of income taxation in Ethiopia.

Merging most rental activities into “business activities” is not, of course, as simple as merging the two schedules (B and C) in Ethiopian context, because of the need to revise the Constitution to accommodate these changes and reorganize the Ethiopian fiscal system, not just the income tax schedules. But constitutional hurdles should not be used as an excuse to foreclose the abolition of Schedule “B” as a separate income tax schedule and the merger of most of its contents with Schedule “C” in particular. Constitutional reforms are not as daunting in Ethiopia as in other tax systems. Due to the political preponderance of the Federal Government and the centralizing influence of the ruling party on power at the time of writing, the Federal Government can reorganize the schedules if it wants to. The Federal Government had never had its way blocked by constitutional niceties when it wanted to effect changes in the past.

Once Schedule “B” is emptied of rental of property in commercial settings, what is left is income from informal rental of buildings and other property by homeowners. Schedule “B” cannot stand on its own as a separate schedule just to capture the income of informal lessors or homeowners. Instead, this type of income may become a subject of a presumptive income tax system, much as

the income of innumerable small, informal and micro-businesses is handled under the current Category C of Schedule “C”. For informal and irregular rentals of residential homes, a final withholding tax (along similar lines of taxation of casual rental of property under Schedule “D”) can be conceived to deal with cases of casual rental of property. Once commercial rental of buildings and other property is brought under the business income tax regime, informal rental of residential homes is brought under Category “C” (presumptive) tax regime and casual rental becomes the subject of final withholding taxation under Schedule “D,” it is hard to see how Schedule “B” can survive all these shearing and pruning of its sources.

Another category that should be considered for reorganization is the taxation of casual rental of property – chargeable with tax under Schedule “D”, Article 35. Taxation of income from casual rental of property was originally designed as part of Schedule “C” income when this source of income was first mentioned in the 1978 Income Tax Amendment Proclamation. It was in subsequent income tax reforms that this source of income was taken out of Schedule “C” and became chargeable as a separate category under Schedule “D” – making it obligatory for Schedule “C” businesses to file separate returns for income from casual rental of property. The idea of requiring businesses to file separate income tax returns for casual rental of their property has never been clear, which is partly responsible for the rarity of this tax in practice. The practice seems to have overtaken the law in this regard by doing what is sensible, i.e., reporting income from casual rental of property as part of business income under Schedule “C,” rather than under Schedule “D”. To the extent businesses report their income from casual rental of property, the practice is more sensible than the law and it just goes to show that the requirement of separate filing is irrational. Some of the interviewees have suggested that Article 35 should be for reporting of the income of non-business lessors from casual rental of property. This kind of

separate tax is quite sensible in view of the fact that this type of income would otherwise go untaxed. And in view of the fact that the lessors are perhaps beyond the radar of the tax administration otherwise, it might even be appropriate to institute a final withholding tax obligation upon all organizations that make payments for casual rentals of property.

**b. Looking Beyond the Income Tax Schedules of Ethiopia: Lessons from
Comparative Income Tax Structures**

At some point in the future, the income tax structure of Ethiopia will have to be transcended. Hundred years from now, no one can predict if the income tax will continue to be relevant, indeed if taxation will survive as a form of revenue for governments. Taxation, like anything else in life, is subject to the dialectics of change, always sitting in judgment and pronouncing the death of one form of taxation over another and even proclaiming the superfluity of taxation as a source of revenue for governments. We don't have to look far into the future to imagine the demise of one structure of income taxation and the emergence of another, as we have already witnessed alternative structures of income taxation in the rest of the world. And in our search for the best structure of income taxation (which should not and need not incidentally be the enemy of the good), we must naturally turn to the alternative income tax structures out there. The search for alternative income tax structures for Ethiopia is borne out of the dissatisfactions with the existing income tax structure, which, however much we tinker with it through internal reforms, may not yield the results we expect from it in terms of achieving the basic tax policy aims of tax equity and administrability. There are limits to what reforms of the system within the system can do to effect the necessary changes. It is therefore necessary to cast glances

beyond the existing schedules and imagine what other structural possibilities exist for the income tax system of Ethiopia.

i. The Comprehensive Income Tax Model

The forbidding heights of the comprehensive income tax model remained the Holy Grail of many income tax systems of the world with aspirations of reaching all the bases of the income ground. Economists and writers like Henry Simons and Robert Haig, from America and George Schanz from Germany explored the theoretical possibilities of an income tax model and laid the groundwork for the development of the idea of the comprehensive income tax systems. The comprehensive income tax model drew its biggest supporters from those that saw the cardinal task of the income tax to be, in the words of Henry Simons, “a more equitable apportionment of tax burdens.”¹⁵ The explicit endorsement of the ethical line in income taxation by the comprehensive income tax model has continued to draw supporters from various quarters.¹⁶

For a dissertation that has taken “equity” as a point of critical focus, the comprehensive income tax model is of course the most natural model to propose for the Ethiopian income tax system. As even those countries that have tried to introduce aspects of the comprehensive income tax model can attest, however, it is much easier to express platonic love for the comprehensive income tax model than to imagine having successful marriage with it in actual income tax systems. The comprehensive income tax model has proven itself to be daunting even for the most endowed income tax administrations of the world. Actual income tax systems, modeled after the comprehensive income tax system, have failed far short of the ideal. The gap between

¹⁵ See Chapter Three, above

¹⁶ See Chapter Three, above

the real and the ideal has divided critics. While many critics have urged their governments to scale the heights of the comprehensive income tax mode, others have despaired of the quixotic pining after the comprehensive income tax and equally urged their governments to abandon the whole idea. If the going has become hard even for the most sophisticated income tax administrations of the world, how much more difficult would it be for an income tax administration of Ethiopia? The ideal beauty of the comprehensive income tax model notwithstanding, practical considerations militate against even the pretention to adopt the comprehensive income tax model in Ethiopia. That does not, of course, mean that Ethiopia should not undertake the “doable” aspects of comprehensive income taxation.

ii. The Dual Income Tax Structures

The shift from the current schedular income tax structure of Ethiopia to a dual income tax structure is not as difficult as at first it appears. Ethiopia has some elements of a dual income tax structure. Schedule “D” is principally designed for taxation of passive income or income from capital. What it lacks is a uniform income tax rate structure. Ethiopian income tax structure has progressive income tax rate structures for “earned income” – Schedule “A” (income from employment) and Schedule “C” (income from business activities). It is quite possible to collect the current Schedules “A,” “C” and a portion of Schedule “B” into one Schedule and rename that as “income from labor” or “earned income” and impose progressive income tax rates upon that income. Passive incomes that are currently subject to tax partly under Schedule “B” and partly under Schedule “D” can be collected into a single schedule which charges “income from capital.” Thus, the road from the current unstructured income tax system of Ethiopia into a dual income tax system is not as far as it is at first supposed.

iii. The Flat Tax Model

The flat tax model is the brainchild of the counter-revolutionary movement against the representations and abuses of the comprehensive income tax systems in the developed world. Vexed by the many loopholes and preferences that dent the so-called comprehensive income tax systems, some writers suggested a flat world of taxation in which neither preferences nor tax rate differentials existed. In one of the few cases in which theoretical models received an audience, the flat tax models found a berth in actual tax systems of some countries of the world, most notably in Eastern Europe and Russia. The reputation of the flat tax model rests on what the supporters tout as a simpler, fairer and more efficient tax system.

Since its emergence, the flat tax has spawned a number of variants – a flat tax on income with or without allowances, a flat tax rate upon all payments to employees and a parallel flat tax on income of businesses which operates pretty much like the VAT and a flat tax with tax credits.¹⁷ After the introduction of the VAT in 2002, Ethiopia cannot claim to be unfamiliar with the flat tax system. In view of the numberless problems of the taxation of employment income vis-à-vis other types of income, it is indeed tempting to recommend the flat tax as a panacea to many of the problems of the Ethiopian income tax system as a whole. It may sound counter-intuitive but one of the countries which dared to introduce a flat tax, Russia, actually saw its revenues jump by 26% after moving its progressive income tax with a high marginal tax rate of 30% to a flat tax with a rate of 13%.¹⁸ With that news, one of the biggest stumbling blocks to any new tax proposal

¹⁷ See Chapter Three, above

¹⁸ See Ivanova, Keen and Klemm, *The Russian Flat Tax Reform*, p. 4

is removed.¹⁹ The recommendation of the flat tax as a solution to Ethiopia, however, requires detailed studies of the fortunes of the flat tax in those countries which have introduced one or another form of the flat tax model and the revenue implications of the transitions from the current system of income taxation into the flat taxation world.

iv. The Consumption/Expenditure Tax Model

The direct consumption model remains a theoretical model at the time of writing.²⁰ At the moment, Ethiopia cannot afford to plunge into untested waters. Nonetheless, nothing, not even the direct consumption tax model, should remain off the table in the future.

v. Lessons from African Income Tax Structures

It is misleading to refer to other African income tax structures as alternative models of income taxation for Ethiopia. African income tax structures vary quite considerably – from global income tax structure of South Africa to highly regimented income tax structures, like that of Ethiopia. The reason why African income tax structures are held up as models for Ethiopia is because some African countries have travelled much farther than Ethiopia in bringing their income tax systems in line with some principles of tax equity.

¹⁹ However, according to Ji and Ligthart, of the countries that introduced the flat tax, only Latvia, Lithuania and Russia saw their revenues stable or jump after the introduction of the flat tax, with others experiencing a reduction in revenues from the personal income tax; Ligthart attributed the jump in Russian revenue from the flat tax to the recovery of the Russian economy; see Ji and Ligthart, *The Causes and Consequences of the Flat Income Tax*, p. 6

²⁰ Fear mongering aside, there are serious questions about the viability of the expenditure tax in actual tax systems accustomed to income taxation; according to Sorenson, a Swedish Government Committee undertook a study and raised a red flag citing serious technical problems for a transition from an income tax system into an expenditure tax system and problems of “coordination with other countries relying on the conventional income tax;” see Sorenson, *The Nordic Dual Income Tax – In or Out?*, p. 5

Ethiopia, as an African and developing country, can take a few lessons from the income tax structures of some African countries. The first lesson is courage. From some of the African countries, Ethiopia can take courage that it is possible to super-impose elements of a global income tax structure over an underlying schedular income tax structure. For example, from Kenya and Uganda, Ethiopia can take the lesson of treating withholding of income tax as final as long as it is the only source of income of an employee (this removes most employees from the roster of self-assessment income tax regime, thus dispelling the fears of some that this requirement will overwhelm the ill-equipped resources of the Ethiopian tax administration).

The second lesson, from some African countries, is that Ethiopia can take the virtue of having uniform tax rates upon some sources of income – especially income from capital. Uniform income tax rates are not necessarily equitable but they at least have the virtue of treating all forms of income equally and holding off the temptation of structuring affairs in order to place income under a lower-taxed source.

Whichever way it turns, whether out of the introspection of its past and current failings, or out of that irresistible pull of the desire to join a community of nations, the Ethiopian income tax system must break free from the inertia of going about its old ways. It has taken over nine chapters to drive this thesis home, but in the end one peremptory sentence can deliver the punch-line – the Ethiopian income tax system must reform.

BIBLIOGRAPHY

Books

Abdella, Amin and John Clifford. *The Impact of Tax Reform on Private Sector Development*. Addis Ababa. AACCSA, Nov. 2010

Adolino Jessica R., and Charles H. Blake. *Comparing Public Policies: Issues and Choices in Six Industrialized Countries*, Washington D.C., CQ Press, 2001

Arnold, Brian J. "Canada." in *Comparative Income Taxation: A Structural Analysis*. Edited by Hugh J. Ault and Brian J. Arnold. 3rd edition. Aspen Publishers, 2010

Arnold, Brian J. and Michael J. McIntyre. *International Tax Primer*. 2nd edition. Kluwer Law International, 2002

Arnold, Matthew. *Culture and Anarchy: An Essay in Political and Social Criticism*. London Smith, Elder and Co. 1869

Ault, Hugh J., and Brian J. Arnold, *Comparative Income Taxation: A Structural Analysis*. 3rd ed. Aspen Publishers. 2010

Bastable, C.B. *Public Finance*. 3rd edition. London: Macmillan Co. Ltd.1932

Bird, Richard M. *Tax Policy & Economic Development*. Baltimore and London, the John Hopkins University Press. 1992

Bird, Richard M. and Milka Casanegra de Jantscher, eds. *Improving Tax Administration in Developing Countries*. Washington D.C.: International Monetary Fund, 1992

Burns, Lee and Richard Krever. "Individual Income Tax." in *Tax Law Design and Drafting*, edited by Victor Thuronyi. vol. 2. pp. 495-563. Washington D.C.: International Monetary Fund. 1998

_____. "Taxation of Income from Business and Investment." in *Tax Law Design and Drafting*, edited by Victor Thuronyi, vol. 2, pp. 597-681. International Monetary Fund, 1998

Casanegra de Jantscher, Milka and Richard M. Bird. "The Reform of Tax Administration." in *Improving Tax Administration in Developing Countries* edited by Richard and Milka Casanegra de Jantscher. International Monetary Fund. 1992

Cooper, Greame S., Richard E. Krever, Richard J. Vann and Cameron Rider. *Cooper, Krever & Vann's Income Taxation, Commentary and Materials*. 5th edition. Sydney. Thomson. 2005

Due, John F. and Ann F. Friedlaender. *Government Finance: Economics of the Public Sector*. Delhi: A.I.T.B.S. Publishers and Distributors. 2002

Eshetu Chole. "Towards a History of the Fiscal Policy of the Pre-Revolutionary Ethiopian State: 1941-74." in *Underdevelopment in Ethiopia* by Eshetu Chole. pp. 64-78. Addis Ababa: Organization for Social Science Research in Eastern and Southern Africa, 2004

_____ "The Dismal Economy: Current Issues of Economic Reform and Development in Ethiopia." in *Underdevelopment in Ethiopia* by Eshetu Chole. pp. 209-235. Organization for Social Science Research in Eastern and Southern Africa, Addis Ababa, 2004

Faria, Angelo G. A., and M. Zuhtu Yucelik. "The Interrelationship between Tax Policy and Tax Administration." in *Tax Policy Handbook* edited by Parthasarathi Shome. pp. 267-272. International Monetary Fund, Fiscal Affairs Department, 1999

Federal Tax Course 2000, Chicago, CCH Incorporated, 1999

Gest, Guy, "France," in *Comparative Income Taxation: A Structural Analysis*, 3rd edition, edited by Hugh J. Ault, and Brian J. Arnold, pp... Kluwer Law International, 2010

Graetz, Michael J. and Deborah H. Schenk. *Federal Income Taxation: Principles and Policies*. 6th edition. Foundation Press. 2009

Haig, Robert Murray. "The Concept of Income: Economic and Legal Aspects." in the *Federal Income Tax* edited by Robert Murray Haig. pp... New York: Colombia University Press. 1921

Hall, Robert E. and Alvin Rabushka. *The Flat Tax*. 2nd edition. Stanford: Hoover Institution Press, 1995

Herber, Bernhard. *Modern Public Finance*. 5th edition. Reprint, Delhi, A.I.T.B.S. Publishers & Distributors (Regd.). 2004

Hobbes, Thomas. *Leviathan*. edited with an introduction and Notes by J.C.A. Gaskin. Oxford's World Classics. Oxford University Press. 1996

Holland, David and Richard Vann. "Incentives for Investment." in *Tax Law Design and Drafting*, edited by Victor Thuronyi, vol.2. pp.980-1020. Washington D.C.: International Monetary Fund, 1998

Holmes, Kevin. The Concept of Income (2001), cited in *Comparative Tax Law* by Victor Thuronyi. Kluwer Law International. 2003

- Hyman, David N. *Public Finance: A Contemporary Application of Theory to Policy*. 8th edition. India Edition. Delhi: Thomson. 2005
- Ishi, Hiromitsu. *The Japanese Tax System*. 3rd edition. New York. Oxford University Press. 2001
- Ivanova, Anna, Michael Keen and Alexander Klemm. *The Russian Flat Tax Reform*. IMF Working Paper WP/05/16, Washington D.C.: International Monetary Fund. 2005
- Kaplow, Louis. *The Theory of Taxation and Public Economics*. Princeton: Princeton University Press. 2008
- Lathrope, Daniel. *Global Issues in Income Taxation*. Thomson/West. 2008
- Marshall, Alfred. "Economics of Industry (1901)." cited in the *Federal Income Tax* edited by Robert Murray Haig. New York. Columbia University Press. 1921 (iv, 93)
- Martor, Boris, Nanette Pilkington, David S. Sellers and Sebastien Thouvenot. *Business Law in Africa: OHADA and the Harmonization Process*. Eversheds. 2002
- Melz, Peter, "Sweden." in *Comparative Income Taxation: A Structural Analysis*. Edited by Hugh J. Ault and Brian J. Arnold. 3rd edition. Pp... Aspen Publishers, 2010
- Mill, John Stuart. *On Liberty and Other Essays*, Oxford World's Classics. edited with an introduction and notes by John Gray. Oxford University Press. 1991
- Moore, Schuyler M. *Taxation of the Entertainment Industry*. New York: a Panel Publication. 2003
- Murphy, Liam and Thomas Nagel. *The Myth of Ownership, Taxes and Justice*. Oxford University Press. 2002
- Musgrave, Richard A. and Peggy Musgrave. *Public Finance in Theory and Practice*. 5th edition. fifth reprint. New York: Tata-McGraw Hill. 1989
- Muzondo, Timothy R. Richard Courneyea, Jennifer Brooks, and Amina Elmi. "Ethiopia: Introduction of a VAT and a Presumptive Income Tax and Reform of the Income Tax." Washington D.C.: International Monetary Fund, 2000
- Nakazato, Minoru, Mark Ramseyer & Yasutaka Nishikori, "Japan," in *Comparative Income Taxation: A Structural Analysis*. Edited by Hugh J. Ault and Brian J. Arnold. 3rd edition. Pp... Aspen Publishers, 2010
- OECD. *Fundamental Reform of Personal Income Tax*. OECD Tax Policy Studies, No. 13, Paris: OECD. 2006

Olowofeyeku, Abimola A., James Kirkbride and Deborah Butler. *Revenue Law: Principles and Practice*. 3rd edition. Liverpool Academic Press. 2003

Orwell, George. *The Collected Essays, Journalism and Letters of George Orwell*, Volume II: My Country Right or Left 1940-1943, Penguin Books Ltd., 1965 (edited by Sonia Orwell and Ian Angus)

Postlewaite, Guerin. *Problems and Materials in Federal Income Taxation*. 6th ed. Aspen Law & Business. 2002

Raad, Kees van, "The Netherlands." in *Comparative Income Taxation: A Structural Analysis*. Edited by Hugh J. Ault and Brian J. Arnold. 3rd edition. Aspen Publishers, 2010

Rawls, John. *The Theory of Justice*. Revised Edition. Harvard University Press. 1999

Repetti, James. "United States," in *Comparative Income Taxation: A Structural Analysis*. Edited by Hugh J. Ault and Brian J. Arnold. 3rd edition. Pp... Aspen Publishers, 2010

Selanie, Bernard. *The Economics of Taxation*, Cambridge. Massachusetts. MIT Press, 2002, translation by MIT Press

Schenk, Alan and Oliver Oldman. *Value Added Tax: A Comparative Approach, with Materials and Cases*. Transnational Publishers. 2001

Schon, Wolfgang, "Germany," in *Comparative Income Taxation: A Structural Analysis*. Edited by Hugh J. Ault and Brian J. Arnold. 3rd edition. Pp... Aspen Publishers, 2010

Shome, Parthasarathi. ed.. *Tax Policy Handbook*. Washington D.C.: International Monetary Fund. 1995

Simons, Henry. *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy*. Chicago: The University of Chicago Press. 1938

Smith, Adam. *An Inquiry Into The Nature and Causes of The Wealth of Nations*. 1776. Edited by Edwin Cannan and with introduction by Max Lerner. New York: The Modern Library. 1937

Slemrod, Joel and Jon Bakija. *Taxing Ourselves, a Citizen's Guide to a Debate over Taxes*, 4th edition. Cambridge: Massachusetts Institute of Technology. 2008

Stotsky, Janet. "The Base of the Personal Income Tax." in *Tax Policy Handbook*. edited by Parthasarathi Shome. Washington D.C.: International Monetary Fund. 1995

Tanzi, Vito (1987), cited in *Improving Tax Administration in Developing Countries* edited by Richard M. Bird and Milka Casanegra de Jantscher (eds.), *Improving Tax Administration in Developing Countries*. Washington D.C.: International Monetary Fund. 1992

Taye Assefa (ed.) *.Digest of Ethiopia's National Policies, Strategies and Programs*, Addis Ababa: Forum for Social Studies, 2008

Thuronyi, Victor, *Comparative Tax Law*, Kluwer Law International., 2003

_____ ed., *Tax Law Design and Drafting*. vol. 1. Washington D.C.: International Monetary Fund. 1996

_____ ed. *Tax Law Design and Drafting*. vol. 2. Washington D.C.: International Monetary Fund. 1998

Tibebu, Teshale. *The Making of Modern Ethiopia: 1896-1974*. The Red Sea Press, 1995

Tilahun Teshome and Taddese Lencho. eds.. Position of the Business Community on the Revision of the Commercial Code of Ethiopia. Addis Ababa: Addis Ababa Chamber of Commerce and Sectoral Associations. PSD Hub Publication No. 8. July 2008

Tiley, John. *Revenue Law*. 5th edition. Oxford, Hart Publishing. 2005

_____ "The United Kingdom," in *Comparative Income Taxation: A Structural Analysis*. Edited by Hugh J. Ault and Brian J. Arnold. pp... 3rd edition. Aspen Publishers, 2010

Torgler, Benno. *Tax Compliance and Tax Morale: A Theoretical and Empirical Analysis*. Edward Elgar Publishing Limited, 2007

Van der Heeden, Koenraad, "The Pay-As-You-Earn Tax on Wages," in *Tax Law Design and Drafting*, edited by Victor Thuronyi, vol. 2, pp. 564-596. International Monetary Fund, 1998 564-596

Vanistendael, Frans, "The Legal Framework for Taxation," in *Tax Law Design and Drafting*, edited by Victor Thuronyi, vol. 1, pp.... International Monetary Fund, 1996

Vann, Richard, Australia, in *Comparative Income Taxation: A Structural Analysis*. Edited by Hugh J. Ault and Brian J. Arnold. pp... 3rd edition. Aspen Publishers, 2010

Vegh, Perla Gyongyi. ed. OECD Model Tax Convention on Income and On Capital and Key Tax Features of Member Countries, Condensed Version – 2005, IBFD Tax Travel Companions, Amsterdam: IBFD. 2005

Williams, David, "The Value Added Tax," in *Tax Law Design and Drafting*, edited by Victor Thuronyi, vol. 1. Washington D.C.: International Monetary Fund, 1996

Zee Howell H. "Theory of Optimal Commodity Taxation." in *Tax Policy Handbook*, edited by Parthasarathi Shome. Washington D.C.: International Monetary Fund, 1995

Zee Howell H., "Theory of Optimal Income Taxation," in *Tax Policy Handbook*, edited by Parthasarathi Shome. Washington D.C.: International Monetary Fund, 1995

Journal Articles

Andrews, William. "A Consumption-Type or Cash Flow Personal Income Tax." *Harv. L. Rev.*, 87 (1974)

Avi-Yonah, Reuven. "The Three Goals of Taxation," *Tax Law Review*. 60(2006-2007)

Bekele Haileselassie. "Salient Features of the Major Income Tax Laws." *Journal of Ethiopian Law*. 15 (1992)

Bird, Richard M., and Eric Zolt. "Dual Income Taxation and Developing Countries." *Columbia Journal of Tax Law*. 1 (2010)

Bittker, Boris I. and George K. Rahdert. "The Exemption of Nonprofit Organizations from Federal Income Taxation." *The Yale Law Journal*, 85, No. 3 (Jan., 1976)

Bittker, Boris. "A 'Comprehensive Tax Base' as a Goal of Income Tax Reform." *Harv. L. Rev.*, 80 (1967)

_____ "Comprehensive Income Taxation: A Response." *Harv. L. Rev.* 81, No. 5 (1968)

Bradley, Keith, and Saul Estrin. "Profit Sharing in the British Retail Trade Sectors: the Relative Performance of John Lewis Partnership." *The Journal of Industrial Economics*, XL(September 1992): pp. 291-304

Buehler, Alfred G. "Ability-to-Pay." *Tax Law Review*. 1 (1945-1946)

Perdices de Blas and Revuelta Lopez. "Markets and Taxation: Modern Taxation Principles and School of Salamanca." *Esic Market*. 138(2011)

Dodge, Joseph M. "Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-Pay Principles." *Tax Law Review*, 58(Summer 2005)

- Elkins, David. "Horizontal Equity as a Principle of Tax Theory." *Yale L. & Pol'y Rev.* 24, (Winter 2006)
- Eshetu Chole. "Income Taxation in Pre- and Post-Revolution Ethiopia: A Comparative Review." *Ethiopian Journal of Development Research*, volume 9, No. 1(April 1987)
- Fisher, Irving. "The Double Taxation of Savings." *The American Economic Review.* 29, No. 1 (1939)
- Forstakis, Theodore. "Greece – National Report." *Michigan State Journal of International Law.* vol. 15, Issue 2. (2007)
- Garbarino, Carlo. "Italy – National Report." *Michigan State Journal of International Law.* vol. 15, Issue 2 (2007)
- Genser, Bernd. "The Dual Income Tax: Implementation and Experience in European Countries." *EKONOMSKI PREGLED*, 57 (3-4) (2006)
- Graetz, Michael. "100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System." *The Yale Law Journal.* 112(2002)
- Green, Ronald M. "Ethics and Taxation: A Theoretical Framework." *The Journal of Religious Studies* vol.12, No. 2 (Fall, 1984)
- Gunn, Alan. "The Case for an Income Tax." *The University of Chicago Law Review.* 46, No. 2 (Winter, 1979)
- Head, John G. "Henry Simons, Revisited, Report of the Canadian Royal Commission on Taxation." *FinanzArchiv/Public Finance Analysis*, New Series Bd. 29. H. 2 (1970)
- Hines, James R. "Non-Profit Business Activity and the Unrelated Business Income Tax." *Tax Policy and the Economy.* 13 (1999)
- Kaplow, Louis. "Horizontal Equity: Measures in Search of Principle." *National Tax Journal.* vol. 42, No. 2 (June 1989)
- Kay, J. A. "Tax Policy: A Survey." *the Economic Journal.* 100 (March 1990)
- Kendrick, M. Slade. "The Ability-to-Pay Theory of Taxation." *The American Economic Review*, vol. 29, No. 1 (Mar., 1939))
- Kornhauser, Marjorie. "The Rhetoric of the Anti-Progressive Income Tax Movement: A Typical Male Reaction." *Michigan Law Review*, vo. 86, No. 3 (Dec. 1987)

_____ “Choosing A Rate Structure in the Face of Disagreement.” *UCLA L. Rev.*, vol 52 (August, 2005)

Margalioth, Yoram. “Tax Competition, Foreign Direct Investments and Growth: Using the Tax System to Promote Developing Countries.” *Virginia Tax Review*, 23 (2003)

Martinez, Leo P. “The Trouble with Taxes: Fairness, Tax Policy, and the Constitution.” *Hastings Const. L. Q.* vol. 31, No.4 (Summer 2004)

Musgrave, Richard A. “In Defense of an Income Tax.” *Harvard Law Review*. 81(1967)

_____ “Horizontal Equity: Once More.” *National Tax Journal*. vol. 43, No. 2, (June 1990)

Narveson, Jan. “Anarchy, State, and Utopia Thirty Years Later: Nozick on Taxation.” *NYU J. L. & Liberty*. 1 (2005)

Joseph A. Pechman. “Why We Should Stick with the Income Tax.” *The Brookings Review*. vol. 8, No. 2 (1990)

Sneed, Joseph S. “The Criteria for Federal Tax Policy.” *Stanford Law Review*. vol. 17, No. 4 (Apr., 1965)

Steinmo, Sven. “The Evolution of Tax Policy Ideas: Tax Policy in the 20th Century.” *British Journal of Politics and International Relations*. vol. 5, No. 2. (June 2003)

Sugin, Linda. “Property, Taxation and Distributive Justice: Theories of Distributive Justice and Limitations on Taxation: What Rawls Demands from Tax Systems,” *Fordham L. Rev.* 72 (April, 2004)

Stewart, Miranda. “Global Trajectories of Tax Reform: The Discourse of Tax Reform in Developing and Transition Countries.” *Harvard International Law Journal*. vol. 44, No. 1 (Winter, 2003)

Taddese Lencho. “The Ethiopian Tax System: Excesses and Gaps.” *Michigan State Journal of International Law*. Issue 20, No. 2 (2012)

_____ “Towards Legislative History of Modern Taxes in Ethiopia (1941-2008).” *Journal of Ethiopian Law*, Vol. 25, No. 2 (2012)

_____ “Income Tax Assignment under the Ethiopian Constitution: Issues to Worry About.” *Mizan Law Review*. vol. 4, No. 1 (2010)

Tapan-Mitra and Efe A. Ok. "Personal Income Taxation and the Principle of Equal Sacrifice Revisited." *International Economic Review*. vol. 37, No. 4 (November 1996)

Teshome Mulat. "Some Properties of the Ethiopian Personal Income Tax." *Ethiopian Journal of Development Research*. vol. 9, No. 1 (April 1987)

Vanderlinden, Jacques. "Civil Law and Common Law Influences on the Developing Law of Ethiopia," *Buff. L. Rev.* vol. 16 (1966-1967)

Warren, Alvin C. "Comments: Fairness and a Consumption-Type or Cash Flow Personal Income Tax." *Harv. L. Rev.* vol. 88 (1975)

Magazines

Addis Ra'iy, Meskerem – Tikimt 2004 E.C., 2nd year, Issue 3 No. 7 Ethiopian Peoples' Revolutionary Democratic Front (EPRDF) Concept Magazine

Cover Interview with Ato Sufian Ahmed, Minister of Finance and Economic Development, "Ethiopia is Ready to compete", *The African Economy*, October – December 2009

Cover Interview, with Ato Sufian Ahmed, Minister of Finance and Economic Development, "We Are Laying Foundation to Transform the Economy", *The African Economy*, September – November 2011

Ato Sufian Ahmed, Ministry of Finance and Economic Development, Ethiopian Business Climate Improving, *The African Economy*, October – December 2010

Solomon Gizaw, Income Tax Proclamation: Comments on Final Draft, in Economic Focus, the New Tax Proclamation, Special Issue, vol. 5, No. 1, p. 29

Ayalew Werota, Standard Integrated Government Tax Administration System (SIGTAS), The Emerging System, *Gebi Lelimat*, vol. 2, No. 2, April 2006

Newspapers

Altman, Daniel, a Tax Code Not Intended for Amateurs, February 04, 2003, www.nytimes.com/.../a-tax-code-not-intended-for-amateurs; accessed on August 12, 2012

Buffet, Warren, Stop Coddling the Super-Rich, The New York Times, August 14, 2011, at <http://www.nytimes.com/2011/08/15/opinion/stop-coddling-the-super-rich.html>? Accessed on March 19, 2012

Conference Emphasizes Building Tax Administration Capacity, The Ethiopian Herald, 9 June 2012, Vol. LXVIII No. 233

Demoztagnoch Kenegadewoch Yeteshale Taks Yikeflalu, Addis Zemen, *Sene 3*, 2004 E.C. 71st year, No. 273

Editorial, *Fortune*, New Dividend Tax Interpretation Unlawful, Unfair, vol. 13, No. 665, January 27, 2013

Ekonomiw Yemiyamenechwin Gebi Bagbabu Mesebiseb Yigebal, Addis Zemen *Sene 2*, 2004 E.C. 71st year No. 272

Interviews with Ato Wosenyeleh Abebe and Ato Teferi Alemu, *Kokeb*, 1st year No. 4, *Megabit 4*, 1985 E.C.

Mahlet Mesfin, Tax Authority Claims 210m Br. In Back Taxes from Libya Oil (sic), *Fortune*, vol. 12, No. 574, May 1, 2011

_____, ERCA seeks Dividend Tax Whether Retaining Earnings or Not, *Fortune*, vol. 13, No. 659, December 16, 2012

_____, Tax Auth. Spends 33m Br on Confiscations, ERCA gets around 400 million Br back due to tip-offs from informants, *Fortune*, vol. 11, No. 547, Oct. 24, 2010.

_____, BGI Blames Employees for Underreporting, Brewery Claims distributors poor record keeping, traditional reporting of sales caused discrepancy, *Fortune*, vol. 10, No. 552, November 28, 2010

_____, BGI Pays Tax Auh. (sic) 24m Br of 109m Br Owed, Around 1.5 Br. Goes to three Informants who alerted the ERCA about underreporting, *Fortune*, vol. 10, No. 551, November 21, 2010

_____, Tax Authority Shells Out Millions for Tips, *Fortune*, vol. 12, No. 595, September 2011

_____, Taxman to Probe Potential Windfall Profits to Petroleum Distributors, *Fortune*, vol. 13, No. 633, June 17, 2012

Melkam Aschalew, ERCA Determined to go Back in Time to Claim Dividend Tax, *Fortune*, vol. 13, No. 664, January 20, 2013

Muluken Yewondwossen, ERCA to Collect Tax Arrears from Undistributed Dividend, *Capital*, December 17, 2012

_____, Undistributed Dividend Tax applies, *Capital*, January 21, 2013

Tamirat Gebre Giorgis, Al-Amoudi's Horizon Acquires Matador-ATC's 69pc for \$18m, *Fortune*, vol. 11, No. 562, February 06, 2011

Tax Authorities to Explain Demand on Dividend Tax, in Retrospect, *Fortune*, vol. 13, No. 664, January 17, 2013

Yohannes Woldegebriel, Dividend Tax Notice Illegal, *Fortune*, vol. 13, No. 664, January 20, 2013

Zafu Eyesuswork Zafu, Dividend Tax Law Mistakes Unforgivable, *Fortune*, vol. 13, No. 673, March 24, 2013

Unpublished Articles/ Student Theses/Manuscripts

Deso Chemed, Taxation of Agricultural Income and Rural Land Use Payment: the Law and the Practice in Oromia, Addis Ababa University School of Law, Senior Thesis, 2008, unpublished

Estifanos Denbu, Taxation of Income from Rental of Buildings under Schedule B, Addis Ababa University School of Law, Senior Thesis, 2008, unpublished

Eyerusalem Ejigu, The Foreign Tax Credit: Its Limitations and Computation Methods under Proc. No. 286/2002, Addis Ababa University, School of Law, Senior Thesis, 2007, unpublished

Kalkidan Negash, The Taxation of Multinational Enterprises under Ethiopian Law, Addis Ababa University, School of Law, Senior Thesis, 2005, unpublished

Kefaynans Sira Askiyajoch Komite Lehig Balemuyawoch Komite Muyawi Asteyayet Endisexibet Yeqerebe Riport, Miyazia 2003 E.C., in Amharic, unpublished

Lila Desta, Taxation of Corporate Distributions in Ethiopia: The Adequacy of the Existing Rules and Lessons from Comparative Study, Mekelle University, College of Law and Governance, Department of Law, L.L.M Thesis, February 2012, unpublished

Muuz Abraha Income Tax Withholding in Higher Education Institution in Mekelle City, Mekelle College of Law and Governance Studies, Graduate Program in Taxation and Investment, 2011

Selam Taddese Income Tax Exemption for Religious Institutions and NGOs, Addis Ababa University, School of Law, Senior Essay, unpublished, 2009

Solomon Teshome. Tax Exclusion under the Ethiopian Employment Income Tax Law, Fringe Benefits in Kind, Addis Ababa University, School of Law, Senior Thesis, 2008, unpublished

Sorenson, P. B., The Nordic Dual Income Tax – In or Out?, Speech delivered at the meeting of Working Party 2 Fiscal Affairs, OECD, 14, June 2001

Taddese Lencho, Legal Transplantation and Mis-Implantation: Evidence from the Tax Reforms of 2002, a monograph, unpublished, 2010

_____, *Be Itiyophiya Higa Mangist Sila Takatatut Ye Taksina Gibir Siltanat Andand Natiboch* (Some Points about Taxation Powers in the Ethiopian Constitution), 2004 E.C., in Amharic, unpublished

Weynalem Weldesenbet, Taxation of Partnerships and Partners under Ethiopian Law: Comparative Study, Addis Ababa University, School of Law, Senior Thesis, 2008, unpublished

Zerihun Assegid Presumptive Taxation of Small Businesses in Ethiopia: The Law and Practice Relating to Standard Assessment in Addis Ababa City, Senior L.L.M Thesis, Mekelle University, College of Law and Governance Law Department, January 2012, unpublished

General References

Black's Law Dictionary. ed. Brian A. Garner. Seventh edition. 1999.

Encyclopedia Britannica 15th edition. Micropaedia Ready Reference. Vol.10 (2005)

Political and Economic Dictionary of Africa, eds. David Seddon, with Daniel Seddon-Dains, first edition, London: Routledge (2005)

The American Heritage Dictionary of the English Language. 3rd edition.

Webster's Ninth New Collegiate Dictionary. Merriam Webster Inc., Springfield, Massachusetts.

Government Documents

The Provisional Military Government of Socialist Ethiopia, Office of the Chairman of the Council of Ministers, *Tikimt*, 3, 1975 E.C., in Amharic, unpublished

Provisional Military Government of Socialist Ethiopia, Ministry of Culture and Sports, undated, in Amharic, unpublished

Ye Itiyophiya Biherawi Tiyatre, Liyu Liyu Yefexera Maberetacha Kifiyawoch Memeriya, Yekatit 1982 E.C., in Amharic, unpublished (Ethiopian National Theatre, Directives on Various Emoluments for Creative Works, Yekatit 1982 E.C., in Amharic, unpublished)

Ba Itiyophiya Federalawi Dimokrasiyawi Ripablic, Ye Ganzabina Ikonomi Limat Minister, Le Gabiwochina Gumruk Balesiltan, date blurred

U.S. Department of Treasury, Tax Reform for Fairness, Simplicity and Economic Growth, p. 13 available at <http://www.treasury.gov/resource-center/tax-policy/Documents/tres84v1C-2.pdf>, last accessed August 14, 2012

The Transitional Government of Ethiopia, The Economic Policy During the Transitional Period (An Official Translation), Addis Ababa, November 1991

The Federal Democratic Republic of Ethiopia, Ministry of Finance, Tir 01, 1993, in Amharic, unpublished

Be Gabi Gibir Awaj Qux. 286/94 sila Takatatu Wana Wana Hasaboch Mabrarriya, 1994 E.C., in Amharic

Ministry of Finance and Economic Development letter written to the then Ministry of Revenues, 17/03/1996 E.C., in Amharic, unpublished

World Development Report 1997, The Role of the State in a Changing World, the International Bank for Reconstruction and Development/the World Bank, Washington D.C., 1997

Ministry of Finance and Economic Development, Letter to Ministry of Revenues and Addis Ababa Finance and Economic Development Bureau, 15/09/98 E.C.,(exempting Cuban expatriates working for the Health Bureau in Addis Ababa City Administration) in Amharic, unpublished

The Federal Democratic Republic of Ethiopia, Ministry of Finance and Economic Development, Letter Written to Ministry of Revenues, 15/09/98 E.C., in Amharic, unpublished

Federal Inland Revenue Authority, Ministry of Revenue, Letter written to the Ethiopian Civil Service College, 25/2/1999 E.C., in Amharic, unpublished

United Nations Conference on Trade and Development, Tax Incentives and Foreign Direct Investment, A Global Survey, ASIT Advisory Studies, Geneva, 2000

United Nations Conference on Trade and Development, Tax Incentives and Foreign Direct Investment, available at http://unctad.org/en/Docs/iteipcmisc3_en.pdf, last accessed on August 20, 2012

Ethiopian Revenues and Customs Authority Letter to Addis Ababa Finance and Economic Development Revenues Agency, *Sene*, 22, 2001 E.C., in Amharic, unpublished

Ethiopian Customs and Revenues Authority, Bahr Dar Branch, Customers Services Business Process, 08/10/2001 E.C., in Amharic, unpublished

Federal Democratic Republic of Ethiopia, Ministry of Finance and Economic Development, Ethiopia: Sustainable Development and Poverty Reduction Program, July 2002, Addis Ababa

Be Gebi Gibir Awaj Quxir 286/1994 Lay Yeqerebe Mabrarriya, Be Itiyophiya Gebiwochina Gumruk Balesiltan Aqabe Hig Direktoret Be Fitihaber Gudiyoch Astebabari Yetezegaje, Tahsas 2003 E.C., Addis Ababa

Ye Itiyophiya Gebiwochina Gumruk Balesiltan, Ye Ageritu Ye Amist Amet /2003-2007/ Ye Idigatina Ye Tiransformeshin Iqid Le Itiyophiya Gebiwochina Gumruk Balesiltan Yeminorew Endemta, Yekatit 2003 E.C., Addis Ababa, in Amharic, unpublished

Ethiopian Revenues and Customs Authority, Arada Sub City Small Tax Payers Branch Office, Letter to Ethiopian Orthodox Tewahido Church Addis Ababa Diocese, 2003 E.C., in Amharic, unpublished

Ethiopian Orthodox Tewahido Church Addis Ababa Diocese Secretarial, 2003 E.C., in Amharic, unpublished

Be Addis Ababa Ketema Asitedader Ye Fayinansina Ekonomi Limat Biro Ye Gebiwoch Ejensi, Le Medebegna Qurx Gibir Awesasen Sir'at Be Sira Lay Yiwil Zend Yetexameru Ye Nigd Sirawoch Ayinet, 21/5/2003 E.C., in Amharic, unpublished

Ministry of Finance and Economic Development Letter to Ethiopian Revenues and Customs Authority, 21/08/2003 E.C., in Amharic, unpublished

Be Addis Ababa Ketema Asitedader Faynansina Ekonomi Limat Biro Ye Gebiwoch Ejensi, Gibir, Le Gibir Kefayu Hibreteseb Yetezegaje Ye Ginizabe Maschebechana Mereja Sechi Tsihuf, Tahsas 1996 E.C., Addis Ababa, in Amharic

Addis Ra'iy, Ethiopian Peoples' Revolutionary Democratic Front (EPRDF) Concept Magazine, Tikimpt 2004 E.C., in Amharic

Letter written to AAU, Natural Science Faculty, Addis Ababa, ERCA, Customers Education and Support, 18 *Miazia* 2004 E.C, in Amharic, unpublished.

Letter written to Kotebe Teachers' College, ERCA, Arada Sub City Small Taxpayers Branch Office on 22/08/04, in Amharic, unpublished

Revision Proposals of the Large Tax Taxpayers' Branch Office, ERCA, Addis Ababa, 2004 E.C., in Amharic, unpublished

Federal Democratic Republic of Ethiopia, Ministry of Finance and Economic Development, Legal Opinion Letter Written to Ethiopian Revenues and Customs Authority, 27/11/2004 E.C., in Amharic, unpublished

Ethiopian Revenues and Customs Authority, **Internal Memo:** ERCA, 22/05/2004 Re: Implementation of Dividend Tax, in Amharic, unpublished

IRS, IR-2006-180, November 17, 2006

Federal Democratic Republic of Ethiopia, Central Statistical Agency, Statistical Abstract, 2008, Addis Ababa

The Federal Democratic Republic of Ethiopia, The New Federal Budget Grant Distribution Formula, May 2007, Addis Ababa

Federal Democratic Republic of Ethiopia, Growth and Transformation Plan 2010/11-2014/15, Ministry of Finance and Economic Development, November 2010, Addis Ababa

Ministry of Trade, Ethiopian Standard Industrial Classification (ESIC), 2010, (First Publication)

IRS Publication 598 (Rev. March 2012), Tax on Unrelated Business Income Exempt Organizations

Ethiopian Revenues and Customs Authority (ERCA), Statistical Bulletin (vol. 1), February 2011, Addis Ababa

United Nations Model Double Taxation between Developed and Developing Countries, United Nations, Economic and Social Affairs, 2011

Cases

McCulloch v. Maryland 17 U.S. (4 Wheat) 316, 431 (1819), quoted in Martinez, Leo P., "The Trouble with Taxes: Fairness, Tax Policy, and the Constitution," *Hastings Const. L. Q.*, vol. 31, p. 416, foot note 15

Nicol v. Ames 173 U.S. 509, 516 (1899), quoted in Joseph S. Sneed, "The Criteria for Federal Tax Policy," *Stanford Law Review*, vol. 17, No. 4 (Apr., 1965), p. 572, foot note 14

Eisner v. Macomber, 252 US 189 (1920), cited in Guerin Postlewaite, *Problems and Materials in Federal Income Taxation* (6th edition), Aspen Law & Business, 2002, p. 39

Connally v. General Construction Co., 269 U.S. 385 (1926), quoted in Daniel Pilla “Ten Principles of Federal Tax Policy,” Legislative Principles Series, The Heartland Institute available at http://heartland.org/sites/all/modules/custom/heartland_migration/files/pdfs/28542.pdf, last accessed on August 5, 2012

Commissioner v. Glenshaw Glass Co 348 U.S. 426 (1955), cited in Guerin Postlewaite, *Problems and Materials in Federal Income Taxation* (6th edition), Aspen Law & Business, 2002, p. 40

Mitchell and Edon v. Ross [1961] 3 All ER 49, 55; 40 TC 11, cited in John Tiley, *Revenue Law*, 2005, p. 136

Lord Macnaghten in **London County Council v. A.G.**, cited in Abimola A. Olowofoyeku, James Kirkbride and Deborah Butler, *Revenue Law: Principles and Practice*, 3rd edition, p. 73, foot note 23

Shell Ethiopia Ltd. v. Inland Revenue Administration, Civ/App/File/No. 763/78, in Amharic, unpublished

Makwor Ethiopia PLC vs. IRA, Federal Tax Appeal Commission, File No. 480, *Sene* 24, 1995 E.C., in Amharic, unpublished

Seferian Ethiopia PLC v. Federal Inland Revenue Authority (FIRA), Federal Tax Appeal Commission, File No. 562, *Ginbot* 1, 1998 E.C., in Amharic, unpublished

FIRA vs. Mekonnen Tsion Central Automotive, Federal Supreme Court Cassation File No. 18628, Vol. 1, No. 2, 1999 E.C., in Amharic, pp. 109-110

Ethiopian Seventh Day Adventist Church v. Akaki-Qality Sub-City Administration Revenues Office, File No. 66474, Federal Supreme Court, Cassation Division, vol. 13, pp. 506-510, in Amharic

ERCA v. Matador Addis Tyre PLC, Federal App/File/No. 66470, Federal Supreme Court, *Sene* 06 2003 E.C., in Amharic, unpublished

Lideta Sub-City Revenues Bureau v. Demissie Gebre Federal Court Cassation File No. 58620, *Sene* 02, 2003 E.C., unpublished, in Amharic

W/ro Etaferaw Wondimu v. Akaki Qality Sub-City Small Business Taxpayers' Branch Office Tax Appeal File No. 1454/04/783/04, Yekatit 15, 2004 E.C., in Amharic, unpublished

Re DHL Ethiopia, unpublished, internal documents, ERCA

Re Red Fox Ethiopia, unpublished, internal documents, ERCA

Laws

The Constitution of the United States of America available at <http://www.usconstitution.net/const.pdf> last accessed July 09, 2013

Education Tax Proclamation No. 94/1947, *Negarit Gazeta*, 7th year, No. 3

Educational Expenditure Proclamation No. 95/1947, *Negarit Gazeta*, 7th year, No. 3

Proclamation to Provide for the Payment of Tax by All Individuals and Businesses No. 107/1949, *Negarit Gazeta*, 8th year, No. 12

The Personal and Business Tax Legal Notice No. 138/1949, *Negarit Gazeta*, 9th year, No. 4

Proclamation to Provide for the Payment of Tax by All Individuals and Businesses, 1949, Proc. No. 107, *Negarit Gazeta*, 8th year, No. 12

Universal Declaration of Human Rights available at <http://www.un.org/en/documents/udhr/> accessed on July 11, 2013

A Proclamation to Provide for Cattle Tax, 1954, Proc. No. 142, *Negarit Gazeta*, 14th year, No. 1

The Civil Code of Ethiopia, 1960, *Negarit Gazeta*, Gazette Extraordinary, 19th year, No. 2

The Commercial Code of the Empire of Ethiopia of 1960, *Negarit Gazeta* – Extraordinary Issue No. 3 of 1960, Addis Ababa, 1960

Proclamation to Provide for Payment of Income Tax No. 173/1961, *Negarit Gazeta*, 20th year, No. 13, Article 3(e)

Proclamation to Provide for a National Lottery No. 183/1961, *Negarit Gazeta*, Year 21, No. 3

Municipality of Addis Ababa Amusement Tax Regulations, 1964, Legal Notice No. 291, *Negarit Gazeta*, 23rd year, No. 20

Kenyan Income Tax Act Cap. 470 (1974) available at www.eac.int/customs/index.php?option=com_docman&task... last accessed on August 06, 2012

Government Ownership of Urban Lands and Extra Houses Proclamation No. 47/1975, *Negarit Gazeta*, 34th year, No. 41

Urban Land and Urban Houses Tax Proclamation No. 80/1976, *Negarit Gazeta*, 35th year, No. 25

Income Tax Amendment Proclamation No. 155/1978, *Negarit Gazeta*, 38th year, No. 3

The Vienna Convention on Diplomatic Relations and Optional Protocol, 18th April 1961

Proclamation to Amend the Income Tax, 1978, Proc. No. 155, *Negarit Gazeta*, 38th year, No. 3

Petroleum Operations Income Tax Proclamation No. 296/1986, *Negarit Gazeta*, 45th year, No. 7

Petroleum Operations Proclamation No. 295/1986, *Negarit Gazeta*, 45th Year, No. 6

Sales Tax Council of State Special Decree, 1990, Decree No. 16, *Negarit Gazeta*, 49th year, No. 11

Proclamation to provide for the Encouragement, Expansion and Coordination of Investment, 1992, Proc. No. 15, *Negarit Gazeta*, 51st year, No. 11

Proclamation to provide for the Encouragement, Expansion and Coordination of Investment No. 15/1992, *Negarit Gazeta*, 51st year, No. 11

Mining Proclamation No. 52/1993, *Negarit Gazeta*, 52nd year, No. 42

Mining Income Tax Proclamation No. 53/1993, *Negarit Gazeta*, 52nd year, No. 43

See Income Tax (Amendment) Proclamation No. 62/1993, *Negarit Gazeta*, 52nd year, No. 54

Income Tax Amendment Proclamation No. 107/1994, *Negarit Gazeta*, 54th year, No. 3

Payment of Tax on Gains from Capital Proclamation No. 108/1994, *Negarit Gazeta*, 54th year, No. 4

The Constitution of the Federal Democratic Republic of Ethiopia, *Federal Negarit Gazeta*, 1st year, No. 1, Addis Ababa – 21st August 1995

Ministry of Revenues, Directive to Waive Tax and Customs Penalties No. 5/1996 E.C., in Amharic, unpublished

Mining Income Tax (Amendment) Proclamation No. 23/1996, *Federal Negarit Gazeta*, 2nd year, No. 11

Ugandan Income Tax Act, Cap. 340 (1997) (iv, 294) available at www.opm.go.ug/assets/media/resources/.../INCOME%20TAX%20ACT.p.. last accessed August 21, 2012

Ye Gebiwoch Minister, Kapitalin Lemasadeg Yewale Ye Aksiyon Tirf Dirshan Kegebi Gibir Netsa Endihon Lemadreg Yetefeqedu Yesira Meskochin Lemastawoq Yeweta Ye Gebiwoch Minister Memeriya Quxir 17/1996, in Amharic, unpublished

Yegibiwoch Minister, Gibir Yemekifel Gidetachewin Belake Huneta Lemiwotu Gibir Kefayoch Silamiset Shilimat Ye Wota Memeriya Quxir 30/1998, unpublished

Ye Gebiwoch Minister, Yelake Yesira Wixet Lasmezegebu Serategnoch Silemisax Shilimat Yewoxa Memeriya Quxir 31/1998, in Amharic, unpublished

Cooperative Societies Proclamation No. 147/1998, *Federal Negarit Gazeta*, 5th year, No. 27
Capital Goods Leasing Business Proclamation No. 103/1998, *Federal Negarit Gazeta*, 4th year

Ethiopian Revenues and Customs Authority, Directive on Issuing a Certificate of Tax Clearance to Taxpayers who Complied with their Tax Obligations; Nehassie 2001 E.C.

Ethiopian Revenues and Customs Authority, Directive on Rewards to Informants on the Use of Cash Register Machines, Nehassie 2001 E.C.

Income Tax (Amendment) Proclamation No. 227/2001, *Federal Negarit Gazeta*, 7th year, No. 9

Income Tax Proclamation No. 286/2002, *Federal Negarit Gazeta*, 8th year, No. 34

Value Added Tax Proclamation No. 285/2002, *Federal Negarit Gazeta*, 8th year, No. 33

Excise Tax Proclamation No. 307/2002, *Federal Negarit Gazeta*, 9th year, No. 20

Turnover Tax Proclamation No. 308/2002, *Federal Negarit Gazeta*, 9th year, No. 21

Value Added Regulations No. 79/2002, *Federal Negarit Gazeta*, 9th year, No. 19

Investment Proclamation 280/2002, *Federal Negarit Gazeta*, 8th year, No. 27

Council of Ministers Investment Regulations on Investment Incentives and Investment Areas Reserved for Domestic Investors No. 84/2003, *Federal Negarit Gazeta*, 9th year, No. 34

Income Tax Regulations 78/2002, *Federal Negarit Gazeta*, 8th year, No. 37

Federal Democratic Republic of Ethiopia, Ministry of Finance and Economic Development, Directive to Determine Tax on Windfall Profits obtained by Banks No. 29/2003 E.C., in Amharic, unpublished

Addis Ababa City Administration, Finance and Economic Development Bureau, Revenues Agency, 21/5/2003, in Amharic, unpublished (the Standard Assessment Table for Small Businesses)

Council of Ministers Regulations on Investment Incentives and Investment Areas Reserved for Domestic Incentives, 2003, Regs. No. 84, *Federal Negarit Gazeta*, 9th year, No. 34

Investment (Amendment) Proclamation, 2003, Proc. No. 373, *Federal Negarit Gazeta*, 10th year, No. 8

Ye Bego Adiragot dirijitochina Mahiberat Ejensi, Ye Bego Adiragot Dirijitochina Mahiberat Ye Gebi Masigegna Sirawoch Lay Yemisemarubatin Huneta Lemewosen Yewoxa Memeriya Quxir 07/2004, Meskerem 2004 E.C., in Amharic, unpublished

Copyrights and Neighboring Rights Protection, 2004, Proc. No. 410, *Federal Negarit Gazeta*, 10th year, No. 55

Oromia National Regional Government Rural Land Use Payment and Agricultural Income Tax Amendment, 2005, Proc. No. 99, *Megeleta Oromia*, 13th year, No. 13/2005

The Revised Export Trade Duty Incentive Scheme Establishing Proclamation No. 543/2007, *Federal Negarit Gazeta*, 13th year, No. 57

Council of Ministers Regulations To Provide for the Obligatory Use of Sales Register Machines No. 139/2007, *Federal Negarit Gazeta*, 13th year, No. 4

Directive No. 46/2007, Issued to Provide for the Use of Sales Register Machines, unpublished

Ethiopian Revenues and Customs Authority Establishment Proclamation No. 587/2008, *Federal Negarit Gazeta*, 14th year, No. 44

Building Proclamation No. 624/2009, *Federal Negarit Gazeta*, 15th year, No. 31

Higher Education Proclamation No. 650/2009, *Federal Negarit Gazeta*, 15th year, No. 64

The Federal Government of Ethiopia Financial Administration Proclamation No. 648/2009, *Federal Negarit Gazeta*, 15th year, No. 56

Charities and Societies Proclamation No. 621/2009, *Federal Negarit Gazeta*, 15th year, No. 25

National Lottery Administration Re-establishment Council of Ministers Regulation No. 160/2009, *Federal Negarit Gazeta*, 15th year, No. 21

Mining Operations Proclamation No. 678/2010, *Federal Negarit Gazeta*, 16th year

Commercial Registration and Business Licensing Proclamation No. 686/2010, *Federal Negarit Gazeta*, 16th year, No. 42

Income Tax (Amendment) Proclamation No. 693/2010, *Federal Negarit Gazeta*, 17th year, No. 3

Directive No. 29/2003 E.C., A Directive to Impose Tax on Windfall Profits of Banks, in Amharic, Ministry of Finance and Economic Development, unpublished

United Nations Model Double Taxation Convention between Developed and Developing Countries, Department of Economic and Social Affairs, United Nations, New York, 2011

Qajeelfama Qooddi Galii Mootummaa Naannoo Oromiyaa Bulchinsa Aanaalee fi Magaalotaa Murtessuf Bahe, in *Oromiffaa*, unpublished

Private Organizations Pension Proclamation No. 715/2011, *Federal Negarit Gazeta*, 17th year, No. 79

Council of Ministers Investment Incentives and Investment Areas Reserved for Domestic Investors Regulations No. 270/2012, *Federal Negarit Gazeta*, 19th year, No. 4

Export Trade Duty Incentive Schemes Proclamation No. 768/2012, *Federal Negarit Gazeta*, 18th year, No. 62

Export Trade Duty Incentive Schemes Proclamation No. 768/2012, *Federal Negarit Gazeta*, 18th year, No. 62

Investment Proclamation No. 769/2012, *Federal Negarit Gazeta*, 18th year, No. 63

Online Resources

Alemeida, Patricia Dias de, with assistance of Albert Atangana and Felix Buma, Cameroon – Individual Taxation, Country Surveys IBFD, Amsterdam, updated up to 28 Feb., 2011

Almeida, Patricia Dias de, Cameroon – Individual Taxation, Country Surveys, IBFD, Amsterdam updated up to 28 February 2011

Barry, Ibrahim, “Senegal – Individual Taxation,” Country Surveys, IBFD, Amsterdam, up dated up to 1 Nov. 2009

Benchekroun, Laila, Morocco – Individual Taxation, Country Surveys, IBFD, Amsterdam, updated up to 13 March 2012

Boadway, Robin, *Income Tax Reform for a Globalized World: The Case for a Dual Income Tax*, Prepared for the International Symposium of Tax Policy and Reform in Asian Countries, Hitotsubashi University, Tokyo, Japan, July 1-2, 2005, available at www.econ.hit-uc.jp/~kokyo/sympojuly05/papers/boadway-asian-tax-reform-pdf; accessed on July 13, 2012

Norstebo, E. & T.K. Gjerde, Norway – Individual Taxation, Country Analyses, IBFD (accessed 24 July 2012)

Gentry William M., “Optimal Taxation,” Encyclopedia of Taxation and Tax Policy available at <http://www.urban.org/publications/1000539.html> accessed on August 12, 2012

Hamzaoui, Ridha, Egypt – Individual Taxation, Country Surveys IBFD, Amsterdam, updated up to 1 March 2012

Hattingh, Johann, South Africa – Individual Taxation, Country Surveys IBFD, Amsterdam, updated up to 6th March 2012

_____, South Africa – Business and Investment, Country Surveys, IBFD, Amsterdam, updated up to 15 February 2013

L. Pakarinen, Finland – Individual Taxation Sec. 1, Country Analysis IBFD (accessed 24 July 2012)

Mill, John Stuart, *Principles of Political Economy, Abridged with Critical, Bibliographical and Explanatory Notes, and a History of a Sketch of Political Economy* by J. Laurence Laughlin, The Project Gutenberg Ebook, September 27, 2009

Munyandi, Kennedy, Zambia – Individual Taxation, Country Surveys, IBFD, Amsterdam, updated up to 16 August 2012

Namubiru, Patronella, assisted by Kennedy Munyandi, Uganda – Individual Taxation, Country Surveys, IBFD, Amsterdam, up dated up to 16th March 2012

Namumbiru, Patronella and Kennedy Munyandi, Uganda – Business and Investment, Country Surveys, IBFD, Amsterdam, up dated up to 15 February 2013

Omondi, Frederick, assisted by Kennedy Munyandi, Kenya – Individual Taxation, Country Surveys, IBFD, updated up to 20 March 2012; (accessed on)

Omondi, Frederick, Kenya – Corporate Taxation, Country Surveys, IBFD, Amsterdam, updated up to 4 March 2013

Page, Bill, Tanzania – Individual Taxation, Country Surveys, IBFD, Amsterdam, updated up to 13 March 2013

Pilla, Daniel “Ten Principles of Federal Tax Policy,” Legislative Principles Series, The Heartland Institute available at http://heartland.org/sites/all/modules/custom/heartland_migration/files/pdfs/28542.pdf, last accessed on August 5, 2012

Ries, Alexis Ribiero, Congo (Demo. Rep.) – Corporate Taxation, Country Surveys, IBFD, Amsterdam, updated to 1 March 2013

Romano, Carlin, A Survey and an Assertion, Twelve potted philosophers and a theory of human values, book reviews, summer 2011, *the American Scholar*, accessed at theamericanscholar.org/a-survey-and-an-assertion/3.uakianh-gwo accessed on June 22, 2012. (reviewing *Examined Lives: From Socrates to Nietzsche*, by James Miller; Farrar, Straus & Giroux; 422 pp.; \$28)

Taddese Lencho, Ethiopia, Corporate Taxation, Country Surveys, IBFD, Amsterdam, updated up to 1 March 2013

Pakarinen, L., Finland, Individual Taxation Sec. 1, Country Analysis, IBFD (accessed 24 July 2012)

Pilla, Daniel J., Ten Principles of Federal Tax Policy, Legislative Principles Series, Number 9, the Heartland Institute, 2010

Ji, Kan, and Jenny E. Ligthart, The Causes and Consequences of the Flat Income Tax available at https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=res_phd_2013&paper_id=116 last accessed on August 03, 201

APPENDIX

Questionnaires

Schedule A Questions

Name: _____ (optional)

Position: _____ (optional)

1. How long have you worked in the Tax Authority? _____
2. Do you have any experience of employees coming to the Tax Authority to report their income from different organizations?
 - a. Yes
 - b. No
3. If not, is the Authority completely dependent upon different organizations reporting the income of employees from multiple employments?
 - a. Yes
 - b. No
 - c. DK*
4. Are employees of international organizations and embassies filing their income taxes and paying the taxes due?
 - a. Yes
 - b. No
 - c. DK
5. If not, what schemes do you use to ensure that employees of international organizations and embassies pay their taxes? Please state:

* DK stands for 'Don't know'

6. Are there any schemes in place to monitor attempts by employees to turn certain payments in the context of employments into income from other sources, such as schedule C or Schedule D? For example, does the Authority monitor employers when employees and employers agree to re-characterize income as income from consultancy services or independent services?

a. Yes

b. No

c. DK

7. If not, do you think from your experience that the Authority is simply satisfied that tax has been paid no matter under what Schedule?

a. Yes

b. No

c. DK

8. Do you think employees who also earn income from other sources (Schedule B, C or D) should report income under these different schedules?

a. Yes

b. No

9. Do you think employees who also earn income from other sources (Schedule B, C or D) should report income under a single schedule and pay one income tax?

a. Yes

b. No

Schedule B Questions

Name: _____ (optional)

Position: _____ (optional)

1. How long have your worked in the Tax Authority? _____

2. Do real estate companies that generate income from rental of real estate and from sale of buildings pay one income tax?
 - a. Yes
 - b. No
 - c. DK*

3. If yes, under which Schedule do they pay income tax?
 - a. Schedule B
 - b. Schedule C
 - c. DK

4. Do real estate companies that generate income from rental of real estate and from sale of buildings pay two different income taxes – for income from rental of real estate under Schedule B and for income from sale of buildings under Schedule C?
 - a. Yes
 - b. No
 - c. DK

5. Is a real estate company involved in the sole business of constructing buildings and renting them out to customers subject to income tax under Schedule B or Schedule C?
 - a. Schedule B
 - b. Schedule C
 - c. DK

* DK stands for 'Don't know'

6. Do other businesses (e.g. banks) that generate income from rental of buildings and offices pay income tax under Schedule C for whole of their income?

a. Yes

b. No

c. DK

7. Do other businesses (e.g., banks) that generate income from rental of buildings and offices pay income tax under Schedule B separately from their other income?

a. Yes

b. No

c. DK

8. Article 35 of the Income Tax Proclamation targets one form of rental income: casual rental of property. Are there any reports of payments of tax on income from casual rentals of property?

a. Yes

b. No

c. DK

9. If yes, what sectors have so far reported payment of income tax from casual rental of property? Please mention

10. What types of casual rentals do you think should Article 35 target?

11. Article 7 of the Income Tax Regulations (No. 78/2002) states that income from lease of business shall be taxable under Schedule C. Are there reported cases of payment of income tax on income from business lease under Schedule C?

a. Yes

b. No

12. What cases in your opinions warrant the payment of income tax on income from business lease? Why?

Schedule C Questions

1. Do businesses that generate income from multiple trade activities report their aggregate income?

a. Yes b. No c. DK*

2. If yes, how often do you aggregate their income?

a. Very often b. Sometimes c. Rarely

3. Article 70 of the Income Tax Proclamation requires aggregation of income from several business activities falling under Schedule C (except when one of the businesses is a category C). Do you have schemes in place to ensure that taxpayers who carry on several businesses report their aggregate income regardless of whether these businesses are in one regional state or not?

a. Yes b. No c. DK

4. If yes, what schemes are in place to ensure that individuals with multiple businesses pay income tax on their aggregate income? (please specify):

5. If not, what do you think are the reasons?

a. Lack of administrative supervision

* DK stands for 'Don't know'

- b. Decentralization of tax jurisdiction and absence of coordination?
 - c. Others(please specify)_____
6. Do you check whether religious organizations, NGOs and charitable organizations carry on trade to supplement their income?
- a. Yes
 - b. No
 - c. DK
7. If yes, do you impose income tax on their supplemental income from business activity?
- a. Yes
 - b. No.
 - c. DK
8. Do you have schemes in place to monitor whether religious organizations, NGOs, and charitable organizations carry on business activity?
- a. Yes
 - b. No.
 - c. DK
9. If yes, what are the schemes?
- a. We coordinate with the Ministry of Justice, Agency for Registration of Associations
 - b. We require religious organizations, NGOs and charitable organizations to report business activities
 - c. We require information from various governmental agencies on the activities of religious organizations, NGOs and charitable organizations;
 - d. Other schemes (please specify)_____

6. If yes, what do you think are the policy bases for these tax rate differentials? (Please state your reasons):
7. Do you think the current Schedule D of Ethiopian income tax should be maintained?
 - a. Yes
 - b. No
8. If yes, why do you think they should be maintained? (Please state your reasons):
9. If no, why do you think they should be removed from the income tax? (Please state your reasons):
10. If you believe that Schedule D income tax should be maintained, what other sources of income do you think should be included in addition to the ones already chargeable under the current Schedule D? (Please list):
11. Do you think income from Schedule D sources be aggregated where a person derives income from multiple Schedule D sources – such as, from dividends, interest and royalties in any given tax year?
 - a. Yes
 - b. No
12. If not, why not? (Please state your reasons). Hint: your reasons might be related to worries over administrative complications.