



## INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE AND MANAGEMENT

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## CHANGING PHASE OF ETHIOPIAN TAXATION

MOHAN. M.P

ASST. PROFESSOR

DEPARTMENT OF ACCOUNTING &amp; FINANCE

MEKELLE UNIVERSITY

ETHIOPIA

## ABSTRACT

*This article aims in examining the gradual changes in the field of taxation in Ethiopia. It explains the tax policy of the government and how the taxation affects the different sections of the society. The study for this article has led to examine the effect on the revenue of the government after the implementation. It makes a comparison of earlier system of taxation and the modern system. The main objective of the study is to make awareness in the international level and especially to the business community of Ethiopia. The knowledge of taxation is yet to reach and improve among the lower level of business community. To achieve the aim of study, history of taxation as far as reachable is complied. To understand the modification and the changes in tax policy, illustration also exhibited. Even though the government is trying its level best to create the awareness among the business people especially the small business groups, it has not found a hundred percent fruitfulness yet. The government should conduct more awareness program in the implementation of the tax policy, especially in the book keeping system. The government of Ethiopia has taken a series of reform measures with the objective of improving the tax system, to strengthen the tax administration and to make the balance of trade positive. It is also trying to attract internal and external investment. All these activities are aimed to generate adequate revenue to apply for the developmental activities, keeping in mind the eradication of poverty. It is recognized throughout the developing world that the partnership between government and the private sector are the key elements that will lead to the reduction of poverty. The new vision of the government of Ethiopia is to bring the rapid and sustainable development which is essential for supporting the millennium goal of reducing poverty by half of 2015. The government's economical and social development objectives require sustainable and dependable domestic revenue.*

## KEYWORDS

History of Ethiopian Taxation, Progress of Taxation, Tax policy of Ethiopian government.

## INTRODUCTION

Taxes are important sources of public revenue. The existence of collective consumption of goods and services necessitates putting some of our income in the hands of government. It is a compulsory contribution to the government by an economic unit without expectation of direct and equivalent return from the government for the contribution made. It is compulsory payment levied by the state and refusal will lead to legal punishment. There is no direct and *quid pro quo* between the state and the people. The tax payer cannot claim reciprocal benefit against the tax paid. A tax is a payment for meeting the expenses in common interest of all citizens, and it is to be paid regularly and periodically which is a personal obligation imposed on a tax payer. In order to get the continuity of taxation in Ethiopia, it is to examine the history of taxation as far as reachable.

## HISTORY OF TAXATION IN ETHIOPIA

Even though there is no reliable documentary evidence for the introduction of taxation in Ethiopia from the history, it is assumed that taxation was a source of government revenue in earlier Axum Kingdom in Ethiopia around 500AD. In earlier days people used to contribute from their cattle and agricultural products to the governors of the state. This kind of traditional tax system continued for a long time until it is replaced by the modern tax system in the mid of 20<sup>th</sup> century. Evidences show that even in 19<sup>th</sup> century taxes were paid in kind and in money. Taxes in kind include salt, honey, cow and cow products horses etc. Under Emperors Tewodros II (1855-1868), Yohannes IV (1872-1889) and Menelek II (1889-1913) the empire began to emerge from its isolation. During the period of Tewodros II itself the system of taxation in the form of direct and indirect was existing. Direct tax included land tax, Provincial administration taxes, taxes for appointees and appointments, taxes on livestock, taxes on honey etc. During this period peasants were asked to pay tax even more than two times a year. Indirect tax during this period included toll taxes, Caravan taxes, Frieda (taxes on slaughtering of cattle). Emperor Meilike II towards the end of 19<sup>th</sup> century established a fixed system of agricultural taxes. Following this with the growth of trade in the early 20<sup>th</sup> century reforms were there in the agricultural and other taxation. More recent reforms were the fruit of Ethiopia's emergence as a modern state. They involve all the mechanism of modern tax collection, tax schedules and the development of trained and regularly paid civil service

The traditional tax system continued during the relatively modern administration of Emperor Haile Sellassie I (1942 – 1974). During that period Income tax, Land use tax, Education tax, Health tax, Road tax, Transaction tax, Turnover tax etc were existing.

- Income tax - On personal, business, rental, and agricultural income.
- Land use tax - Based on the fertility of land.
- Education tax - Levied on the land used for promoting education.
- Health tax - Levied on the land used for health activities.
- Road Tax - On the nature and load capacity of vehicles.
- Transaction tax - On the import and export on the goods manufactured locally.
- Turnover tax - Imposed on the every sale at all stages of production and Distribution irrespective of their origin.

Ethiopia was under Derg rule (Military rule) from the year 1975 to 1991. During the Derg period taxes were similar to those imposed during the period of Haile Sellassie, but legislated some proclamations relating to different components of taxes. In order to raise more revenue during the period to support the war efforts, there was an increase in the tax rates and also coverage.



During Derg period some of the taxes like land tax, rental income tax, health and education tax were cancelled and other taxes were restructured and continued until the transitional government of Ethiopia (1991- 1995) amended a new taxation structure. Regional governments were formed in Ethiopia on the basis of the proclamation number 7/1992 and major changes took place in the tax policy. Tax brackets and tax rates were modified. New tax basis such as tax on mining activities and capital gains were also introduced.

#### CHANGES OF TAXES FROM EARLIER PERIOD TO TRANSITIONAL GOVERNMENT PERIOD

Earlier period taxes		Transitional government Period taxes
1. Personal income tax Proclamation 1976 (Rate 10% to 85%)	Amended	Employment /Personal income tax, Proclamation 30/1992 and 107/1994, under this monthly income up to birr 120 is exempted and rate reduced 10% 40% range. It is further amended by Proclamation 286/2002
2. Business Profit tax Proclamation No.18/1990	Replaced	Proclamation 107 of 1994, according to which tax rates were lowered from 10% to 40% range. Tax rate of incorporated bodies reduced to 45%. It is further amended by proclamation 286/2002.
3. Mining activities tax: Earlier it was not in existence	Newly introduced	Proclamation 53/ 1993, 45% of tax for large scale mining and 35% to small scale mining . It is further amended by proclamation 23/1996
4. Capital gain tax ; earlier it was not taxed	Newly introduced	Proclamation 53/1993. Tax on shares , bonds and urban houses. Tax is 15% on gain realized on securities and 30% of gain on urban houses.
5. Rental Income tax: It was cancelled during the derg period	Re-introduced	It is imposed on the income derived from rent of home building material and goods and is exempted first 1200 birr of annual income and imposed tax rate ranging from 10% to 45% on each additional taxable income .It is further amended by proclamation 286/2002.
6. Sales tax	Introduced	Proclamation 68/1993. It is 5% on selected list of agricultural and essential goods and 12% for others . on January 1, 2003 VAT is introduced.
7. Excise tax : imposed On imported alcohol as per 1943 rules and motor fuel tax after five years	Amended	As per proclamation 122/1993 and amended again by proclamation 307/2002
8. Import duties : During derg rule custom duty on luxury goods were imposed as per regulation 42/1976 and it is raised from 100% to 200%. In 1979 it was amended . In 1990 Vehicle duty raised to 230% in 1990	Replaced	It is replaced by the custom tariff regulation No.122/1993. Accordingly duty reduced from (5%-230%) to (5% - 80%). Imposed duty rate ranging from 5% -15% as most of the commodities which were freely imported previously.
9. Exports – coffee, hides and skins live animals (cattels ) ivory, chat were taxed	Cancelled taxes	By the proclamation 38/ 1993. duties levied on export of goods except coffee to encourage export.

#### TAXES DURING THE PERIOD OF FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA (FDRE)

The new constitution of Ethiopia adopted in November 1994 gives power to the federal and regional governments to levy and collect taxes from the source allocated to them. The frame work of income tax proclamation 286/2002 includes two chapters, chapter I and Chapter II. Chapter I provide the substantive provisions and chapter II provides procedural provisions. Chapter one includes sections I to V and articles from 1 to 37. Chapter two includes sections I to XI and articles 38 to 120.

##### Chapter- I . Sec.I General Provisions (Article 1 to 9)

###### 1 Short title

2 Definitions: 1) Person 2) Body 3) Association of person 4) Related Person 5) Relative 6) Business 7) Tax Payer 8) Withholding agent 9) Permanent Establishment 10) Income 11) Taxable income 12) Employee 13) Tax authority 14) Minister 15) Fiscal year 16) Category of tax payer

###### 3. Scope of application

Resident – Apply to their world wide income

Non Resident –Apply to their Ethiopian source of income

###### 4. Obligation to pay tax: Every person obliged to pay

###### 5. Determination of Residential Status.

###### 6. Source of income

###### 7. Foreign tax credit

###### 8. Schedules of Income (A, B, C, D )

###### 9. Foreign Exchange Transactions

In addition to the above, Council of Ministers issued Income tax Regulation 78/2002

It includes 7 parts.

###### Part I. General

###### Part II. Tax payable under Schedule A

###### Part III. Tax payable under Schedule B

###### Part IV. Tax payable under Schedule C

###### Part V. Other income Schedule D

###### Part VI. Declaration of Income and Assessment of Tax

###### Part VII. Other Provisions

**AMENDMENTS MADE BY “FDRE”**

1. Employment income tax reduced from 40% to 35%.
2. Business income tax reduced from 40% to 35%.
3. Mining activities of small scale and large scale were equalized.
4. Export duty on coffee export cancelled.
5. Custom duty reduced from 80% to 35%
6. Agricultural income tax collection made under the control of regional Government
7. Taxpayer Identification Number (TIN) is introduced.
8. Tax withholding system is introduced.
9. VAT is introduced replacing the sales tax.

**MAJOR TYPES OF TAXES NOW EXISTING IN ETHIOPIA****I. DIRECT TAXES:** It includes the following:

- 1) Employment/ Personal Income tax
- 2) Business Profit tax
- 3) Tax on income from rental of building
- 4) Tax on interest on income from deposit
- 5) Dividend income tax
- 6) Tax on income from royalties
- 7) Tax on income from games of chances
- 8) Tax on gain of transfer of investment property
- 9) Tax on income from rental of property
- 10) Rendering of technical services outside Ethiopia
- 11) Agricultural income tax
- 12) Land use tax.

**II. INDIRECT TAXES:** It includes the following:

- 1) Turnover tax
- 2) Excise tax
- 3) Value Added Tax
- 4) Customs Duty

**III. STAMP DUTY****SCHEDULE OF TAXES AS PER PROCLAMATION****1. TAX ON INCOME FROM EMPLOYMENT / PERSONAL INCOME TAX**

Every person deriving income from employment is liable to pay tax on that income at the rate specified in schedule A

Table- 1: **Schedule A**

Employment income per month	Tax rate	Deduction in birr
0 - 150	Exempt	-
151 - 650	10%	15
651 - 1400	15%	47.50
1401 - 2350	20%	117.50
2351 - 3550	25%	235
3551 - 5000	30%	412.50
Over 5000	35%	662

Source: Income tax Proclamation 286/2002

**2. BUSINESS PROFIT TAX**

This is the tax imposed on the taxable business income or net profit realized from entrepreneurial activity. Taxable business income would be determined per tax period on the basis of the profit and loss account or income statement which shall be drawn in compliance with the Generally Accepted Accounting Standards. Corporate businesses are required to pay 30% flat rate of business income tax. For unincorporated or individual businesses the tax ranges from 10% to 35%. Unincorporated or individual businesses are taxed in accordance with the schedule C

Table -2: **Schedule C**

Business Income per year	Tax rate	Deduction
0 - 1800	Exempted	-
1801 - 7800	10%	180
7801 - 16800	15%	570
16801 - 28200	20%	1410
28201 - 42600	25%	2820
42601 - 60000	30%	4950
Over 60000	35%	7950

Source: Income tax Proclamation 286/2002

**3. Tax on Income from Rental of Buildings**

Tax is imposed on the income from rental of buildings. If the taxpayer leased furnished quarters, the amounts received attributable to the lease of furniture and equipment would be included in the income and taxed. The tax payable on rented houses would be charged at the following rates:

- On income of bodies 30% of taxable income
- On income of persons according to the following schedule

Table -3

Income per year	Tax rate	Deduction
-----------------	----------	-----------



0 - 1800	Exempted	-
1801 - 7800	10%	180
7801 - 16800	15%	570
16801 - 28200	20%	1410
28201 - 42600	25%	2820
42601 - 60000	30%	4950
Over 60000	35%	7950

**4. TAX ON INTEREST INCOME ON DEPOSITS IN ETHIOPIA**

Every person deriving income from interest on deposits shall pay tax at the rate of 5%. The payers are required to withhold the tax and account to the Tax authority.

**5. DIVIDEND INCOME TAX ON DIVIDEND FROM SHARE COMPANY.**

Every person deriving income from dividends from a share company or withdrawals of profit from a private limited company shall be subject to tax at the rate of 10%. The withholding agent shall withhold or collect the tax and account to the tax authority.

**6. TAX ON INCOME FROM ROYALTIES FOR USE OF CERTAIN RIGHTS**

Royalty income means payment of any kind received as consideration for the use of or the right to use any copy right of literary artistic or scientific work including cinematography films, and films or tapes for radio or television broadcasting. Royalty income shall be liable to tax at a flat rate of 5%. The withholding agent who effects payments shall withhold the foregoing tax and account to the tax authority. Where the payer resides abroad and the recipient is a resident, the recipient shall pay tax on the royalty income within the time limit set out.

**7. TAX ON INCOME FROM GAMES OF CHANCE LIKE LOTTERIES**

Income from winning from games of chances e.g. lotteries shall be subject to tax at the rate of 15%, except for winning of less than 100 birr. The payer shall withhold or collect the tax and account to the tax authority.

**8. TAX ON GAIN OF TRANSFER OF CERTAIN INVESTMENT PROPERTY**

Any gain obtained from the transfer (sale or gift) of building held for business, factory, office and share of companies and such income is taxable at the following rates. Building held for business, factory and office at the rate of 15%, Share of companies at the rate of 30%, Gains obtained from the transfer of building held for residence shall be exempted from tax provided that such building is fully used for dwelling for two years prior to the date of transfer.

**9. TAX ON INCOME FROM RENTAL OF PROPERTY**

Income derived from casual rental of property including any land, building or moveable property not related to a business activity. This type of income is subjected to tax at a flat rate of 15% of the annual gross income.

**10. RENDERING OF TECHNICAL SERVICE OUTSIDE ETHIOPIA**

Any kind of technical service rendered outside Ethiopia to resident persons in any form shall be liable to tax at a flat rate of 10% which shall be withheld and paid to the tax authority by the payer. The term technical service means any kind of expert advice or technological service rendered.

**11. AGRICULTURAL INCOME TAX**

Farmers and agricultural producer- co-operatives earning up birr 600 per annum are required to pay 10 birr (Proclamation 152/1978). The tax rate of every additional income varies from 10% to 89% for the income above 600 birr.

**12. LAND USE TAX**

Farmers, who are not the member's producer's co-operatives, are required to pay a land use tax fee of Birr 10 per hectare per annum (Proclamation 77/1976 and 152/1978) presently regional states have their own land use rent systems.

**INDIRECT TAXES****1. TURNOVER TAX**

Turnover tax should be paid on goods sold and services rendered by persons not registered for Value Added Tax. The rate of turnover tax is 2% on goods sold locally, for service rendered locally, 2% on contractors, grain mills, tractors, combine harvesters and 10% on others. Exemptions are available as per tax proclamation 308/2002

**2. EXCISE TAX**

It would be imposed on the goods imported or either produced locally in accordance with the schedule given in excise tax proclamation 307/2002

**3. VALUE ADDED TAX**

VAT proclamation 285/2002 which has replaced the sales and excise tax proclamation 68/1993( as amended ) and which has come in to force as of January 1,2003 is a consumption tax which is levied and paid as VAT at the rate of 15% of the value of every taxable transaction by registered persons every import of goods other than exempt import and a import service rendered in Ethiopia for a person registered in Ethiopia for VAT or any resident legal person by a non resident person who is not registered for VAT in Ethiopia (Article 7(1)a-c and Article 23(1) and (2)

**4. CUSTOMS DUTY**

When goods are imported or exported it would attract payment of duties and taxes according to the tariff of Harmonized Commodity Description and coding system. Payment of duties and taxes according to the preferential tariff rate where goods are imported from the preferred country; payment of duties and taxes at the rate in force on the day the declaration of the goods presented to and accepted by the customs office.

**5. STAMP DUTY**

Memorandum and articles of association of any business organization, co-operatives or any other form of associations shall be charged with stamp duty.

**CONCLUSION**

Now Ethiopia is in the path of developing activities. In its federal system, regions are having more autonomy. Many enterprises Public, micro, small, medium and large enterprises are growing up. Tax policy of the government should be to attract the investments from different sectors and it is to widen the tax basis and to avoid the over imposition of tax on existing income base. Tax payers should have the stage of opportunity to appeal and to express the opinion about the tax policy. More importance should be given to improve the book keeping system among the business community. When imposing penalties, it should be to correct and to guide the tax payers and should not be a overburden and a punishment and it is the stage of modern tax implementation stage.

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