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L L B THESIS

Tax imposition assessment and collection

law & practice

by *Your*

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Tax imposition assessment and collection

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Introduction

History tells us Ethiopia's tax system dates back to ancient times. For example in the Axumite kingdom there was a practice of traditional taxation. The traditional taxation provides for taxes on crops livestock and livestock products such as wool, butter and milk. The tax on wool was practically levied on mountainous areas of the country. Hunting taxes were imposed especially, on elephant hunters in the form of ivory taxes. Handicraftsmen were subjected to a sort of production taxes. Thus one can infer from the above points that taxation in traditional Ethiopia had been excessively burdensome and arbitrary.

In Zerayacob's chronicle it is stated that there was taxation to ancient times however it was during Zerayacob's time that the first tax system was introduced. The tax system was set for those people engaged in livestock production.

The first important reform carried out by Emperor Menelik II towards the end of the 19th century resulted in the establishment of a fixed tithe rather than the underfined and essentially arbitrary system of agriculture taxes.

The establishment of tax assessment has emerged with the establishment of government. In this establishment it is difficult to indicate the exact time and when taxation began. But many documents indicate that taxation was introduced during the time of King Zarayacob in 15th C.

From its citizen activities the government has to discharge tax and needs a huge amount of finance to provide those economic, social and political activities to its needs. So any government to sustain as a government should generate revenue. There are several sources of revenue. From that revenue the most essential is tax.

Now a day's in Ethiopia the government takes encourage able measures to reform the tax system and follow a good tax policy. Form those effective measures proclamation No 286/2002 and regulation No. 78/2002 are the one. Because of these measure, there are some legal practical problems appear. The main purpose of this paper is that to see those problems. Which are directly related with the income tax assessment tax payer's backs of account and records according to the income tax laws are applicable the tax authorities or Administration in the income tax assessment process. This research paper is divided in to three chapters. The first chapter discusses definitions of tax and general background of tax imposing assessment and collection.

The second chapter deals with the concept of assessment on taxpayer's books of income tax assessment on taxpayer's books of account, types and ways of income tax assessment, computation of taxable income, exemption, exclusion, tax rate and the importance of books account in assessing income tax. The third Chapter deals with federal Inland Revenue and its tax Jurisdiction power and involved in assessment of income tax on taxpayer's in detail. Finally, a conclusion and some recommendation are presented

Chapter One

General back ground of taxation

Before we discuss in detail the historical background of tax imposing assessment and collection it is important to define the term “tax” according to different authors.

1.1 Definition

Black’s law dictionary defines the term tax as:

A charge by the government on the income of an individual dual corporation as well as the value of an estate or gift.

A particular burden laid up on individual or property to support the government and is a payment exacted by the legislative authority.¹

We can understand from the above definition that tax is levied on a person and organization that carries out business activities and gain income from it. So the payment of tax concerns not only natural persons but also legal person or organization, and corporations, which carry out business activities.

Tax is also defined as:

Public burdens imposed generally up on the in habitants of the state or up on some civil there of for government purpose with out reference to peculiar benefits to particular individual or property.²

It is clear from this definition that states impose tax on their citizens without any direct and reciprocal benefit to tax payers. But it should be underlined that tax authorities should make clear/ to the tax payer the reason for forcing them to pay tax and the purpose for which the amount collected is to be used.

Bhatia defines tax as those who are taxed have to pay the sums irrespective of only corresponding return of Services or goods by the government.³

From the above definition we can understand that the major characteristic of a tax is its obligatory nature. Tax payers may not get proportional benefit for contribution however he/she is under obligation to pay tax for the common good. But before a tax authority forces tax payer to pay tax it is important to raise their awareness regarding the purpose and the objective of tax .If this work is effectively done by the tax authority it may enable the authority easily to collect tax on due time and to achieve its aim.

Tax can also be defined as:

_ A compulsory contribution made by citizens for the support of governments operation of the various legitimate functions of the government.⁴ this definition makes clear that tax is the main source of public revenue. Every independent sovereign state tax need to collect on due time in order to discharge its obligation of enhancing the rate of social, economic and political development.

It can be observed from the above discussion that the different theorists define tax in different ways. However gathered they convey similar message concerning the objective of imposing tax. In all definition the main objective of taxation is to support the government revenue as a main source of finance.

According to these definitions taxation in order to bring the social and economic development of a country there should be a means of revenue for a government. Tax is one of the most essential revenues of the government; every person who derives income is required to pay tax. As the result tax payment is compulsory because every person is directly or indirectly the beneficiary of law full activities of a government. So in most

Countries the government imposes and levies tax for the proper implementation socio-economic policies.

Governments before it levies tax it must fulfill certain pre-conditions as to effectively perform the duty on due time with out any difficulty First and for most taxes should be based on the individual's ability. So when a state issues tax laws it should try to avoid any ground for complaint. Thus the legislative body must consider the tax payer is ability to pay the tax.

If the tax law is convenient to the tax payer the tax authorities may fail to consider the ability to pay of tax payers by using its direction any power in the implementation of the law and while imposing, collecting tax.

The failure to consider the ability of tax payer has an influence on government revenue. A government usually needs money. The legislative body has power to enact a tax law and then it is the executive that will enforce the law. It will examine the activities tax administrations.

The administration impose tax in accordance with some reasonable rule proportioning by the authority of a sovereign state in order to achieve the /aim/ of development and enhance the progression in every law full activity of a sovereign state

1.2. Background of taxation

The imposition and assessment of tax is believed to have emerged with establishment of government. In Ethiopia it is too difficult to indicate the exact date and time when taxation began. Some document indicates that taxation was introduced during the period of king Zarayacob in 15th C. In 19th C during the regime of emperor Menilk, tax was levied by money until the time tax was paid either in kind or by wage.⁵

In 1917 and 1926 E .c .Tax was constitutionally levied on all Ethiopian persons who were engaged in military activity and contribute money for the purpose of public interest. It is also introduced with development of government. This was a great progress in which an intention to commence a modern taxation on the side of government was witnessed.⁶

After the Italian invasion the formal tax proclamation was promulgated in September 1936 E.C by proclamation No 60/1936 E.C .That imposed an obligation to pay income tax on any person and employee. This proclamation opened the way to begin the modern tax imposition, assessment and collection in Ethiopia. The 1953 tax proclamation No 173/53 E.C replaced the earlier proclamation and followed the Indian type proclamation that was lived by pro No 173/53 Art 40 by the way of estimation and on the basis of taxpayer books of account records according to their category of the taxpayer.

1.3 Principles of taxation

The principle of taxation is important for achieving the objective of taxation. Then a good tax system is one of designed on the certainty for all tax payers.

The noted economic philosopher Adam Smith in his book an inquiry in to the Nature and Causes of wealth of nations almost set for principles of taxation. The first set is such principles which were enunciated are called canons of taxation.⁷ They were interested in the ways by which an economy can increase its productive capacity and there achieve a higher rate of growth.⁸ Further more the firm view that the private sector is more efficient than the public one and therefore the primary responsibility of economy growths are with the private sector.⁹

The various principles enunciated by economists will be discussed as follows .There are four Canon of taxation as prescribed by Adam Smith. The first principle is the canon of equality.

This canon proclaims that a good tax is that which is based on the principle of equality. It requires that the income of a person that enjoys protection of the state¹⁰ should be taxed on the proportional rate of taxation. However this principle is unacceptable for some scholars or economists. They argue that if we agree with the more propositions that income is subject to diminishing marginal utility then the richer more pay a large proportion of their income as impact tax that is the taxation is progressive.¹¹

The second principle provided by economist is the principle of certainty. This principle implies that the tax payer should be well informed of the period of time amount and method of tax payment .According this principle. The tax which is each individual is blunt to pay ought to be certain and not arbitrary. Based on this principle the tax rules should specify when the tax is to be paid, how it's to be paid and the amount to be paid. A tax system rules must enable tax payers to determine what is subject to tax and at certainty based on the nature or their transactions with applicable laws. Philosophers emphasis on this principle as to claim that a very considerable.

The third principle implies that the mode and timing of tax payment should be so for as possible convenient to the tax payer. By this principle every tax ought to be convenient for the contributor to pay it. If not, it will be difficult to avoid the unnecessary trouble to the tax payer. The convenience of tax payment is important to

ensure compliance with the tax system. The fourth principle is the principle of economy According to this principle the cost of collection of taxes should be the minimum possible, if not to impose tax which is too difficult to administer. Totally if there is a good tax system the tax payer should follow the principle and create the efficiency and fairness in taxation.

1.4 Problem Associated with tax authority

Under this topic, I will try to raise some basic points, which hinder the proper income tax imposing and assessment on taxpayer's books of account and records.

The problem which is relate to the tax administration, the taxpayers or problems of laws and their implementation.

The problems of laws and their implementation are serious and critical Unless we alleviate such problems, which is impossible to collect revenue for a government properly and create smooth and trustable relationship between the tax administration and the taxpayers. Thus, it is important to discuss the problems in detail and recommend possible solution in this research paper.

1.4.1. Lack of Awareness

According to my observation, in general most of the Revenue department heads, team leaders and auditors do not know tax policy, principles of taxation and tax laws properly stated under Art 40 of the Ethiopian income tax proclamation No.286/2002. Consequently, they do not perform their duties in accordance with such code of conduct.

1.4.2 Transparency and accountability

Transparency and accountability are the key elements of the service delivery. As result, the tax authority must strictly make its service transparent and accountable so as to help correct the employee who commit mistake in the tax imposing assessment and collecting of income tax or on the taxpayer books account and records.

However, practically, the tax liability in the tax authority doesn't fulfill the requirement of transparency and accountability. When the tax authority rejects the books of account of taxpayers the reason for rejection of his books of

Account and records should be clearly stated in writing in the assessment notification.

1.4.3 Effective Control Mechanisms

The tax authority before interning to its duty, it is important to establish effective and consequentive control mechanisms in order to achieve its aim. But in case of the tax administration or the tax Authority, there is problem regarding these issues.

In the case of internal effective control mechanisms even though the tax authority is expected and obliged to apply guide lines, rules and others control methods for their employees in doing their day to day activities especially auditors in assessing income tax on tax payers books of account, there is no such mechanisms in the tax authority to control the employees related with the tax assessment.

The absence of such mechanisms gives the tax officers discretion to use extremely subjective measurement in the process of assessing the tax liability on the basis of the taxpayer's books of account. Assessment of tax liability based on such measurement creates differences. Disparity of treatment of individual taxpayers especially tax imposing differ from auditors to auditors within the same revenue department and from sub – city to sub- city is observed.

In addition to this auditors of the tax authority always presume in assessing the income tax on taxpayer's books of account that the taxpayers who maintain the their books of account and records mislead the tax authority by including false and misleading statements in their books of account and records rather than considering tax payer's as stakeholders.

Lack of such control mechanism leads the employees of the tax authority to be corrupted. Prejudice the taxpayers in the assessment process; create unhealthy relationship between the tax authority and the taxpayers. And taxpayers will be prepared to evade their tax liability. The taxpayers by establishing P.L.C shift their tax liability from the city administration to federal government and this may have its own impact on the revenue of the city administration.

In relation to external control mechanisms, income tax proclamation No 286/2002 under Art 38 empowers the tax authority to investigate the place of business activities or practice of taxpayers and related document by sending dully accredited inspectors. But practically, the tax authority does not have any inspector to perform the above legal duty to control the taxpayers who fail their tax liability obligations. The failure of the tax authority to enforce its legal duty stated in the above article creates difference in the treatment of legal and the illegal taxpayers. Such difference also,

contradict with economy, market and tax policies of the country, encouraging unfair trade between the traders.

1.4.4 Adequate Skilled Man power

As we have discussed earlier, the revenue in the form of tax is the backbone of the government to achieve its main purpose. The government should strengthen the capacity of the tax authority in terms of skilled manpower with different professions such as economics, sociology, and accounting, law and so on with adequate theoretical, and practical knowledge. However, in reality, most of the tax authority employees are not well trained and they are not available in sufficient in number.

The causes of these problems are different. One of the causes is that the salary of the employees is not attractive and doesn't consider the market values of such professionals. The other one is that lack of adequate and consecutive training to the employees. Moreover, the tax authorities never intend to promote and motivate its employees. Consequently, a few numbers of skilled employees of the tax authority are forced to migrate for a better salary and working environment as compared to the tax authority. Because of such reasons, the tax authority will be obliged to employ temporary civil servants who are not skilled and experienced in the field of this area.

The lack of skilled full time employees disables the tax authority to enforce and implement the law as provided. In addition to this, such disability creates lack of efficiency, irresponsiveness, arbitrariness, negative attitude towards the taxpayers.

Voiding trustable and smooth relationship between the tax authority and the taxpayers. This may reduce the income of the government

1.5 Problem Associated with Taxpayers

There are problem in connection with taxpayers themselves. These include:

1.5.1 Lack of Awareness

To identify the lack of awareness related in tax laws and for what purpose tax is called by the government. As a major problem of tax payers;

The case of awareness in tax law, most of our city taxpayers don't know the right and duties specified under the tax law. In this respect even if the tax authority sometimes tries to create awareness through its lawyers and by the relevant bodies by preparing Workshop, seminar, symposium, and conference to the taxpayers at different time, they are not willing to participate in such programs to develop their knowledge in tax law.

The other one is lack of awareness related to the purpose of tax. Most of our taxpayers do not have adequate understanding regarding the government activities and for what purpose tax is collected from the taxpayers. However, the taxpayer must know clearly that the government is collecting the tax in order to fulfill social, economic and political needs for its society.

1.5.2 The tax payer's desire

In this regard, the taxpayers mostly have different reasons to cheat the tax authority. One is to evade the tax liability. The taxpayers prepare their books of account and records for the tax purpose in a day or a week rather than maintaining it from the beginning to end of the tax year. Some of tax payers maintain two types of books of account and records that is one for purpose of tax and the other one is to know the transaction of the business activities for their own purpose.

1.5.3 Lack of Education

This is the basic instrument to achieve the goals intended. It is very essential to communicate from foreign and domestic traders to have adequate information to strengthen their trade activity in quality and quantity.

Most of our taxpayers are illiterate. Because of this they are not able to get enough information and enhance their trade activity to execute their obligation of paying tax which they ought to pay and it even makes them unable to request their right specified under the law which is to be implemented by the tax authority. Even if they know the fact that they are illiterate; they do not use professionals to maintain books of account and records for their businesses. This is simply to avoid costs related to maintaining books of account and records such as purchasing books and employing skilled manpower.

1.6. Problem of the law and its implication

It is easy to indicate the problem related with the law, which influence the imposing, assessment and collection of different kinds of tax based on taxpayer books of account and records according to the tax law. If we say law, it is clear that it includes proclamation, regulation and directives.

Income tax proclamation No.286/2002 Art. 69 provide:¹²

“For any reasons, the records and books of account are unacceptable to the tax authority. The tax authority, may assess the tax by estimation”²

When legislative body enacted this law, it did not consider the existing economic, social and political situations. It merely included such article by taking from income tax proclamation No. 173/53 Art 40 .This was promulgated 40 years ago. Thus, the legislative body, which adopted this article, did not have any new intention different from the legislative body, which promulgated income tax proclamation No 173/53 It only incorporates the intention of the pervious legislative body. As far as the phrase “for any reason” in art 69 of the income tax proclamation No 286/2002 is concerned, we can see two different options of scholars.

Some academicians and officials in the tax authority argue that the phrase enables the tax authority to discharge its duty and it is an instrument to control and administer the taxpayers who failed to maintain proper books of accounts and records.¹³

Even the tax authority accept the book of account for some tax payers who want to avoid or evade taxes use their right improperly and then would not pay fair tax as compared to similar taxpayers by this option we can understand that a phrase “for any reason” helps the tax authority as an instrument to control the taxpayers in supporting the above argument.

On the other hand, it is possible to argue that the phrase discourages and frustrates the taxpayers from maintaining books of account and records. Similarly some scholars says that “--- Tax laws should not give absolute power to the tax authority in process of taxation” because the tax payers may feel that since the tax authority is able to reject their books of account and records for any reason. Why do we maintain books of account and records and spend money for such reject able books of account and records. Most of the tax authority officials argue that such phrases is a means of control mechanism, some officials argue to the contrary. Some of the officials argued to this phrase said:-

“I think this phrase is prejudicial to the proper tax payers”

According to the writer of this paper , the phrase “ ----- for any reason ----“ gives the tax authority unlimited and extreme discretionary power to reject the tax payers books of account and the records when ever it feels like it in an arbitrary manner. Such type of decisions by the tax authority jeopardizes the right of the taxpayers. For instance, because of non – aggregation of income by the taxpayers, the tax authority easily rejects – the taxpayer’s books of account and records rather than assessing the tax liability by aggregating the incomes of taxpayer in accordance to Art 70 of the income tax proclamation No 286/2002 a taxpayer.

Always required submitting payment vouchers of the purchase of tomato, fire wood, onions, potatoes, and other similar goods which is never expected in the existing tangible circumstances. Moreover, the tax authority accepts the income of the taxpayer derived from the above goods for its benefits in assessing the income tax liability of the taxpayer after rejecting the expenses of the above goods, which is totally unfair

Because of the above and other similar unjustifiable reasons, when the tax authority assesses the tax liability of the tax payer by the way of estimation, the taxpayers are obliged to pay high amount of tax which they never earned. This also forces the taxpayers to terminate their business activities. Consequently, it creates unfair competition between taxpayers, causes market distortions, discourages investment, reduces different types of government revenue and causes social economic crises by increasing the number of unemployed.

In addition to the above legal problem, the other and most essential legal problem relates to the directives, which are issued by the city Administration of Revenue Agency in Addis.

In this regard, we can identify three main problems i.e. lack of polarization enactment by unauthorized body and contradiction to the law.

Directives serve as a guideline for the officials of the tax authority and taxpayers to discharge their duties properly in due time. However, most of the directives enacted by the revenue agency of the authorities are not publicized as to be known by the taxpayers. Even most of the employees of the tax authority are unaware of them. Thus, the absence of the publication of the directives to reach to the employees of the tax authority and to the tax payer's with in appropriate time makes directives paralyzed and ineffective to create trustable and smooth relation ship between the tax authority and taxpayer's.

The legislative body when it enacts income tax proclamation No. 286/2002 under Art 42 sub article d and Art.2 sub articles 14 authorized the Ministry of Finance and economic development to issue directives for the better implementation of the above proclamation and regulations issued there under i.e. regulation No. 78/2002. In addition to these provisions Art – 26 of the Regulation authorized the ministry of revenue to issue directives for the proper implementation of this regulation.

However, giving this power to different organ has its own problem. Thus, it is very difficult to implement which one in practice. It is also important to remember that the directives, which may be issued by ministry of revenue based on Art. 26 or regulation No 78/2002 is given to the head of Finance and Economic development Bureau. However, practically, the Revenue Agency of the city issues such directives even if it has a problem the directive issued by unauthorized organ still determines the assessment of income tax based on the taxpayer's books of account and records with out legal ground. Likewise, such directive always prevails over the stated proclamation and regulation practically.

In principle directives should never contradict the hierarchy of the superior laws i.e. proclamation and regulation. Nevertheless, with regard to directives issued by the Revenue Agency of city administration it contradicts the income tax proclamation No 286/2002 and Regulation No.78/2002. For instance, proclamation No. 286/2002 makes mandatory for taxpayer's which is category

“A” and “B” to maintain books of account and records. If those taxpayers fail to maintain books of account and records for two or three consecutive years, the law urges the tax authority to notify to licensing authority to suspend or revoke the taxpayer's license respectively. In addition to this regulation No. 78/2002 encourages category “C” taxpayers to maintain books of account and records and subsequently acceptable to the tax authority the authority shall assess the tax liability on the basis of such books of account and records. Therefore, both proclamation and regulation encourage all taxpayers to maintain books of account and records in foreseeing the importance of books of account and records in assessing income tax.

However, revenue agency of the city administration issues directives contrary to the above stated laws.

From the above articles of the directive especially the underlined phrases indicated that the revenue Agency issues the directive only to boost its revenue rather than issuing directives, which coincides with the proclamation and the regulation. In addition to contradicting the law, such directives discourage all taxpayers from maintaining books of account and records. At the same time, such directives prejudice the right of taxpayers in requesting to pay more than they were expected to pay.

Most of the tax officials who responded to my questionnaire agree with the above opinion. To site a sample of the response given by some tax officials may be important here.

“Most directives focus only to enhance the government revenue, by forgetting the impact on the taxpayers”

“Of course directives may be drawn to implement the proclamation by the authorized body given in the proclamation. In my opinion it is not the case of to be unauthorized but it is the case of giving due attention, time and professional person to draw these directives.” Therefore, the Revenue Agency of the city Administration, with out authorization issues directives to execute its duty in a way it feels better rather than issuing directive, which goes in line with proclamation and regulation. As the result such directives prejudice the right of taxpayers, which is insured by the proclamation and Regulation. Moreover, it creates unfair competition between taxpayers, distorts market, reduces revenues, discourages investment and causes social crises.

1.7. Exclusion

The term Exclusion on the other hand refers to:

“Items that are excluded from gross income (i.e. not taxed) because of particular I.R.C. Provision.”¹⁴

From the above definition, we can understand that some thing is totally excluded from income tax payment. This means the income totally excluded from tax liability is not part of taxable income. The legislative organ enacts laws providing for exclusion by considering social policy. Provisions in a tax law that favor education, religious and charitable organizations reflect a desire to encourage and support of the institutions.¹⁵

1.8. Tax rate

The income tax structure is predominant and well-known tax rate structures are three types, proportional, progressive and regressive tax rate structure. The common

classification usually applied in taxation is on the basis of degree of progression of a tax. A tax rate is called proportional, when the tax liability increases on the same proportion as increases of income.¹⁶ On the other hand, if the liability increases in absolute terms as the income increases it is known as a progressive rate.¹⁷ In case of proportional rate, both the tax liability and the income increase in the same proportion, whereas in the case of progressive rate increase of income gives rise to an increase of tax liability so not increase in the same proportion. The progressive tax rate is the tax liability as proportional of income falls with the increase income.¹⁸

The term tax rate on other hand is uses to denote the amount of tax per unit of the tax base. Accordingly, therefore the tax rate is proportional where the tax rate remains unchanged for each unit of the base. But if the rate rises as the tax base increase, the tax rate is progressive and it is regressive if the rate diminishes as the income increases.¹⁹

When we come back to our income tax law, proclamation N0. 286/2002 adopted two types of tax rates, which are proportional, and progressive tax rate based on the nature of the taxpayer.

On income of corporate bodies thirty percent (30%) of taxable income.

On income of person or individuals from ten percent up to thirty five percent
Percent (10%-35%) of taxable income.²⁰

As compared to the previous income tax rate the current proclamation provides a reduced tax rate on business income as a measure of the tax reform progress. The reduced tax rate is believed to serve as an investment incentive.

Chapter two

The concept of assessment

Tax assessments of Income tax on taxpayer's books of account have a great role for both the taxpayer and the tax authority in the process of tax administration. The concept of assessment of income tax on taxpayer's books of account is highly related with the formation and development of accounting. Therefore, let us see some definitions and principles of accounting.

Authors define accounting as:

“... The process of identifying, measuring and communicating economic information to permit informed judgment and decision by users of the information”¹

This definition makes clear that accounting is useful for users in leading them to make a good decision as it is a process of identifying, measuring and communicating economic information.

Accounting can also be defined as;-

“... The art of recording, classifying and summarizing in terms of money transaction and events of a financial character and interpreting the results there of.”

We can understand that the accounting is very important in business activity and transactions. So the principles of accounting are concerned, there are many principles of accounting, such as, going concern, accrual, consistency and prudence.² Accounting is also related with the tax assessment on taxpayer's books of accounts

On the other hand we can understand from the above principles two of the methods of accounting are mentioned in proclamation. No.286/2002. These are:-

Cash base Accounting³ and

Accrual base Accounting⁴

In this Article 58(2) of the Income Tax Proclamation, a business entity may prepare its accounts either on cash basis or on accrual basis. In each base system, entries are recorded on the basis of actual receipt of cash or actual payment of cash. When income is earned by a business or expenditure is incurred by it, no entries are made in account books. Thus accrued income i.e. income earned but not received or outstanding expense i.e. expenses incurred but yet to be paid are completely ignored when final accounts are prepared according to the principle of accounting

The actual basis of accounting is the financial effect of the transaction is recorded in the books as and when they occur irrespective of actual receipt or payment of cash. This system relates the revenue and expenses to the accounting period during which they were earned or incurred. Companies are required under Article 58(3) of the proclamation to account for tax purposes on accrual basis.

The concept of books of account and records have got statutory base in the 1960 Ethiopia commercial code imposes obligations on traders and business organization to maintain books of account and other necessary documents.⁵

The Income tax proclamation No. 173/53(lie down) obligates to some taxpayers to maintain books of accounts and records. These are category “A” and “B” taxpayers for the purpose of income tax assessment especially for income from business.⁶

The Income tax proclamation No. 286/2002⁷ and Regulation No. 78/2000⁸ provide a similar obligation like pro. No. 173/53 (as amended). In all cases the taxpayers have to maintain books of account and records in a better way by considering the current situations and government policy.

2.1 Definition of Assessment

Before dealing with detail the type of income tax assessment, it is better to define what is meant by assessment. Assessment means

“...the listing and valuation of property for the purpose of apportioning a tax alone or in proportion to benefit received. Also determine the share of a tax to be paid by each of many people, apportioning the entire tax to be levied among the different tax payers establishing the proportion due from each.”⁹

It indicated to the above, definition assessment could be computation and determination of the amount of tax payable, and sometimes it could be the process of determining taxable income to which a given tax rate applies up on the person who has received benefit.

The assessment of Books of Account Training Manual prepared by the tax authority or tax administration revenue Agency defines the term “Assessment” as follows:-

“An assessment is basically a review by tax officials of a
Tax declaration and information provided by the tax payer
and a verification of the arithmetical and financial
accuracy of the declared tax liability”¹⁰

One can understand from the above definition, the tax authority evaluates the arithmetical and financial accuracy based on the taxpayer's declaration and information to determine the tax liability upon the taxpayers. Therefore, assessment refers to the whole procedure of assesses is to imposing the tax liability upon the taxpayers.

2.2 Types of Assessment

The tax authority or the tax administration and the taxpayer play a significant role in the preparation and submissions of tax information. By considering their role assessment will be divided into two. We will try to see each of them.

A. Self Assessment

Each taxpayer has their schedule, according to their categories which is provided under the current income tax proclamation No. 286/2002 does the declaration of income tax. Declaration except that of employment income tax is an obligation imposed on the taxpayer himself. On the other hand, according to Art. 10 sub art. 2, of the proclamation income tax from employment is not normally subject to declaration since it is payable through the withholding scheme by the employer.

In another way, according to Proclamation No.286/2002 Art 64 types of income declaration has a duty of the tax to make declaration annually on due time which are provided by the law. After the declaration has been made, the tax authority shall have a duty to determine the income tax within 5 years according to Art. 71 of the proclamation. If the tax authority fails to determine the tax liability within the specified period and it be known to the taxpayer, the income tax will be barred by the time limitation. However, if the taxpayers had made evasion or fraud during his declaration, the tax authority has a power to determine the tax even after the limitation period has lapsed.¹¹

B. Regular Assessment

The tax administration or authority has a mandate to ask to request the taxpayers to produce his books account with all necessary information materials, and documents. Which are useful for the assessment of payable tax. In addition to this, tax authority shall have the power to send duly accredited inspectors to the place of business or practice of the tax payers in order to verify the statements and to erects vouchers, stacks of other material items document and account made by the tax payer.¹²

At the regular assessment auditing mechanism of accounts and details of the taxpayer's accounts should be carried out by the tax authority. Assessment concerning the schedule "C" the details of examination can be done on the balance sheets, the profit and loss statement or accounts, information's and inquiries of the files. Through investigation, if the tax authority obtains unpaid tax, it has the right tax authority obtains unpaid tax, it has right to oblige the taxpayer to pay such amount of tax by giving assessment notification¹³ before the limitation period of time

According to the proclamation assessment can be carried out by the following ways:

- Assessment by book of Accounts¹⁴
- Assessment by Estimation¹⁵
- Standard Assesment¹⁶

In this section, we have seen the ways or the system of income tax assessment in our income tax law. In the next section, we will discuss the above- mentioned ways on system of assessment of income tax in details.

2.2.1 Types of Tax Assessment

As we have mention in the above section according to proclamation No. 286/2002, there are three ways or systems of income tax assessments.

2.2.1.1 Assessment on tax payer books of account

According to Ethiopian taxation system income tax may be paid on the basis of books of account and records maintained by taxpayers. So for the purpose of tax assessment especially for schedule “C” which applies to business profit tax, taxpayers classified under categories “A” and “B” have the obligation to maintain books of account and other necessary documents, which are located the purchase activity those necessary for the tax assrssmrt.¹⁷

Those taxpayers who are obliged to keep books of account records are required to submit them to the authority for inspection upon request personally or by their dully appointed representatives.

According to Art 19 of the income tax regulation No. 78/2002 balance sheet and profit and loss statement shall disclose the following :-

- Gross profit and the manner, in which it is computed,
- General and administrative expense,
- Depreciation, and
- Other reserves,

As Per Article 48 of the Income Tax Proclamation, the tax payer shall submit to the authority within specified period of time the declarations of the income supported by appropriate documents vouchers and pay the income tax forthwith.

Conversely, if a taxpayer either fails to submit his books of account and records or the authority rejects them for any reason, assessment of income tax liability is conducted by estimation. Thus, failure to maintain books of accounts and late

declaration of annual income within the specified time shall entail penalty proclamation No286/94 from Art 86-92.

2.2.1.2. Assessment by Estimation

The income tax proclamation gives power to the authority to determine the income tax by estimation on the following situation

- When the tax payer which belongs to categories “A” and “B” fail to maintain books of account and records.¹⁸
- When the books of account is rejected for any reason by tax authority.¹⁹

In this regard, whenever taxpayers’ books of accounts are not accepted for any assessment by estimation it will be based on and conducted on the following manners

- By the daily income estimation
- By the information of purchases and
- By aggregation of both of them

As it is maintained above, the daily income estimation is conducted now by the committee of daily income estimators of the kebele. The committee by collecting information from the taxpayers and other persons to the tax administration. Whenever income tax is assessed by estimation, information could be a necessary tool in assessing the income in this connection, Information should be collected from different places, when information on purchase and sales are necessary in addition to the daily income estimation and also assessment can be conducted by aggregation of both of them.

2.2.1.3 Standard Assessment

This proclamation No. 286/2002 has introduced this kind of assessment. It is useful to assess the tax liability of the taxpayers who do not maintain books of account and records and when ever it is impossible to get information of the tax authority from the third party about such taxpayer's business activity.

This standard assessment especially designed for category "C" tax payers based on the schedule issued by council of ministers regulation in considering the variations and types of business, business size and business location. Since it is fixed amount in advance and avoid the assessment problem for the taxpayer, it may create smooth relation ship with the taxpayers and the tax administration.

2.2.2 Computation Taxable Income

Before we discuss the whole procedure of income tax assessment on taxpayer's books of account and records to compute the tax payable income, it is better to define important terms, which are very useful to easily understand the matter.

The term "Income" is defined on the proclamation No. 286/2002 as:- Art 2 Income "shall mean"

"Every sort of economic benefit including non-recurring gains in cash or in kind, from whatever source derived which is mentioned Proc Art 2/10 and in whatever from paid credited or receivid."²⁰

In the same proclamation "Taxable Income" is defined as:-

"The amount of income subject to tax after deductible items allowed under this proclamation and regulations issued therunder"²¹

For ever businessman or person taxable income is computed for each tax period on the basis of profit and loss of account otherwise known as income statement which should be prepared in accordance with General Accepted Accounting Principles and

Subject to provisions of income Tax proclamation No. 286/2002, Regulation No. 78/2002, and related directives issued by the appropriate or authorized organ.

2.2.2.1 Computing Taxable Income

Using the income statement, taxable income of businessman or body can be determined by the following ways:- according to the tax proclamation

1. Take the gross income as shown in the income statement which is prepared in accordance with the generally acceptable accounting principles.

2. Deduct expense from gross income in accordance with the income tax proclamation and regulation²² which is the direct cost of producing the income, such as

3. the direct cost of manufacturing, purchasing, importation selling and such other similar costs.

4. Add back any item deducted if the expenses, which is not located by the Income Tax proclamation and Regulation²³ properly.

5. Finally we can get the taxable income. After getting the taxable income we can easily determine the tax liability on the basic of the legal personality of the tax payers. If the taxpayer is corporate body multiple by thirty percent (30%) proportional income tax rate.

Person who is engaged in hotel business activity submits a profit and loss statement to the authority as follows:-

Sale of the hotel alcohol the amount of Birr purchases of the hotel and the operating expense.

1. Excise tax

For various purposes excise tax is levels on both specified dimensionally produced and imported goods According to the proclamation No307/2002 there are three reasons why the government imposes excise tax on imported and domestically produced goods.

The first is to discourage the importation of luxury and basic goods which have inelastic demand. The second is to defer the entry of hazardous goods that have detriment effect to social health and cause Sick problems.

Since Jan wary 2003 the Ethiopian government has reduced the minimum and maximum excise tax rate to 10 and 100 percent respectively. Preciously the maximum tax rate was 150, Percent. The Ethiopian custom author (ECUA) collects excise tax on occur 60 various kinds of commodities. Some of the imported items that are subject to excise tax include cigarettes. Soft drinks alcoholic beverages vehicles, magnetic tax type or other video recording or reproducing apparatus, television camera, radio broad cost receivers combined with VCD or DVD players and thers.²⁴

Excise tax is compounded and charged on the total of the CLF Value multiplied by excise tax rate.

2. VAT

In Ethiopia VAT is levied at a flat percentage rate. To the exclusion of goods stated under Art 8 of the proclamation No285/2003 and goods exemplified frame VAT by the direction issued by the ministry of finance and Economic. Development; VAT is levied on all imported goods and is collected by customs at standard rate of 15 Percent of CIF plus any other import taxes. Some of the items and services exempted from VAT include.²⁵

The supply of import of national or currency and of securities

- The import of gold to be transferred to the National bank of Ethiopia
- The import or supply of prescription drugs specialized in directive issued by the ministry of Health and the rendering of media services
- The supply of goods and rendering of services in the form of humanitarian aid as well as import of goods transferred to state agencies and public organization for the purpose of rehabilitation after natural disaster, industrial accidents.

- Goods imported by the government or organizations, institution or projects exempted from doted and other import taxes to the extent provided by law or by agreement.

3. *with holding tax*

In Ethiopia with holding tax rate is levied on commercial imported items on a flat rate i.e. 3 percent of CLF²⁶

4. *Sur tax*

In Ethiopia sur tax is levied on all goods imported in to the county at that percentage rate of 10% except fertilizers, petroleum and lubricants, motor vehicles for freight and passengers, and special purpose motor vehicles, aircraft, spacecraft, and pats there of and capital (investment goods).In this chapter attempt has been made to introduce the Ethiopian tax authority in pancreas and its operation.

2.2.3 *Tax Exemption*

Exemption is defined as

“... Freedom from a general duty of service, immunity from a General burden, tax or charge or immunity from the payment of taxes.”²⁷

We can understand, from the above expression that the taxpayer is free from legal duty of taxation or payment of taxes. The legislative body does this by considering the socio-economic state of the society and other relevant circumstances. The concept of exemption is that the amount exempted is already assessed and included in brackets of each respective schedule but exempted for payment, which it is a part

oftaxable income but exempted from payment of taxes. Exemption under the Ethiopian tax system is provided by Income tax proclamation, other municipal laws, international treaties and conventions. Exemption of tax is the power of Minister and the council of Minister by proclamation No.286/2002 Regulation No. 78/2002, for example exempted income from the tax for similar policy reasons.²⁷

Chapter Three

Federal Inland Revenue

Federal inland revenue as a income tax proclamation No 286/94 Art 2/13/ Stated is in land revenue /tax Authority/ shall mean the Federal inland Revenue Head office or any of its branch offices established in any part of Ethiopia and the tax authorities of the Regional states. It is under the Minster of finance. “Minster” shall mean the Minster of finance and Economic Development. And Ministry Shall mean the Ministry of finance and Economic Development. And Ethiopia has its own fiscal year mean that the budgetary year. According this fiscal year inland revenue has lay down the tax on the tax payers according the constitution Art 96 the federal power of taxation.

1. The federal Government shall levy and collect custom duties, taxes and other charges on imports and exports.
2. It shall levy and collate income tax on employees of the Federal government and internal organizations.
3. It shall levy and collect income profit, sales and excise taxes on enterprises owned by the federal government.
4. It shall tax the income and winnings of national lotteries and other games of chances.
5. It shall levy and collect taxes on the income of air, rail and sea transport services
6. It shall levy and collect taxes on incomes of houses and properties owned by the Federal Government, It shall tax rents.
7. It shall determine and collect fees and charges relating to licenses issued and services rendered by organs of the Federal Government.
8. It shall levy and collect taxes on monopolies
9. It shall levy and collect Federal stamp duties.

So by those given constitutional power Federal Inland revenue collect the tax impose assesses and collect from the tax payers. As stettet in chapter two the concept of assessment federal inland revenue tax assessment according their

categories tax paupers books of account assessment by estimation and by the standard assessment. On this activity there is its own problems which is related with tax authority and related with tax payers then the problem of the low and its implication. Under this section I will try to raise same points as it was mentioned in the pervious chapter there is lack of awareness these the revenue department heads team leader and auditors do not know the tax policy, principles of taxation and tax laws properly. It is stated under the proclamation No 286/2002 Art 40.

The other problem is Transparency , accountability and lack of effective control mechanisms. Transparency and accountability are the key elements of the service delivery. So the tax authority must strictly make its service transperence and accountable. The employee who commit mistake in the tax imposing assessing and collecting of tax or on the tax payer book's of account and records. It is essential internal effective control mechanisms. Even though the authority is expected an obliged to apply guide lines rules and other control mechanisms.

Lack of such control mechanism leads the employees of the tax authority to be corrupted. Prejudice the tax paupers in the assessment process, create unhealthy relationship between the taxpayer and the authority and the tax payer will be prepared to evade their tax liability so to audio this problem federal tax authority must create the internal and external control mechanism.

Problems associated with taxpayers are problem in connection with taxpayer themselves. These include Lack awareness lack of education and the tax payer's desire. Most of the taxpayers don't know their right and duties specified under the tax law. In this respect even if the tax authority sometimes tries to create awareness through its lawyers and by the relevant bodies by preparing workshop, seminar, symposium and conference to the taxpayers at different time. They are not willing to participate in such programs to develop their knowledge in tax law And the taxpayer don't have adequate understanding regarding the government activities and for what purpose tax is collect from the taxpayer. How ever the tax payer must

know clearly that the government is collecting the tax in order to fulfill social economic and political needs for its society.

3.1. Features of Taxation

The importance of definition is to distinguish a concept from similar concepts that are ambiguous with the term to be defined. Therefore, we have to distinguish taxes from fines, fees, penalties and etc. It is tried to discuss the difference between taxes and other revenue sources below.

As recognized by US law, user fees and charges are closely related and generally share certain basic characteristics that differs them from taxes.¹ First, they are imposed on specific persons, activities or properties that burden the rest of the population. Second, they come with a distinct set of legal protections to ensure that the level of charge does not exceed the cost of service, benefit, or mitigation of the public bad allocated to the person charged and to ensure that the proceeds of mitigation and not used for general governmental purposes.²

For example, commodity charges are fees for products or services provided by governments to consumers in a fashion similar to the way private sector businesses provide products or services. Water and electricity are some of the commodities. Governmentally imposed commodity charges are often called rates, which have been deposited into special funds for use solely to support the enterprises. Those charges were recognized as something different from taxes.³

The consumer pays for a commodity which is furnished for his comfort and use. Fees for special access or use of a public facility such a swimming pool, tennis court, toll bridge can also be appropriately labeled a commodity charge. The other part of commodity charge is public programs to handle negative impacts from those who cause them. Sewer, garbage, and storm water are typical examples of burden offset charges.⁴

Special assessments have occasionally been referred to as special taxes. Conceptually, however, they are not taxes at all. They are rather, a distinctive form of user charge which allocates the cost of public improvement that increases the value of

an asset to the owner of that asset. Like other user fees, the amount of special assessments must rebate directly to the cost of the improvements, relate to the value of the improvements to the property assessed, and be deposited in special accounts for the particular improvements. Among the various types of user charges, assessment are similar to commodity charges because they both allocate costs of positive externalizes to those who benefit from a service, product on an improvement.⁵

Where it is properly understand the difference between taxes and other sources of public revenue: taxes are to raise money; yet so are fees. For instance, municipal water utilities do not charge rates for any purpose other than to raise money. However, that does not transform those rates in to taxes.⁶ Taxes are different form fines in that most taxes are imposed for fiscal purposes where as fines are imposed for non-fiscal purpose. In addition, taxes are different from fees in that the former are compulsorily levied where as the latter are not.

3.2. Principles of Taxation

As it was mentioned in chapter one^{1,3} federal inland revenue follow this Adam smith principles he was the first man to lay down what he called the maxims of taxation. It is the standard by which tax systems are made. These canons are used by considering two points: The interest of the population of tax payers to require the government to have certain accepted course of conducts of in the application. A good tax system reflects the application of maxims of taxation, and now it is time to consider each of them as used in good taxing system.⁷

1. The principle of Equity

Adam smith said that the subject of every state hold to contribute towards the support of the government as nearly as possible in proportion to their respective abilities, that is in proportion to the revenue to, the revenue and goods they enjoy and the protection of the states.⁸

However, there are some controversies on what Smith said as “in proportion to their respective abilities.” Some say that he was in support of proportional taxation and others say he was support progressive taxation.⁹

2. The Maxim of Certainty

The tax each individual is bound to pay out to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid or/ and other things are all to be clear and explained to the contribution and to every person.

An uncertain tax system subjects the tax payer to the mercy of the tax officer who can either aggravate the upon any of the noxious contributor or explore by the terror of such aggravation some present or perquisite to himself. The uncertainty of taxation encourages the some conceive government’s decentralization policy as a novel undertaking. For instance, it was argued that

“Given the diversity of our people and the recent turbulent history of our Country, the logic of decentralization is a compelling one. Ethiopian society must construct a political framework that provides sufficient space to all its constituents. This is an objective which excessive centralism cannot fulfill.”⁹

As regards to the legal frame work, for a decentralized system of governance was the charter, which set up the transitional Government of Ethiopia (TGE, 1991). The charter guaranteed the right of nations, nationalities and people to self determination; the right to administer own affairs within defined judiciary; meaningful participation and fair representation in the central government.¹⁰ The next significant legislative act was proclamation No 33/1992, the most important legal instrument in connection with fiscal decentralization. This proclamation defines the sharing of revenue between the central

government and regional governments. It also sets the objectives of revenue sharing and the principles used in the sharing of revenue sources. Finally, it categorizes revenue sources as central, regional and joint (shared between the center and regions).¹¹ The assignment of functions and revenue sources are also restated in article 51,52,96,97 and 98 of the federal constitution.

3.3 General over view of Federal Taxes

If federalism presupposes two sets of governments, one central the other in the units, it is natural that they should have the necessary powers for raising revenues through taxation and other means for meeting their respective needs of expenditure. Taxes in a democratic set up are imposed by laws made by the representative of the people taxed assembled in the national parliament or states legislatures.¹²

Legally, units of federation might claim perfect equality among themselves and with federation and insistence on state rights might induce them to create friction and embarrass a spirit of co-operations but that does not conceal the real inequality of strength and capacity prevailing amongst them for maintaining comparable standards of administration. Some sources of taxation might be vested in all units of a federation, but their productivity will vary in accordance with size, volume of resources and economic prosperity of the state concerned.¹²

Unless deliberate attempts are made to bring about financial equality among states, unevenness in the standards of government is hence bound to ensue there by weakening the basis of the federal system.¹³ A federal system requires a constitutional definition of the manner in which the various levels of government exercise this vital power. This definition has to address two principal concerns:

- The availability of means for each level of government to acquire the revenue requisite to the exaction of its functions and maintenance of its autonomy.

- The regulation of the exercise of the taxing power as to prevent the occurrence of intergovernmental conflicts.

Generally speaking, the constitutional fiscal arrangement of federations exhibit exclusive and concurrent legislative competencies in relation to taxation.¹⁴

An exclusive legislative power exists where the right to levy and collect a particular type of tax is constitutionally reserved for or assigned to either the national government or sub national governments only. It exists where the constitution allows the national and sub national governments to operate in the same tax field so long as it prohibits them from taxing the same subject.¹⁵

In general, concurrent tax powers occur where the national government and sub national entities have equal constitutional authorities to levy and collect the same kind of tax in respect of the same fields of taxation, each independent of the other and such powers may apply to specified types of taxes.¹⁶

Under the FDRE constitution the Federal Government and States have their respective exclusive taxing power. They are required to exercise it only over the revenue sources that fall within its jurisdiction.¹⁷ This is followed by two consequences:

- Federal tax legislation may not apply to revenue sources specified for state taxation and vice versa
- The abstention of one level of government from its tax power with respect to one of the revenue sources under its exclusive jurisdiction does not entitle the other to exercise that power.

The constitutional obligation of the federal and state governments to respect each other's powers deserves attention in matters of taxation. Because of this, each is required to desist from interfering with the others acts of imposing and collecting its own constitutionally assigned levies.¹⁸

3.3.1. Federal Inland Revenue Tax Jurisdiction

The federal government is entitled to exercise right conferred to it by the constitution. It is envisaged that under Art. 51(10) the federal government has bestowed to revenue source. Accordingly, it has the inherent power to entertain powers given under Art 96 of the constitution.

For assurance of accountability, it may be argued that revenue means should be related as closely as possible to revenue needs. Thus, tax instruments intended to further specific policy objectives should be used by the level of government that has the responsibility for such services. The central government should be responsible for expenditures having benefits that expend across sub national boundaries or that are characterized by economies of scale not realized at the sub national level may be considered as an illustration of the federal government's jurisdiction of tax levy.

At first glance of the provisions of Art. 96 of the FDRE constitution, the phrase "levy and collect" is obviously seen. So, it seems good if we delineate this pervasive phrase. In light of this, black's law dictionary define 'levy' as --- the legislative function and declaration of the subject and rate or amount of taxation --- exercise of legislative function --- determining that a tax shall be imposed and fixing amount, purpose and subject of taxation--- "¹⁹ and the term 'collect' is also connoted as " to receive payment."²⁰ In this context the word 'collect' shows the authority to receive money from the tax payers.

Thus the phrase "levy and collect" is not the distinctive features of the FDRE constitution. To display taxing power other countries constitution used the same. For instance, the United States constitution article 1 section 8 provides "the congress shall have the power to levy and collect--- "²¹shows an instance of similarity of using the same phrase. Under the FDRE constitution it stands for the power to legislate and collect the money from the tax payers.

Sub-article 1 of Art. 96 prescribe “The Federal Government shall levy and collect custom duties, taxes and other charges on imports and exports.”²²

This potential revenue source reflects the national character of taxes. It presupposes the administration of balance of trade between Ethiopia and any other concerned foreign country. Import-export tax is productive. Tax payers are under obligation to pay tax over trade commodities at the gate. The Federal Government enters into negotiation and made international agreements with respect to trade activities which stands for the whole interest of the people of the country.²³ The Federal Government is assigned to administer the revenue sources of import-export tax proceeds. For instance, if we see from the perspectives of convenience of taxation, the federal government has the Potential power in terms of skilled man to collect and keep record of accounts of taxes derived from inter state commerce.²⁴ Art.96 (8) provides that the “Federal Government shall levy and collect taxes on monopolies.”²⁵ The term monopoly refers to “a privilege or peculiar advantage vested in one or more persons or companies consisting in the exclusive right or power to carry on a particular business or trade, manufacture a particular or control the sale of the supply of a particular commodity.”²⁶The phrase ‘control of the sale of the supply of commodities’ connoted that the exclusive right holder dominate the total sale of a product or service over the whole country. Irrespective of the sovereignty of the states of the federal set up of Ethiopia, the product of the monopolist control the market structure there by taxed over such revenue sources. Until the competitors come up with the same valuable product of the exclusive right holder of an identified product he will stand to exist as monopolist.

In addition, the Federal Government has rested exclusive jurisdiction over revenue sources from the winnings of lottery and other games of chance, entertainer, musicians or sports person,²⁷ immovable property and appurtenances,²⁸ livestock and inventory in agriculture and forestry²⁹ and on royalties derived from copy right of artistic, literary or scientific work.³⁰

The Federal Government and states are vested with the power to tax income from employment. But, each level of government may tax only the income of an employee to which its power of taxation relates. The federal taxation applies only to salaries and wages accruing to the employees of the federal government, federally owned enterprises and international organizations, states taxation applies only to salaries and wages earned by employees of the states, state owned enterprises and private undertakings.³¹

3.3.2 Federal States tax Jurisdiction

As per the FDRE constitution assigns taxation authority the states power of taxation is the second category of the same instrument. Until now, the relationship between the federal government and regional states were not adequately and clearly defined. In any case, each regional state government must formally devolve adequate decision making authority and control over resources to zonal, woreda and kebele administrations in order to promote democratic decentralization and get government closer to people.³²

The constitution of the FDRE has empowered, the sub national states in Ethiopia to finance number of tax sources. Similar to the case of federal government, these sources of revenue for states are related either to the functions of the states under the constitution or things which solely belong to the ownership of states. Hence, fees for land usufruct rights, fees and charges relating to licenses issued and services rendered by state organs and taxes on income transport services on water bodies within their territory are regarded as the functional assignment of taxing powers to the states.³³ On the basis of ownership, states own tax powers over income from their properties and profit, sales excise and personal taxes on income of their properties and profit, sales, excise and personal taxes on income of their enterprises.³⁴

Additionally, it seems on the basis of administrative efficiency and convenience of tax collection that incomes of private farmers and farmers associated in cooperative, profit and sales on individual trades and taxes from mining and royalties and land rentals on mining operations are assigned to the states.

With regard to the productivity of revenue sources, the tax sources of regional states in Ethiopia are concluded as being unproductive and limited in variety. For example, though there is devolution of revenue powers upon states, these resources are inadequate to finance extensive social, economic and cultural responsibilities, and as a result, there is a great discrepancy between the devolution of spending responsibilities and revenue powers of states.³⁵ And there has not been meaningful integration and coordination between these units of government functioning at the grass roots partly because the very concept of revenue powers of states and its structure is not well conceived and developed in Ethiopia.

3.3.3. Concurrent Jurisdiction of taxation

Concurrent power of taxation is a third category under the FDRE constitution. It refers to area of jurisdiction exercised by both the federal and state governments. These are matters which are not allocated exclusively either to the federal government or to the states. The state legislative could make laws as equally as the house of people's representatives. Most constitution do have concurrent list of powers. Even if the United States constitutions have none, the Supreme Court has identified certain matters of competence in which both the federal and state governments could exercise. This relates to matters such as inter state commerce, labor relations, alien registration and postal power.³⁶In the Canadian constitution the concurrent fields are agriculture and immigration only. The Indian constitution is special in that it has enumerated about 47 items, concurrently belonging both to the national government and the states. The FDRE constitution, however, has provided the concept of concurrence only in the field of taxing powers.³⁷

The doctrine of concurrence leads to the question of how to tackle overlapping and inconsistent laws passed by the center and regions on the same matter. In both Indian and Canada in case of repugnancy between the state and the federal government legislation over concurrent matters, the central law prevails. In the United States of America the courts have devised the doctrines of central paramount and occupied field.³⁸ According to these doctrine states have power to legislate on these concurrent matters as far as the national government has not acted on it. In simple terms the national law prevails over the state law. Article 71 of the German basic law provides “in matters coming within the concurrent legislative competence, the regions (Landers) may legislate so long as and, to the extent that the center does not exercise its competence --- the appearance of a center law on a relevant topic displaces not merely region law but, region competence at that extent and the center power become to that extent exclusive.³⁹ Having this in mind, in our constitution the way it is stipulated seems a unique features. Obviously the word “jointly” purports acting together while the expressions “levy” and “collect” connote legislative and administrative actions respectively. According to the constitution, the federal government and states are empowered to exercise in common the powers to legislate and administer in respect of joint taxation.⁴⁰

Art. 98 of the FDRE constitution, provides that the federal and state governments jointly levy and collect taxes from tax bases which belong to the two unit of government together. This provision is construed as both units of government should act together starting from legislating the tax laws to administering and collecting the tax revenues. However, this way of interpretation is undoable non-practical as long as it would give rise to the question how two units of government make law jointly. Apart from this, it is smooth to say that the law enacted by one tier of government which is confined to joint tax jurisdiction should get approval from another layer of government to be effective.⁴¹

On the other hand, taking the wording of Article 98 clear, it is too far to interpret it as if it follows the levy and collection of taxes from the joint tax sources by both the federal and state governments, per laws enacted by each tier of governments independently. The prohibition against dissociate levy and collect by each government with respect to their own laws on the joint sources of revenue is suggested in the discussion of article 100 of the draft constitution, which is the current art. 98 of the FDRE constitution. The discussion in the constitutional Assembly under lines that there should be a consensus through negotiation on the question which level of government should levy and collect taxes from joint tax jurisdiction on behalf of the other layer.⁴² Of course, this assertion seems settling the potential conflict, but the question left here is that what if the two levels of governments could not reach on agreement?

The phrase “jointly levy and collect” reveals that the constitution has taken as each level of government cannot unilaterally levy and collect taxes falling under Art. 98. Even they cannot modify the rate of taxes falling under the same provision unless the Joint session of the house of people’s representative and the state council at hand is conducted. When we come to the provisions of the constitution, sub-art 1 of art 98 states “The federal government and the states shall jointly levy and collect --- taxes on enterprises they jointly establish.”⁴³ This means, if these to levels of governments owned enterprises jointly, they are empowered to levy and collect revenue sources derived there by. In the discussion of constitutional assembly the constituents underline that each units of government should receive revenue from what their ownership extends to which on the other hand reflects an equal access to benefits from matters of joint ownership.⁴⁴

Sub Arr. 3 stated that “The federal government and the states shall jointly levy and collect taxes on incomes derived from large-scale mining and all petroleum and gas operations, and royalties on such operations.” This implies that in our country both the federal government and the states jointly own taxes on natural resources confirming the provision of art 40(3) of the document. The fact that all natural resources belong to the

state and the people of Ethiopia, presupposes the nations-nationalities and peoples of Ethiopia should partake in sharing the national cake.⁴⁵

The constitutional assembly reasoned out that the rationale of categorizing of taxes on profits of companies and dividends of share holders under the joint taxation jurisdiction as it was thought that when private economic activities grow in the near future, they will be productive and increasing sources of revenue for both levels of governments.⁴⁶

Under the FDRE constitution neither the federal government nor the states have the power to apportion the proceeds from taxes displayed under Art. 98. It is the house of federation which determines division of revenues received from the joint federal and states tax resources per Art. 62 (7) of the same constitution.⁴⁷ This type of apportionment as between the two levels of government is said to be tax-sharing.⁴⁸ It is an approach whereby both the federal government and the states jointly levy and collect certain taxes and shared the proceeds between themselves. Hence, we can deduce that tax sharing becomes exist at the time of revenue from certain taxes are shared between the federal government and the states.

In spite of Art. 62(7) of the constitution which prescribes for the tax sharing approach, the formula for the distribution of proceeds as between the federal government and states that the money from the jointly owned revenue sources is not yet a settled procedure in our country.⁴⁹ This is why currently the sharing is made on ad-hoc basis. The two levels of governments are said to have equal share in the proceeds from direct taxation, while the revenue arising from indirect taxes is to be apportioned between them in the 37% ratio in favor of the federal government. This approach which is sound from the practical point of view represents a tax sharing in the constitution. It takes the taxes in question out of the field of joint jurisdiction and puts them in the exclusive federal Sphere of taxation. Additionally, the practice deviates from the constitutional prescriptions as long as the federal government is said to be performing the administration of the taxes in question.⁵⁰ As such it may well be seen as a violation of the constitutional fiscal design.

The above problem is resulted due to their concurrent involvement in the collection of the same tax is bound to become an extremely cumbersome and grossly inefficient administrative exercise, requiring a highly costly coordination.

3. 3.4. Undesignated powers of taxation

The FDRE constitution has realized that there is another potential taxable source than the previous categories of taxation under article 99 of the same. This provision stands for powers of taxation which is not expressly provided by the constitution to be exercised. It is completely different from article 52(1), which reserves residual taxation to states because this “power of taxation is determined by 2/3rd majority vote of a joint session of the two houses.⁵¹ During the discussion of Art. 101 of the draft constitution which corresponds to the current Art. 99 of the constitution, the participants in the constitutional assembly proved that the undesignated sources of revenue may encompasses an item having national significance or activities of regional nature and that is why the constitutional assembly disregarded this unexpected source of revenue allocating to either federal or state tax jurisdiction.⁵²

After a long debate on the issue, the constituent decided that the power to determine on the tax jurisdiction of undesignated sources of revenue goes to the joint session of the two houses pertaining to the feature of this tax base. Hence, it is confined to only those sources of revenue which have not been specifically allocated to tax jurisdictions of any government.⁵³ The constitution under Art.99 mandates a joint meeting of the House of Federation and the House of Peoples’ Representatives to determine the tax jurisdiction to which undesignated sources of revenue belong. The session is restricted only to make a decision on tax jurisdiction i.e. addressing on the issue of jurisdiction as well as exercising the authority on revenue sources which has not been expressly addressed by the constitution.⁵⁴

At the time of the joint session decided on the matter of undesignated sources of revenue, the government to which jurisdiction assigned, take the position to exercise its power. Therefore, if undesignated sources of revenue decided by joint session is of state(s) power of taxation, such states are mandated the authority of levying and collecting of revenue from such sources.⁵⁵

Where the federal government is granted to undertake the authority of tax jurisdiction over undesignated sources of revenue, it can levy and collect such revenue. If the undesignated source of revenue decided by the joint session mandate the joint tax jurisdiction pursuant to Art 62(7) of the constitution, the House of Federation is empowered to determine the manner of division of revenue from this source.⁵⁶

However, reasonably when we think of the provisions of the constitution on taxation and other pertinent legislation, it comes to our mind that what is the basis on which the joint session of the two houses relied on to categorize the undesignated revenue sources to one of the existing tax jurisdiction? The discussion in the constitutional assembly of the current Art. 99 of the constitution depicts that the intention of the framers of the constitution with regard to the basis of allocating undesignated powers of taxation as it was stated goes to the source of the tax, nature of tax, administrative efficiency and convenience should be the guiding line to allocate the undesignated tax sources.⁵⁷

The joint session of the two houses discussed to decide the assignment of VAT jurisdiction. A long debate was conducted on the session; members were divided in their opinion. Some group of the members raise whether VAT is undesignated tax or not on one hand. The others proposed that the replacement of sales tax with VAT and its assignment to the existing jurisdiction tends to the amendment of the constitution. Hence, this group opts for the amendment procedure of the constitution to determine VAT to the existing jurisdiction at the expense of Art.99. The committee of the session has discredited the notion of constitutional amendment pertinent to VAT.⁵⁸ Eventually;

unanimously the joint session decided that it should belong to the federal tax irrespective of justifying its constitutionality.⁵⁹

3.3.5. Type of Tax

Federal inland revenue have power on those types of taxes which are the relevance of tax assignment principle varies from tax base of tax base. The following section looks into candidates or potential sources for revenues more or less in order of preference. So federal inland revenue have a tax base

1. On Income Tax

Income taxes are the most popular forms of taxation in the contemporary world, in large measure, due to their popularity. In lower income countries like Ethiopia, the coverage of the personal income tax is quite limited and its role as a redistributive element of the fiscal system is further clouded by wide spread tax evasion.⁶⁰ so, it is argued by the authors, under such circumstances, and exclusive federal role for personal income tax is difficult to justify. And they suggested that while the federal government may impose a progressive income tax structure, access to flat charges on the federal base should be given to sub national governments. Bahl (1999:7) also argues that it would be sufficient for the local government to choose an add-on to central government tax rate, because to achieve the advantages of decentralization, the local government need not set the base of the tax.

Individual income tax is the tax on all income received by the individual from all kinds of resources either from employment, from independent contracts, from business and investment and etc. This tax system should ignore the personal status of the person i.e. there is no change whether the person is married or has kids or unmarried.⁶¹

2. On The Excises Tax

Excise taxes are argued to be a good candidate for assignment to the states. Different reasons are given for this argument. They are reasonably assigned to the states under the principle of subsidiarity in taxation and because they are relatively visible, they would help ensure accountability of state officials. As to McClure since the consumption of certain goods and services that are commonly subject to excises are closely related to benefits of public services or to public costs imposed by private actions, these taxes are some times agree with the implementation of the benefit principle.⁶²

Another argument forwarded by Broadway et-al (2000:184) is that specific taxes are unlikely to cause serious disruption to the efficiency of the internal economic union or major misallocations of labor and capital if they are levied on a destination basis. If they are levied on an origin basis businesses can avoid the tax by moving else where, unless the product taxed depended up on a local resource, for example, taxes on oil and gas.⁶³ In relation to this Diaz et-al (2000:183) also indicated that taxation by producing states like to result in appropriate exporting of tax burden to residents of other states. Smuggling from states with low excises to states with high excises is presented as a primary administrative problem. It is likely to be problematic in the case of high value low volume products. As a solution this problem Diaz suggested the federal government to impose floors, below which excise rates can not go, caused by competition among states seeking to attract sales of products they are know intended for smuggling to other states and to protect local sellers from the onslaught of products smuggled from other states, where they are subject to lower taxes.⁶⁴

The preamble of proclamation No 307/2002 prescribes that taxes are imposed on luxury goods and goods that are hazards to health and which are cause to social problems will reduce the consumption of such products to make the community beneficiary of this concept.⁶⁵

3. On The Sales Tax

Policy analysts agree that sales taxes are much better candidates for decentralization to the states especially if significant revenue sources are required. This is because of different reasons. First, given the relatively low degree of mobility of house holds, sales taxes (levied on destination basis) are likely to be much less distorting than taxes on mobile bases like capital. Second, since sales taxes are not significant instruments for redistribution, little equity is lost from decentralizing them to the states.⁶⁶

These days the value added tax (VAT) is the most important form of general sales tax found in most countries (including Ethiopia). Until very recently a central VAT is considered to be the only good VAT by many tax analysts. Independent sub national VATS were considered infeasible and/or undesirable because of various reasons. As mentioned by Bird, some emphasized the possible loss of macro economic control and the general reluctance of central governments to share VAT room; still others emphasized the problems arising from cross boarder trade. With respect to such trade the argument was that sub national VATS were, if levied on an origin basis, distortion, and if levied on destination basis, unworkable.⁶⁷ In contrast to this, some analysts agree that a properly structured dual VAT of the type being used in Canada and the province of Quebec, in which the central and sub national governments both rely on the VAT is feasible for implementation in most countries. The Quebec sales Tax (QST) and the federal VAT (Goods and services Tax or GST) as they now exist in Canada constitute an operational “dual VAT” system with essentially none of the problems usually associated with such systems.⁶⁸ Accordingly to Bird and Gendarme (cited in McClure 1999:29) the tax of the federal government serves as a cross check to ensure that QST has not been evaded on inter provincial trade. Based on Canadian experience Bird (1999:22) suggested that with good tax administration, it is perfectly feasible to operate a VAT at the sub national level on destination basis, at least for large regional governments. As to him what critical is either a unified audit or a very high level of

information exchange. But, when there is no good tax administration, a promising approach suggested by him is to impose what is in effect a supplemental central VAT which is labeled as “compensating” VAT or CVAT. This proposal is believed to have an advantage of protecting the revenue when tax administration is far from well developed. Because it reduces the risk that house holds (and unregistered traders) in any state can lodge VAT by pretending to be registered traders located in other states.⁶⁹

4. On The Capital gains

Capital gains are gains from capital assets (assets that are used for the generation of income or for the production of inventories that are held for sale) like machineries. For example, if you take a house, it may generate two kinds of income: ordinary income, when you hold it or rent it to some body else, and income that may be found by selling it.⁷⁰ Assume that, a house bought for 400,000 dollars in 2002 may be sold for a price of 800,000 dollars in 2006. so the difference between the sale price and the purchase price is known as capital gain. But, between the years he sold his house, he may be renting it for some amount of money. This is an ordinary income in which case the person who owns the house is subjected to ordinary tax. It is only when he sells the house that the owner is subjected to capital taxes. In such cases, there are two types of gains. The first is the inherent gain from the profit (the value of appreciation), and the second is the realized. An appreciation in the value of income regardless of whether it is sold or transferred is income. But, usually, this inherent gain is disregarded by tax systems. A gain from capital is subjected to tax only where the property is realized or converted in to exchangeable property for value realized gain is an accumulation of an inherent gain. In the above example, the property has appreciated by 400,000 dollars within four years, and we talk about capital gains when the person decides to sell the house.

One thing must be understood that it is the business of the tax payer that determines whether the income is ordinary or special. This is to say that if a capital asset is held for sale, it is an inventory. The nature of the asset has little to do with the nature of the gain.⁷¹ For example; a person who is engaged in real state business is always in the business of building houses and selling them. For that person the income that he finds is not capital gain. But, for a person who is not engaged in the business of real estate on a regular basis, any income realized from the sale of capital assets (which is dependent on the capital asset) is considered as a capital gain.

As to the controversy related as to whether capital gains are incomes or not. On one extreme, there are people who believe that capital gains are not incomes and, therefore, should not be subjected to tax. Because, they should only be recognized as the growth of capital. According to these people, when a certain property has appreciated, the appreciated amount only represents the growth of capital rather than an income.⁷²

On the extreme, there are people who believe that capital gains are ordinary income just like incomes that are found from employment and etc and, therefore, be subject to the ordinary roles of income taxation. Some people in the middle say that capital gains are incomes, but they are special kinds of income and governments should have special rules that govern capital gains.⁷³ Because:

- Capital gains are usually accumulated over a number of years and do not represent the amount of gain of one year. Therefore, it would particularly be unfair to apply the ordinary tax rate structure.
- The other reason why capital gains are treated differently is the impact by inflation on capital gains. Inflation calls for special rules of indices of inflation. Governments are usually confused as to which gain is attributable to inflation and which is not. To put it in other terms, some of the gains derived from capital assets is not real because they may reflect inflationary tendencies in the economy. Therefore, it would be necessary for the government to calculate how much of the gain is attributable to inflation and how much of the capital gain is real. Otherwise,

capital gain taxes would be taxes on capital (not on the capital income) which is not the intention of income tax.

To conclude, as we seen previously, it is accepted the capital gains should be treated under special rules. The main feature of special rules is that if capital gains are accumulated over a number of years, long term and short term gains should be distinguished according to the holding period of the capital. This is because property held for a long period of time is more susceptible for inflation than short term gains and they are the sum of several appreciations. Therefore, it would be unfair for the government to impose ordinary income tax upon such property.⁷⁴

5. On The Other Corporate income tax

The corporation is subject to corporate income tax as an entity and when a corporation distributes dividends, the dividends are subject to individual income tax. So, by corporate income tax, we are referring to a situation where a corporation is subject to tax as if it were an entity capable of paying taxes and the share holders are gain subject to tax when dividends are distributed among them. As a result, a corporation is subject to two layers of taxation, as an entity and the members individually. This some low deviates from the concept of income tax.⁷⁵

Many tax analysts forward a strong case for making corporation income tax a federal responsibility. Several difficulties are mentioned in allocating the tax base of corporations among the jurisdictions where they operate. The first one is that the company income tax base is cyclical and therefore not suitable for financing essential services second, as long as the income tax of the states are not uniform, corporations have an incentive to have their income taxed in the jurisdiction where it is treated most favorably.⁷⁶

The determination of the corporate tax base and rate structure in most developing countries is a central government responsibility. But in china it is a joint responsibility

of the center and the provinces. Like wise, when we come to Ethiopian tax system relevant to corporation income tax is similar to china. With regard to this tax system, the FDRE constitution of 1995 recognized in its Art. 98(2) is that it is joint tax responsibility of the Federal and regional states.

CONCLUSION AND RECOMMENDATIONS

1. CONCLUSION

I think as much as possible I tried to indicate some basic problems in tax imposing assessment and collection of tax to the issue at hand, As the mentioned problems are also critical and serious, the authority can not be expected to discharge its duty as provided under the law, in accordance with the tax policy, principle of taxation, market policy, investment policy, social and development policy and others.

The tax authority tries to reform tax administration in different aspects to improve its service. This is commendable and important. But unless the problems cited in the previous chapters cannot be solved by the tax authority, it is too difficult to achieve the goals of tax reform. The problems are which may affect the economic, social and political. So as much as possible, it very important for the tax administration to solve and avoid such problems, which hinders it to perform its duty in accordance with tax law.

2. RECOMMENDATIONS

In this section I will try to indicate some important recommendation which is the basic problems mentioned in above chapters. The implementation of the law Skillman power internal and external control mechanism and awareness.

1. The Income Tax proclamation No.286/2002 Art 96 is should be amended by the legislative body so as to limit the power of the tax administrations in depriving the right of taxpayer' s . This is opinion of the writer of this research paper, the phrase “- - - for any reason - - - “ is better to be substituted by the books of account and records is contrary to the law and for the General Acceptable Accounting principles intention.
2. Some Articles of Income Tax proclamation No. 286/2002 is not implemented properly as stated in the law. Therefore, the tax administration must enforce such Articles properly to fulfill the legislation.
3. The tax authority, in general to have qualified and skilled manpower must pay better and sufficient salary and other benefit comparable to the other civil servants and it must also train its employee to build their capacity. The tax authority should create for its employees about tax policy, principles of taxation, customer service delivery, and other relevant b/c customer is King.
4. The tax authority should also establish effective internal and external control mechanisms by preparing guidelines, directive standard formats to be strictly followed by its employee's especially at the tax imposing assessment and collecting process. The employee should be transparent to the taxpayers in the line with constitution. The tax authority is responsible to create awareness of the tax law among the tax payers. Moreover, it should also support the taxpayers in rendering training on how to maintain books of account and records. It is also necessary to tolerate minor errors in taxpayers' books of account and records.
5. On the other hand the taxpayers are expected to leave traditional system, the desire of cheating. They should maintain books of accounts and records properly.

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for any failure to observe the concentrate rule of citation.**

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Signed -----

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