**UNIT FOUR**

**Ethiopian Tax System**

***Income Tax Proclamation***

***Proclamation No. 286/2002***

Income tax is a very important direct tax. It is an important and most significant source of revenue of the government. The government needs money to maintain law and order in the country; safeguard the security of the country from foreign powers and promote the welfare of the people. It is the foremost duty of the government to bring out welfare and development programs which will bridge the gap between the rich and the poor. All this requires mobilization of fund from various sources. These sources may be direct or indirect.

***What is Income Tax?***

“**Income**” means **every sort of economic benefitincluding gains in cash or in kind, from whatever source derived** and in whatever form paid, credited or received.

“**Taxable income**” means the amount of income subject to tax after deduction of all expenses and other deductible items allowed under this Proclamation 286/2002 and Regulations 78/2002 issued.

“**Employee**” means any individual, other than a contractor, engaged (whether on a permanent or temporary basis) to perform services under the direction and **control of the employer.**

***Sources of Income (Article-6):***

Income taxable under this proclamation shall include, but not limited to:

a) Income from employment;

b) Income from business activities;

c) Income derived by an entertainer, musician, or sports person from his personal activities;

d) Income from entrepreneurial activities carried on by a non-resident through a permanent establishment in Ethiopia;

e) Income from immovable property and appurtenances thereto, income from livestock and inventory in agriculture and forestry, and income from usufruct and other rights deriving from immovable property is much property is situated in Ethiopia;

f) Dividends distributed by a resident company;

g) Profit shares paid by a resident registered partnership;

h) Interest paid by the national, a regional or local Government or a resident of Ethiopia, or paid by a non-resident through a permanent establishment that he maintains in Ethiopia;

i ) License fees (including lease payments, and royalties paid by a resident or paid by a non resident through a permanent establishment that he maintains in Ethiopia.

* The above sources of income are grouped under the following four Schedules:

***Schedules of Income (Article-8):***

The proclamation provides for the taxation of income in accordance with four schedules.

* Schedule 'A' Income from employment;
* Schedule 'B' Income from rental buildings;
* Schedule 'C' Income from business;
* Schedule 'D' Income from other sources including:

**Determination of Employment Income (Schedule ‘A’)**

 ***A.******Determination of Gross employment income:***all type of income like Basic salary, allowance, overtime and bonus

***B. Taxable income***

 I. Every person deriving income from employment is liable to pay tax on that income at the rate specified in Schedule “A”, shown bellow. The first Birr 600 (six hundred Birr) of employment income is excluded from taxable income.

 II. Employers have an obligation (***Liability***) to withhold the tax from each payment to an employee, and to pay to the ***Tax Authority*** the amount withheld during each calendar month. In applying preceding income attributable to the months of Nehassie and Pagumen shall be aggregated and treated as the income of one month.

 Every person deriving income for employment is liable to pay tax on that income at the rate specified in schedule `A`, set out in Article 11. The first Birr 600 (six hundred Birr) of employment income is excluded from taxable income. If the tax on income from employment, instead of being deducted from the salary on wage of the employee, is paid by the employee in whole or in part, the amount so paid shall be added to the taxable income and shall be considered as part there of

According to Article 10 of income tax proclamation, the employers have an obligation to with hold the tax from each payment to an employee and to pay to the tax authority the amount with held during each calendar month. In applying the procedure, income attributable to the months of Nehassie and pagume shall be aggregated and treated as the income of one month.

***B. Exemptions***

The following categories of income shall be exempted from payment of income tax.

 ***I. Income from casual employment***

Income from employment received by casual employees who are not regularly employed provided that they do not work for more than one month for the same employer in any twelve months period.

***II. Contribution of retirement benefits by employers:***

Pension contribution, provident fund and all forms of retirement benefits contributed by employers in an amount that does not exceed 15% (fifteen percent) of the monthly salary of the employee.

 ***III. Income from Diplomatic and consular representatives,*** and Other persons employed in any Embassy, Legation, Consulate or Mission of a foreign state performing state affairs, which are national of that state and bearers of diplomatic passports or who are in accordance with international usage or custom normally and usually exempted from the payment of income tax..

***IV. Payments as compensation***

 Payments made to a person as compensation or gratitude in relation to:

 (i) Personal injuries suffered by that person;

 (ii) The death of another person.

***V. Allowable Deductions***

The following payments, made to an employee by an employer, are allowed as deductions to determine taxable income.

* Reimbursed medical expenses
* Transportation allowance (if provided in the contract)
	+ - federal 25% of basic salary or not more than Br 800
		- Addis Ababa 15% of basic salary or not more than Br 500
* Hardship Allowance
* Desert Allowance
* Reimbursed traveling expense (incurred on duty)

**C. Tax Rate**

The tax payable on income from employment shall be charged, levied and collected at the following rates:

|  |  |  |
| --- | --- | --- |
| **No.** | **Taxable monthly income(Birr)** | **Rates of tax (10%)** |
| **1** | **< 600** | **Exemption** |
| **2** | **(600 – 1,650] on the next 1,050** | **10%** |
| **3** | **(1,650 – 3,200] on the next 1,550** | **15%** |
| **4** | **(3,200 – 5,250] on the next 2,050** | **20%** |
| **5** | **(5,250 – 7,800 ] on the next 2,550** | **25%** |
| **6** | **( 7,800-10,900] on the next ,3100** | **30%** |
| **7** | **over 10,900** | **35%** |

It can be explained as follows

 **Schedule A**

|  |  |  |  |
| --- | --- | --- | --- |
| **No.** | **Taxable monthly income(Birr)** | **Rates of tax (10%)** | **Deduction (Br.)** |
| **1** | **< 600** | **Exemption** | **0** |
| **2** | **(600 – 1,650] on the next 1,050** | **10%** | **60** |
| **3** | **(1,650 – 3,200] on the next 1,550** | **15%** | **142.5** |
| **4** | **(3,200 – 5,250] on the next 2,050** | **20%** | **302.5** |
| **5** | **(5,250 – 7,800 ] on the next 2,550** | **25%** | **565** |
| **6** | **( 7,800-10,900] on the next ,3100** | **30%** | **955** |
| **7** | **over 10,900** | **35%** |  **1,500** |

 ***Methods of employment income tax computations***

There are two methods are used to compute employment income tax.

1. ***Progression method***

The amount of tax is calculated for **each layer** of tax bracket by multiplying the given rate under schedule A For each additional income.

1. ***Deduction methods***

***Income Tax =Taxable Income x tax rate - Deduction***

***Deduction is computed by this formula***

***Deduction = upper taxable income pervious tax bracket tax rate of given bracket-cumulative threshold.***

 **Example1:** The following data were taken from the records of Abraham Co. for July 2008 E.C. that pays payroll to its employees according to Ethiopian payroll system.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Name | Basic salary | Allowance | Overtime worked | Duration of overtime work |
| Abel Tena | Br.2,400 | 250 | 30hrs | Up to 10:00pm |
| Sara Chala | 3,200 | 500 | 20hrs | 10:00pm-6:00am |
| Nega Girum | 1,600 | 100 | 10hrs | Weekends |
| 18hrs | Public holiday |

***Additional information:***

1. All employees are expected to render services of 160hrs per month and all of them did except Sara Chala who has served only 150hrs.
2. All employees are permanent employees except Abel Tena.
3. The allowance of Nega Girum is not taxable.
4. All employees promised to contribute 10% of their basic salary to the credit association of the company

**Required:**

* Determine the gross earnings, taxable income, total deductions and net pay of all employees.

**Solution:**

1. Abel Tena

**Gross earnings**

Gross earnings=basic salary+ overtime+ allowance

Ordinary rate=2,400/160= Br.15/hr

Overtime earnings= 30hrsx1.25xBr.15= Br.562.5

Gross earnings=2,400+562.5+250=Br.3,212.5

**Taxable income**

Taxable income=Br.3, 212.5

**Total deductions**

Pension =0(not a permanent employee)

Payable to credit association=10%x2, 400=**Br**.**240**

Income tax payable= 3,212.5\*0.20-302.5

 =340

Total deductions=0+240+340= **Br.580**

 **Net pay**

Net pay=gross earnings-total deductions=3,212.5 - 580=**Br.2, 632.5**

Sara Chala

**Gross earnings**

Gross earnings=basic salary+ overtime+ allowance

Ordinary rate=3,200/160= Br.20/hr

Overtime earnings= 20hrsx1.5xBr.20= Br.600

Gross earnings=3,000 +600+500=Br.4,100

**Taxable income**

Taxable income=Br.4,100

**Total deductions**

Pension =8%xBr.3, 200= **Br.256**

Payable to credit association=10%x3, 200=**Br**.**320**

Income tax payable= 4,100\*20%-302.5

Income tax=**517.5**

Total deductions=256+320+517.5= **Br.1,093.5**

 **Net pay**

Net pay=gross earnings-total deductions=4,100-1,093.5=**Br.3006.5**

Nega Girum

**Gross earnings**

Gross earnings=basic salary+ overtime+ allowance

Ordinary rate=1,600/160= Br.10/hr

Overtime earnings= 10hrsx2xBr.10 +18hrsx2.5xBr.10= Br.650

Gross earnings=1,600 +650+100=Br.2,350

**Taxable income**

Taxable income=Br.2, 350-100 = Br.2,250

**Total deductions**

Pension =8%xBr.1, 600= **Br.128**

Payable to credit association=10%x1, 600=**Br**.**160**

Income tax payable= 2250\*15%-142.5

Income tax =**Br.195**

Total deductions=128+160+195= **Br.483**

 **Net pay**

Net pay=gross earnings-total deductions=2,350-483=**Br.1,867**

1. **Tax on Income from Rental of Buildings (Schedule ‘B’)**

 **Introduction**

Any income arising from rental of buildings is taxable under schedule ‘B’. Rental income includes all form of income from rent of a building and rent of furniture and equipment if the building is fully furnished. Income from the lease of business including goods, equipments and building which are part of the normal operation of a business, (***called business lease***) are taxable under another schedule that is in schedule ‘C’

Gross rental income also includes any cost incurred by the lessee for improvement to the land or building all payments made by the lessee on behalf of the lessor in accordance with the contract lease. In the lease contract there are two parties involved in renting a building, the lessor and the lessee. The party who grants rent of the building is the ***lessor***. The one who leases the property for use is the ***lessee***. In some occasions the lessor may allow the lessee to sub lease the building for another party. In such circumstances the first lessee becomes the sub-lessor and the third party who rents the building from the lessee is called ***sub-lessee***. The sub lessor must pay tax on the difference between income from the sub leasing and the rent paid to the lessor, provided that the amount received by the sub lessor. The owner of the building who allows a lessee to sub- lease is liable for payment of the tax for which the sub lessor is liable, in the event the sub-lessor fails to pay.

***lessee***

***sub-lessee***

***lessor***

 Owner user third party/sub-lessee

 Sub-lessor

When a building is constructed for the purpose of giving on lease, the owner and contractor should inform the Kebele Administration about its completion and the intention of giving it on lease. This is also applicable when the building is rented before its completion. The Kebele Administration will pass the information to the tax office for the administration of tax. It is also the responsibility of Kebele administration to gather any such information and communicate to tax office in case where the parties fail to do so.

**5.2.2 Taxable Income**

i. Gross income includes all payments, either in cash or benefited in kind, received by the lessor for instance if a computer trader rents a building for use and give computer to lessor, the market value of the computer shall be used as gross rental income.

ii. All payments made by the lessee on the behalf of the lessor. For instance if the lessee pay brokerage fee on behalf of the lessor, such payments are i.e ownership fee on behalf of the lessor , such payments are include in the gross rental income.

iii. The value of any renovation or improvement to the land or the building is also part of taxable income under this schedule if such cost is borne by the lessee in addition to rent payable.

* + - 1. **Deduction**

 Taxable income from schedule B income is determined by subtracting the allowable deductions from the gross income. Allowable deductions include the following:

1. ***For lessor that do not maintain books of accounts***
* taxes paid with respect to the land and buildings being leased; except income taxes; and
* for taxpayers not maintaining books of account, one fifth (1/5) of the gross income received as rent for buildings furniture and equipment as an allowance for repairs, maintenance and depreciation of such buildings, furniture and equipment;
1. ***For lessor that maintain books of accounts***
* For taxpayers maintaining books of account, the expenses incurred in earning, securing, and maintaining rental income, to the extent that the expenses can be proven by the taxpayer and subject to the limitations specified by this Proclamation, deductible expenses include (but are not limited to) the cost of lease (rent) of land, repairs, maintenance, and depreciation of buildings, furniture and equipment in accordance with Article 23 of this Proclamation as well as interest on bank loans, insurance premiums.

i.e. building 5%, computer and related asset 25%, furniture and equipment 20% and other asset 10% of depreciation base.

**Tax Rate**

The tax payable on rented houses shall be charged, levied and collected at the following rates:

(a) if the lessor or owners are bodies , they pay thirty percent (30%) of taxable income,

(b) On income of persons according to the Schedule B (hereunder) Schedule –B

|  |  |  |  |
| --- | --- | --- | --- |
| **No**  | **Taxable income from rental** **(Income per year)**   |  | **Tax rate** |
|  | ***Over Birr***  | **To Birr**  | **%** |
| **1** | **0**  | **1,800** |  |
| **2** | **1,801** | **7,800** | **10** |
| **3** | **7,801** | **16,800** | **15** |
| **4** | **16,801** | **28,200** | **20** |
| **5** | **28,201** | **42,600** | **25** |
| **6** | **42,601** | **60,000** | **30** |
| **7** | **Over 60,000** | **\*\*\*\*\*** | **35** |

It can be explained as follows:

 **Schedule B**

|  |  |  |  |
| --- | --- | --- | --- |
|  **No**  | **Taxable income from rental of building**  **(Income per year)**   | **Tax rate** | **Deduction in birr** |
|  | ***Over Birr***  | **To Birr**  | **%** | **Birr** |
| **1** | 0  | 1,800 | Exempt threshold |
| **2** | **1,801** | **7,800** | **10** | **180** |
| **3** | **7,801** | **16,800** | **15** | **570** |
| **4** | **16,801** | **28,200** | **20** | **1410** |
| **5** | **28,201** | **42,600** | **25** | **2820** |
| **6** | **42,601** | **60,000** | **30** | **4950** |
| **7** | **Over 60,000** | **\*\*\*\*\*** | **35** | **7,950** |

* Computation of income tax on income from rental of building

In order to compute the taxable income from rental of building we use the following approach.

***Sources (income) Amount in birr Amount in birr***

Rental Income Received  **xxxxx**

**Add**: Amount received on the

 i) Lease of furniture xxx

 ii) Lease of equipment xxxxx xxxxxx

**Less**: ***Deductions***:

i) Taxes paid on land and buildings

 Leased xxxx

ii) ***For those not maintain books of***

 ***Accounts***

 Allowance for repair, maintenance

 and depreciation (1/5 of gross income) xxxx

 (OR)

iii) For those maintain books of Accounts

* ***Expenses on***

 a) Cost of lease of land xxxx

 b) Repairs xxxx

 c) Maintenance xx

 d) Depreciation of building, furniture and

 Equipments xxx

 e) Interest on bank loans xxx

 f) Insurance premiums -- xxxxxx (xxxxxx)

**Taxable Income from rental of Buildings** xxxxxx

Example1) Mr. X has a building that is available for rent in year 2008. The following are the details of the property let out

* He has let out for twelve month
* Actual rent for a month is birr 30,000
* He paid 15% of the actual rent received as land taxes and 3% as other taxes
* He spent birr 10,000 for maintenance of the building

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  |  |  | DEPRECIATION SCHEDULE  |
| Type  | YEAR | ORGINAL COST | ADDITION | TOTAL COST |
| building  | 2008 | 3,000,000.00 | \_ | 3,000,000.00 |
| Equipment  | 2008 | 150,000.00 | \_ | 150,000.00 |
| computer & accessory  | 2008 | 100,000.00 | 60,000.00 | 160,000.00 |

***Required*** : compute the taxable income and tax liability

1. He does not maintain any books of accounts in this regard
2. assumes that Mr. X has maintained books of accounts.

 ***Solution :***

 Annual rental income (birr 30,000\*12 months)---------------------------------------360,000

 ***Less***: allowable deductions

* Land tax (15% of 360,000)-------------54,000
* Other taxes (3%of 360,000)--------------10,800
* Maintenance (1/5 of 360,000)----------72,000 (136,800)

 Taxable income………………………………………………  ***223,200***

* Then tax liability should be calculated as follows

|  |  |  |  |
| --- | --- | --- | --- |
| **>** | **130,800** | **35%** | **18,000** |

 = taxable income\* tax rate- deduction

 =birr223,200\*35%-18,000

 =birr ***60,120***

 ***Required*** : compute the taxable income and tax liability

 ***Solution :***

 Depreciation Schedule

* + - 1. For building 300,000\*0.05=15,000
			2. For Equipment 15,000\*.20= 3,000
			3. For computer 16,000\*.25 = 4,000

 Annual rental income (birr 30,000\*12 months) ---------------------------------------360,000

 ***Less***: allowable deductions

* Land tax (15% of 360,000)----------54,000
* Other taxes (3%of 360,000)---------10,800
* Maintenance ---------------------------10,000
* Dep Expense Building----------------15,000
* Dep Expense Equpment-------------3,000
* Dep Expense computer---------------4,000-------------------------- (96,800)

 Taxable income………………………………..………………***263,200***

* Then tax liability should be calculated as follows

|  |  |  |  |
| --- | --- | --- | --- |
| **>** | **130,800** | **35%** | **18,000** |

 = taxable income\* tax rate- deduction

 =birr263,200\*35%- 18,000

 =birr ***74,120***

1. **Accounting for Business Income Tax**

  **Meaning**

 Business means manufacture or purchase and sale of a commodity with a view to make profit. It includes any trade, commerce or manufacture or any other adventure or concern in the nature of entrepreneurial activity. It is not necessary that there should be a series of transactions in a business and it should be carried on permanently. Neither repetition nor continuity of similar transactions is necessary. Profit of an isolated transaction is also taxable under this Schedule, provided that it is a venture in the nature of business or trade. In this connection, it is important that the intention of purchase or manufacture should be sell at a profit.

 **Taxable Business Income**

 Taxable business income shall 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, subject to the provisions of this Proclamation and the directives issued by the Tax Authority.

Business income tax or business profit tax is the tax imposed on taxable business income /profit realized from entrepreneurial activities. it is charged on the profit of business enterprises on their activities arising each accounting period or tax year.

 **Category of Taxpayers**

For the purposes of payment of business tax, taxpayers are categorized into three namely: Category “A”, Category “B”, and Category “C”.

***Category “A” Taxpayer***

Category “A” taxpayer includes;

1. Business that have separate legal personality (share company, PLC and public enterprise) regardless of their annual sales revenue.
2. Any company incorporated under the laws of Ethiopia or in a foreign country and other entities having annual turnover of more than Br500, 000.

 Those who are categorized under “A” have to maintain all records and account which will enable them to submit a balance sheet and profit and loss account.

The following details are included the gross profit and the manner in which it is computed , general and administrative expenses, depreciation, and provisions and reserves (together with the supporting vouchers).

***Category “B” Taxpayer***

 Category “B” taxpayers includes, unless already classified in Category “A” Taxpayer ***,*** business with no legal personality and those enterprises having annual income of more than Br 100,000 and less than Br 500,000 ( i.e. Br 100,000 < sales < Br 500,000). Category “B” taxpayers have to submit the profit and loss statement together with the supporting vouchers.

***Category “C” Taxpayer***

Category “C” includes all taxpayers who are not classified under the other two categories and whose annual turnover is estimated at Br 100,000 or less. Every businessman (except Category “C”) is required to preserve all books of accounts and other records and documents for a period of not less than 5 years after the year of income to which such books and documents relate.

To determine the income tax liability of such tax payer , standard assessment or presumptive method shall be used . Assessment or presumptive tax is fixed amount of tax determined by estimation or best judgment. However, if categories “C” tax payer maintain books of account, they shall pay taxes on the basis of their books of account.

Moreover the tax payer who drives income from different source subjected to the same schedule shall be assessed on the aggregate of such income. For example if the individual has barberry and castle shop, the income of the two business are aggregated.

 **Tax payment Period**

The fiscal year starts on Hamle 1 and ends on Sene 30. The body can change the accounting year only with the permission of the tax authority. When the tax period of a body is changed (with the permission); the period between the previous tax period and the new period will be treated as a “transitional period”.

  **Allowable Deductions**

````````````````````````````````````````````` In the determination of business income subject to tax in Ethiopia, deductions shall be allowed for expenses incurred for the purpose of **earning, securing, and maintaining that business income** to the extent that the expenses can be proven by the taxpayer and subject to the limitations specified by this Proclamation. In order to determine **taxable income** under Schedule “C” the following items of expenditures are allowable for deduction.

1) **Direct cost of producing the income** such as the direct cost of manufacturing, purchasing, importation, selling and such other similar costs.

2) **General and administrative expenses** incurred for earning, securing and maintaining the income. such costs are salary of administrative personnel , utility cost, rental cost ,repair and maintenance and e.t.c.

**3) Bad debt**

4) **Premium payable on insurance directly connected with the business activity ;-** insurance premium directly connected with business activities and against risk of damage or destruction of business premises.

**5) Expense incurred for the promotion of business**

6) **Commission paid for services rendered**, provided that the amount shall not exceed the normal rates provided by other similar businesses or persons

7) **Any payment made by a branch, subsidiary or associated company** in

Subjected to the following two conditions;

1. The payment is made for the service actually received.
2. The service was necessary for the business and could not be performed by other person or by the business itself at lower cost.

8) **Salaries, wages** or other benefit paid to the children of proprietors or member of partnership. Subjected to the following two conditions;

a. such employees shall have the required qualification.

b. the salary payable for such employs shall be equivalent for the post.

9) **Salaries and other personal benefit paid to manager or managers of a private limited company.**

10) **Interest expense**, if the lending institution is recognized by NBE or a foreign bank permitted to lend to enterprises in the country.

**11) Depreciation expense**

**The following are the rates of depreciation permitted per the rule:**

1) **Building**: 5% of the original cost. The cost includes the cost of acquisition, construction, improvement, reconstruction and renewal.

2) **Intangible Assets:** 10% (straight-line basis).

3) **Computers**, information systems, software products and data storage equipment: 25% (on a pooling system). Under pooling system the asset that has the same or similar character pooled together and are called pooled asset. For example projector, LCD, scanner ,flash disk e.t.c.

4) **All other business assets**: 20% (on a pooling system)

All other depreciable business asset such as machineries, vehicles furniture is pooled together. For assets for which the pooling method is used, the rate is applied to the depreciation base for the determination of depreciation. Depreciation base is the book value of the asset on the opening day of the tax period, increased by the cost of acquisition, creation, renewal, etc during the period and reduced by the sales price of the asset disposed during the period. Loss incurred during the period due to natural calamity and other involuntary conversion will also be considered for the computation of depreciation base. Any compensation received for these purposes will be deducted from the book value.

While determining the depreciation base, if it becomes negative, it will be added to the taxable income.

On the other hand, if the depreciation base is Br 1,000 or less in any tax period, the entire amount shall be treated as depreciation for that period. Likewise, gain obtained as a result of revaluation of assets shall not be a basis for determining depreciation base.

For each category of assets, the actual expense incurred for the maintenance and improvement is allowable provided it does not exceed 20% of the depreciation base at the end of the year. If such an expense exceeds 20% of the depreciation base, the excess will be added to the depreciation base of the category.

 According to the Regulation issued by the Council of Ministers, depreciation will be allowed as deduction only if the tax payers keep satisfactory record and submit the same to the tax authority regarding the date and cost of acquisition and a record of the total amount of depreciation deducted on the asset so far. However, depreciation on assets such as fine art, antiques, jewelry, trading stock, etc (which are not subject to wear and tear) are not allowed.

Financial institutions are permitted to deduct special reserves from taxable income in accordance with the directives issued by NBE. However, the amount drawn from such reserves will be added to the taxable income of such institutions.

 **Non-allowable Deductions**

 All those expenses, which are not wholly or exclusively incurred for the business activity, shall not be allowed as deductions per the provisions of law. Such expenses include:

1) **Additional investment:** an increase in the share capital of a company or the original capital of a registered partnership

2) **Pension or provident fund contribution in excess of 15%** of the monthly salary of employees

3)  **Business profit tax and input value added tax ;-** but they can be recovered through collection on sales.

**4) Fines or penalty paid under violation of law**

**5) Losses that are not connected with the business activity**

**6) Losses recoverable by insurance**

**7) Entertainment expenses**

**8) Personal consumption expenses**

**9) Salary, wages, and other personal benefit paid to the partner, or proprietor of an enterprise**

 **Declaration and Payment of Tax**

The following is the procedures for the declaration of taxable income by taxpayers.

A) Taxpayers categorized as “A” are required to declare their taxable income within four months from the end of the tax period

B) Those taxpayers who are categorized as “B” are required to declare their taxable income within two months from the end of the tax period

C) Category “C” taxpayers shall declare taxable income within one month i.e. between July 07 and August each year

  **Assessment of Tax**

Assessment is a tax review by a tax official of the tax declaration and information provided by a taxpayer and a verification of the arithmetical and financial accuracy of the declared tax liability. Pursuant to the proclamation, each taxpayer is required to furnish the tax authority with all information required for the assessment of income tax including information about his operations, and relationship with other bodies that may be necessary for the declaration of income or for supporting the books of accounts.

The procedure for the assessment of business income tax takes two forms:

 A) Assessment by books of accounts, and

 B) Assessment by estimation.

Assessment by books will be done for those who maintain books of accounts (Category A and B). The revenue authority makes assessment by estimation when the taxpayers do not maintain the books or when the submitted books are not acceptable. This is also done if the taxpayer fails to declare his/her taxable income within the time required. Tax, of those taxpayers who have different sources of income, will be assessed on the aggregate of all income.

If the taxpayers keep no records, or if the income tax authority does not accept the submitted books, or if the taxpayer fails to declare tax within the time specified, the income tax authority estimates tax by the use of certain indicators. Category “C” should pay tax at fixed rate on the income estimated by the income tax authority.

Tax assessors will be assigned by the tax office to estimate the daily sales of the taxpayers. The estimates will be done using the best of their judgment and objectivity. The estimated daily sales will be converted to annual income using the number of working days. Tax on annual sales is determined on the basis of presumptive value assigned to each activity.

  **Business Income Tax Rates**

According to the income tax proclamation, the following tax rates are used for computation of business income tax under Schedule “C”. The Range of Taxable Business.

|  |  |  |  |
| --- | --- | --- | --- |
|  **No**  | **Taxable income from rental of building**  **(Income per year)**   | **Tax rate** | **Deduction in birr** |
|  | ***Over Birr***  | **To Birr**  | **%** | **Birr** |
| **1** | 0  | 1,800 | Exempt threshold |
| **2** | **1,801** | **7,800** | **10** | **180** |
| **3** | **7,801** | **16,800** | **15** | **570** |
| **4** | **16,801** | **28,200** | **20** | **1410** |
| **5** | **28,201** | **42,600** | **25** | **2820** |
| **6** | **42,601** | **60,000** | **30** | **4950** |
| **7** | **Over 60,000** | **\*\*\*\*\*** | **35** | **7,950** |

 **Provision for Loss Carry Forward**

 If a business incurs a loss in a year, that loss may be set off against taxable income in the next three years. If there is operating loss for more than one period, earlier losses being set off before later losses. A net operating loss may be carried forward and deducted only for two periods of three years. However, **the loss cannot be carried forward:** If during a year, the direct or indirect ownership of the share capital or the voting rights of a business changes more than twenty-five percent, by value or by number and if the business cannot provide a books of account showing the loss, which are acceptable by the authority.

**Penalties**

The following penalties are provided in the proclamation regarding business income tax.

**For Non-declaration**

Taxpayers who do not declare tax income within the period specified in the regulation will be liable to pay Br 1,000 for the first 30 days of non-declaration. The penalty is Br 2,000 for the next 30 days of non-declaration. Br 1,500 will be charged for each 30 days for failure to declare the taxable income thereafter.

 **For understatement of taxable income**

Understatement of taxable income results in a penalty of 10% of the amount Understatement. If the understatement is substantial, the penalty will be 30%.

 **For late payment**

When a taxpayer fails to pay tax within the due date, he/she will be required to pay a penalty of 5% of the amount unpaid. An additional 2% penalty on the amount unpaid is imposed on the first day of each month for non-payment.

**For failure to keep records**

Failure to keep books of accounts, records and other documents by any taxpayer results in a penalty of 20% of the tax assessed. If this failure continues for two consecutive years, the license of the taxpayer will be suspended. One more year’s failure leads the tax authority to revoke the license of the taxpayer.

**For failure to withhold**

A withholding agent, who fails to withhold tax per the proclamation, will be personally liable to pay tax (which has been withheld). In addition, this failure obliges the agent to pay Br 1,000 per case. The following individuals are also liable in this regard:

1) The manager that has known of the failure

2) The chief accountant or a senior officer who was responsible for the supervision of the withholding activities.

***Recording Business Income Tax***

 Like any business transaction, profit tax payment must be properly accounted for. To record business profit tax, Income Tax Expense will be debited and Income Tax payable will be credited (if the tax is not paid yet) or cash will be credit (if recording is made at the time when the tax is paid).

Example Melat enterprise, unincorporated business has reported earnings before tax of birr 80,000 at the tax year ended Sene 30,2006.

 Required

A. Determine the amount of business income tax?

B. Record necessary journal entries?

Sol.

Deduction method:

**7,200 - 19,800 10%** 720

 = 80,000\* 10-720

 = 8,000-720

 = 7,280

To record recognition of income tax expense

 Income tax expense ……………………7,280

 Income tax payable ………………………. 7,280

To record payment of tax

 Income tax payable…………….. 7,280

 Cash …………………………………… 7,280

***Example2:*** The following information is obtained from Densa private limited company.

* The book value of a pool of computer in the opening balance sheet of the tax period as of Hamle 1, 2006 was birr 150,000. During the year 2006:
* Densa bought data storage equipment for birr 75,000, software products for birr 50,000.
* The existing computer was upgraded and renewed for birr 12,000.
* Densa has also received birr 15,000 as compensation from Haron computer ,supplier ,since some of storage equipments are not functioning.
* Densa also sold two old computers and received birr 8,500

Required:

1. Determine depreciation base of computer?
2. Determine depreciation expense of computer
3. Record necessary journal entries

Sol.

Beg B.V……………………………………………….150, 000

Add: storage equipment …..75,000

 Soft ware product…… 50,000

 Upgrading……………… 12,000 --------------- 137,000

 Subtotal --------------------------------------------287,000

 Less: Compensation………………..15,000

 Cash proceed from selling…..8,500------------- 23,500

 Depreciation base for tax ……………………………. 263,500

 Depreciation expense = .25x 263,500 = 65,875

 Journal entries:

 Dep exp ………………………..65,875

 Accu. Dep ………………………………….65,875

 **SCHEDULE ‘D’ INCOME: OTHER INCOMES**

This is the last and residuary Schedule of income. Any income which is taxable under them Income Tax Proclamation but does not find place under any of the remaining three Schedules of income (i.e., Schedules A, B and C) will be taxable under this residuary

Schedule “D” Other Incomes.

 **Incomes chargeable under this Schedule of income:**

The following incomes shall be chargeable to income tax under the Schedule-D:

**1. Royalties (Article- 31):**

The term “royalty” means a payment of any kind received as a consideration for the use of ,or the right to use, any copyright of literary, artistic or scientific work, including cinematography films and films or tapes for radio or television broadcasting, any patent, trade work, design or model, plan secret formula or process, or for the use or for the right to use of any industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience. It is taxable as follows:

 **Rate of tax:**

Royalties shall be liable to tax at a flat rate of flat rate of **5%**

1. The amount of tax shall be withheld and paid to the Tax Authority by the payer. That is the withholding Agent who effects payment shall withhold the foregoing tax and account to the Tax Authority within the time limit set out in this

 Proclamation.

2. 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 in this Proclamation

3. This tax is a final tax in lieu of a net income tax.

 **2. Income from Rendering of Technical Services (Article- 32):**

The term “technical service” means any kind of **expert advice or technological service rendered.** All payments made in consideration of any kind of technical services rendered outside Ethiopia to resident persons in any form shall be liable to tax under this Article.

 **Rate of tax:**

It is Taxable at a flat rate of 10%

The amount of tax shall be withheld and paid to the Tax Authority by the payer.

 **3. Income from Games of Chance (Article- 33):**

Every person deriving income from winning at games of chance (for example, lotteries, tom bolas, and other similar activities) shall be subject to tax.

 **Rate of tax:**

It is Taxable at the rate of 15% except for winnings of less than 100 Birr.

1. The payer shall withhold or collect the tax and account to the Tax Authority in the manner provided in Article 67.

2. This tax is a final tax in lieu of income tax.

 **4. Dividends (Article- 34):**

Every person deriving income from dividends from a share company or withdrawals of profits from a private limited company shall be subject to tax under Article 34.

 **Rate of tax:**

It is Taxable at the rate of 10%

1) The withholding Agent shall withhold or collect the tax and account to the Tax Authority.

2) This tax is a final tax in lieu of income tax.

**5. Income from Rental of Property (Article- 35):**

Every person deriving income from the casual rental of property (including any land, building, or moveable asset) not related to a business activity taxable under Article 17 shall pay tax on the annual gross income.

 **Rate of tax:**

It is Taxable at the rate of 15%

This tax is a final tax in lieu of a net income tax.

 **6. Interest Income on Deposits (Article- 36):**

As per Article 36, every person deriving income from interest on deposits shall pay tax.

 **Rate of tax:**

It is Taxable at the rate of 5%

1) The payer shall withhold the tax and account to the Tax Authority in the manner provided in Article 67.

2) This tax is a final tax in lieu of income tax.

**SCHEDULE ‘D’ INCOME: OTHER INCOMES**

* This is the last Schedule of income.
* Any income which is ***taxable under the Income Tax Proclamation*** but does not find place under any of the remaining three Schedules of income (i.e., Schedules A, B and C) will be taxable under this residuary Schedule “D” Other Incomes.