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TAX & PUBLIC FINANCE: ETHIOPIAN SYSTEM FOR PROMOTIONAL ACTIVITIES

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Abstract:

Tax is very important for each and every Government. As we are all know that taxation can be classified into direct and indirect taxes.Every Government need revenue to lead the economic, infrastructure, medical, transport, education, telecom, electricity, staff, research, to concession, subsidies, free facility for the unable sector community in the country. To generate the income Government has a constitution as a law to charge a tax for different sectors of people which brought into different categories of the people. No Tax, No Income; No Income, No Revenue; No Revenue, No Government. Government is a public which is common to the all of the people in the country. Whether the direct or indirect tax, the tax must be charged on the basis of the effort of the people income. Some people earn money with their hard work. Some people earn money easily. The easily earned income must be taxed more than the hard earned money. Ethiopian Taxation system is very important for raising income of the Government.

Key words: Tax, Public Finance, Ethiopian Taxation, Direct Tax and Indirect Tax

JEL classification: G10, G20, G30

I. INTRODUCTION

Every Government need revenue to lead the economic, infrastructure, medical, transport, education, telecom, electricity, staff, research, to concession, subsidies, free facility for the unable sector community in the country. To generate the income Government has a *constitution* as a law to charge a tax for different sectors of people which brought into different categories of the people. No Tax, No Income; No Income, No Revenue; No Revenue, No Government. Government is a public which is common to the all of the people in the country. Every country has direct and indirect tax systems. The ability of the assessee one who generate the income through his salary, house property, business, capital gains, and other sources. Different country has a different names where they can classify according to the requirement and style of the people behavior to earn income.

The sales tax, Value Added Tax Customs Duty are the best examples of the indirect taxes. Whether the direct or indirect tax, the tax must be charged on the basis of the effort of the people income. Some people earn money with their hard work. Some people earn money easily. The easily earned income must be taxed more than the hard earned money. Based on the above taxation, it can be classified into different degrees of progression. They are proportional tax, progressive tax, regressive tax and degressive tax.

II. PARTICULARITIES OF THE ETHIOPIAN TAX SYSTEM

In every country, circulating the money is important. Unless the money is circulated the revenue is not generated. So some cases the income tax law and practices act encourage the assesee, so it multiply the money in another terms. Example, dividends paid by the registered company and mutual fund schemes; insurance proceeds by the insurance companies; maturity proceeds of a provident fund/ pension fund schemes.

Any tax payer using the money for other them their constructive purpose of others and in the critical situation premium paid like medical insurance could be deducted from their income. So that their net income will be less so their tax rate also will be less. Different countries having a different sections of the income tax law practice and which mention about the deduction amount for the tax payers.

Income: Taxable income must be calculated after considering the different deduction of the assessee. The each and every income must be calculated appropriately for the income tax purposes.

The Ethiopian tax system also public finance- revenue and spending activities. The Transitional Government of Ethiopia issued Proclamation No. 7/1992, providing for the establishment of Regional Governments. Article 1 (constitution) establishment of the FDRE. According to this legislation and the Constitution, the FDRE shall comprise of the federal government and state members (articles 46 and 50(1)). The federal government and the states are legislated to have their respective legislative, executive and judicial powers (Article 50(2)); Regional Governments are accorded **legislative, executive and judicial powers** in respect to all matters within areas. Exceptions include: defense, foreign affairs, economic policy, conferring of citizenship, declaration of state of emergency, printing of currency, establishment and administration of major development activities.

Powers and duties of federal and regional governments:

i. **Federal government:** Article 51(10)- it shall levy taxes and collect duties on revenue generation sources reserved to the Federal government; it shall draw up, approve and administer the federal government's budget;

ii. **Regional states:** Article 52 (2(e) to levy and collect taxes and duties on revenue generation sources reserved to the states and to draw up and administer the state budget;

Both regional and federal governments have rights to levy taxes and spend it in financing their own activities; Regional Governments are given **tax and expenditure assignments;** Public finance activities of the Ethiopian government - both the federal and the regional governments are responsible in raising revenue and spending;The Transitional Government of Ethiopia issued Proclamation No. 33/1992 that defined the sharing of revenue between the Central and Regional governments; These provisions later incorporated in the constitution;

Revenue Sharing Objectives. Enabling the central government and the national/ regional governments efficiently carry out their respective duties and responsibilities. It assist national/ regional governments develop of their areas on their own initiatives. It also narrows the existing gap in the development and economic growth between regions. Encourage activities that have common interest to regions.

Principles used in the revenue sharing (proc. 33/92). The important principles are, Ownership of the different sources of revenue. The national or regional character of different sources of revenue. It convenience of levying and collection of the tax or duty. The population, distribution of wealth, and standard of development of each region also considered. The other factors that are basis for integrated and balanced economy.

Revenue is categorized as central, regional and joint. Revenue belonging to the federal government (Article 96- federal power of taxation). Revenues belonging to regional governments (Article 97- state power of taxation). The revenues jointly owned by both (Article 98- concurrent power of taxation) are involved. Article 99 –undesignated about powers of taxation. The Proc33/1992 states that Central Government Revenues and revenues jointly owned by the Central and Regional Governments to be collected by the Central Government revenue collection organs. The Federal revenue organs – ERCA along with its branch offices also involved. The regional governments' revenues are collected by regional governments' revenue organs;

The Ethiopian Tax System. Ethiopia is a federal country where there are federal and regional governments;The financial system (tax system in particular) is constituted taking the mode of governance into account; Taxes at federal and regional governments' levels; Taxes account for a significant portion of domestic government revenue;

Income and Value Added Taxation

Income taxation in Ethiopia - It has been in constant revision; The government undertook a significant reform on its income tax system in the year 2002 and issued income tax proclamation No. 286/2002 and Regulations No. 78/2002; Article 2(11) defines Taxable income: Article 6 states the sources of income subject to tax under proclamation 286/2002; The tax system is scheduler system.

Four schedules of Income. "A" income from different employment,"B" income from letout of buildings, "C" income from different businesses, and "D" other sources of income including income from royalty, income paid for services rendered outside of Ethiopia, income from different games of chance, dividends, income from casual rental of property, interest income, specified non-business capital gains.

Employment Income Tax

Who pays this tax? Article 2(12) an employee (definition). Article 12(1)- Employment income includes any payments or gains in cash or in kind received from different employment by an individual; Benefits in kind are also considered to be employment income; See Article 12(2) regarding benefits; Check if fringe benefits are being taxed; if so how? If not why? exemption from employment income tax - Articles 12(Proc 286/2002) and 3 (Reg 78/2002); Employment income is taxed at rates ranging from 10 to 35%. Employment income tax is withheld by employers and is a final tax; Hence employees earning income exclusively from employment are not necessary to declare income (Art. 65(3)).

Category "A" mentioned persons and bodies. (Art 18(1)). Any company incorporated under the laws of Ethiopia or in a foreign country and any other business having an annual turnover of Birr 500,000 or more. The category "B" unless already classified in category "A" any business having an annual turnover of over birr 100,000 (Art 18(2)). Category "C" except of category A and B and whose annual turnover is estimated by the Tax Authority as being up to Birr 100,000 (Art 18(3));

Schedule B income/ Income from Let out of Buildings. Article 14 (286/2002) income tax shall be imposed on the income from rental of buildings; Article 5/1/78/2002 gross income.

Schedule "C" Income / Business Income Tax. Art 17/286 /2002 - The scope of schedule "C" income. Art 18/286/2002 Taxable different Business Income which determined per tax period on the basis of the income statement, drawn in accordance with the Generally Accepted Accounting Standards, subject to provisions of the proclamation and the directives issued by the Tax Authority.

Tax Rate. Individuals taxed at rates ranging from 10 to 35 per cent; taxable business income of these bodies is taxable at the rate of 30% .

Deductible Expenses

The deductable is deduction of different expenses which mentioned **in** Art 8/78/2002 deductible expenses; Arts 21 (1)/286/2002 and 9/78/2002 non-deductible expenses. Arts 10/78/2002 and 21(3)/286/2002 deductible interest;

Depreciation. Buildings on a straight line basis at 5%. Intangible assets on straight line basis at 10%. The two pools of assets are computers, information systems, software products and data storage equipment 25%. All other business assets 20%.

Withholding tax on payments and imports. According to Articles 53/286/2002 and 24/78/2002 organizations having legal persony, governmental agencies, private nonprofit organisaiton, and non-governmental organizations (NGOs) are required to hold 2 per cent of income tax on payments for the provision of goods and services. They are,

i. Supply of goods involving more than Birr 10,000 in any one transaction or one supply contract
ii. Rendering of the following services involving more than Birr 500 in one transaction or one service contract

iii. consultancy services;designs, written materials, lectures and dissemination of information etc

iv. If a person subject to holding tax fails to provide the TIN to the withholding agent, Article 91 (2)/286/2002 requires the withholding agent to withhold 30 per cent of the payment

Withholding Income tax on Imports

- A tax imposed at the time of imports of goods for commercial purposes.
- 3% of the CIF value;
- both withholding taxes on payments and imports are creditable against the total tax due;

Tax Assessment and Declaration

- Tax assessment is based on the books of accounts for those that are required to keep and properly kept accounts;
- Estimated assessment for those that are required to keep but fail to keep proper accounts.
- standard assessment for those that are not required to keep proper accounts.
- Category A taxpayers declare within 4 months while Category B declare within 2 months from the end of the assessment year.

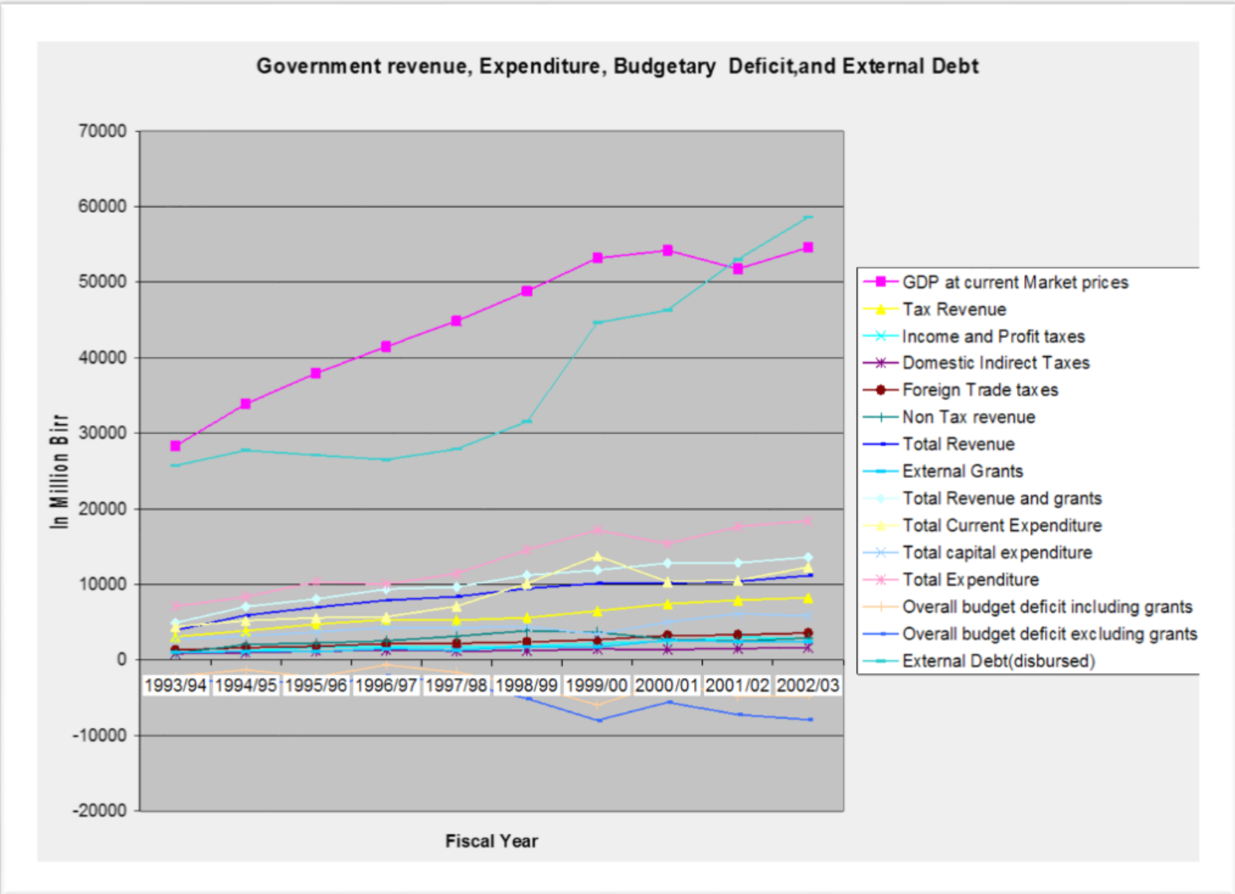
Standard Assessment for Category "C" Taxpayers

- Standard assessment amounts intend to reflect variations in the type of business, business size and business location. Payment is due on 7th July to 6th August every year. The loss Carry Forward (Art 28 (1&3)/286/2002)

Schedule D Income – Other Income

- Include tax on royalties, dividends, interest, etc, withholding taxes; Some of them are final taxes;

Table of Ethiopian Income by Tax



Source: Ministry of Finance and Economic Development, Ethiopia

Value Added Tax

History: Emergence and rapid spread of VAT is among the most important tax development of the later 20th c VAT invested in 1954 by a French economist Maurice Laurie who was joint director of the French tax authority. The theory is that the end consumer carries the burden of VAT, not the business, which is merely collecting the VAT on behalf of tax authority. According to international monetary fund report 2004, more than 4 billion, 70% of the world population new live in countries with VAT, raise about 18 trillion in tax revenue, roughly one quarterly of all government revenue over 136 (72%) of them have made VAT part of their tax system, and from 53 member of countries of African union 33(60%) of them are introduced VAT (Gebrie, 2008, pp.186-187).

Meaning: Different authors who wrote about the tax have defined value added tax (VAT), According to encyclopedia Britannica VAT is "A sales tax designed like other sales taxes to tax private consumption by individual of the goods or services subjected to tax" this definition failed to list out other features that distinguishes VAT from other kinds of taxes. One can understand from this definition VAT is a variety of sales tax and the tax is imposed on consumer. Black law dictionary on its parts provides that "VAT is a tax assessed at each step in the production of a commodity production on cost and its selling price "(Yohanes and Sisay, 2009 pp.66).

The VAT belongs to the family of sales tax a VAT way be defined as "a tax to be paid by the manufactures or traders of good and service on the basis of value added by them" . It is not a tax on the value of the commodity being sold but on the value added to it by the manufacture or trader. They are not liable to pay the tax on the entire value of the commodity. But have to the tax only on the net value added by them in the production or distribution (Dr. R. parameswaran, 2005, p. 105).

It is broad tax based because it is charge in different stage at production and distribution chain rather than on – time imposition. It also affects sectors, that is, import manufactures whole seller and retailer sector. VAT is family at sale tax sales tax is a tax imposed on a sale of goods or services and computed as a percentages of the total tax collected at multiple stage. VAT is a self-assessed tax since the VAT liability is calculated paid by the tax payers (proc, No 285/2002).

VAT in Ethiopia: VAT is a new tax system introduced in Ethiopia this tax system is not new to other countries. The modern concept of VAT was truly introduction in France in 1954. The concept of VAT was propounded first by American experts by 1920's. But at that time Americans failed to implement it. In Ethiopia, VAT was introduced since January 1/2003 designed to replace the cut dated sales tax which was served for more than four decades, which was collected at manufacturing level. VAT is taken as dispensable components of tax reforms in developing countries such as Ethiopia by considering it a miracle tax to replace direct and indirect taxes entirely. Since 1993 the Ethiopia government has made major economic shift from central planning to market oriented economic system (Yohanes and Sisay, 2009, pp. 186-187).

VAT Refund: VAT registered person shall got refund if at least 25% of the value of a registered person in a single transaction of substantially all of the asset of a taxable activity provide a notice in writing signet by the transferred is finished with 21 days after the supply taken place is taxed at a zero rate the authority shall refund the amount of VAT applied as a credit in excess of the amount of VAT charged for the accounting period within a period of two months after the registered person files an application for refund accompanied by documentary proof of payment of the excess amounts.

In the case of other registered persons the amount of VAT charged for the accounting period is to be carried for word the next five accounting period is to be carried for word to the next five accounting periods and credited against payment for these period and any unused excess remaining after the end of this five month period shall be refunded by the authority with a period of two months after the registered person files an application for refund accompanied by documentary proof of payment of the excess amounts. Where the tax authority satisfied for refund application in over paid tax the tax authority shall.

- First apply the amount of the excess in reduction of any tax levy interest of penalty payable by the person under the customs proclamation the income tell proclamation and excise tax proclamation.
- The repay any amount remaining to the person amount to be refunded is more than 50 by.

When registered person is entitled to refund and the tax authority is satisfied but does not pay the refund within specified date the authority shall pay the person the refund plus interest set at 25% over and above the highest cam mercies lending interest rate that prevailed during the preceding quarter (Gebrie, 2008, p. 119).

Nature of VAT: VAT is characterized by the following features,

- VAT is "general tax or comprehensive" that applies in principle to all commercial activities in valuing the production and distribution of good and provision of services.
- VAT is "consumption tax" because it is levied in sales of good and the provision of service rather than income, capitals or saving.
- VAT is "broad based tax" since the government collects such tax from all sectors that is importer, manufacturing whole sale, and retailer sector.
- VAT is "percentage of price" which means, the actual tax burdens is visible at each stage in the production and distribution chain.
- VATis collected "fractionally" because each time the item is changes hand in the process of production and distribution the VAT is assessed on the incremental value.
- VAT is "neutral" because regress of how many transactions are involved VAT liability the amount of tax they have paid to other person on purchases for their business activities.
- VAT is indirect tax because VAT is paid total authority by the seller of the goods, who is the taxable person but it is actually paid by the buyers to the seller as part of the price.

The federal democratic republic of Ethiopia (FDRE) has adopted VAT in to be a tax system in 2003. It has been introduced on January 1/2003, replacing the former sale tax system. The VAT proclamation no 285(2002) has been ratified by the house of people representatives six months before VAT implementation.

VAT is introduced in Ethiopia by proclamation (285/2002 replacing sale tax, with the following objective.

- To collect tax on the added value whenever the sale transaction is conducted since the former sale tax system did not allow collection is conducted.
- To minimize the damage that may be caused by attempts to avoid and evade the tax and ascertain the profit obtained by tax payers
- To enhance economic growth and improve the rational relationship between the gross domestic production and gross revenues.
- To enhance saving and investment as it is a consumption tax and doesn't a tax capital.

Registration of VAT: In Ethiopia, registration for VAT is categorized into two. They are, Obligatory registration and voluntary registration.

I. Obligatory registration

Any person conducting a commercial enterprise or instancing to conduct commercial enterprises or intending to conduct a commercial enterprise may apply to be registered for VAT. However if the taxable turnover of the enterprise, which is gross income for 12 calendar monthly exceeds or is likely to exceeds birr 500,000, the person conducting the enterprise must be register for VAT with FIRA or. The Federal Inland Revenue. If the turnover is below birr 500,000 of business activity one may apply for voluntary registration (Gebrie, 2008, pp.201-2002).

II. Voluntary registration

A person, who carried on taxable activity and is not required to be register for VAT, may voluntarily apply to the authority for such registration. If he/she regularly is supplying or rendering at least 75% of his good and services to registered persons (Gebrie , 2008, pp. 202-203)

Benefit of voluntary registration

Input VAT can be recovered if a person is registered. It will therefore be beneficial to voluntarily register where the person makes mainly zero - rated supplies. The term any person for purposes of VAT registration includes sale proprietor, company, incorporated body or unincorporated body, club or association. A commercial enterprise refers to any business of whatever nature and includes such as ordinary business, example, shop, contractors, manufacture wholesaler etc., trades and profession, example builders, engineers, accountants, lawyers etc. and activities of non- profit making bodies example societies, association (Gebrie, 2008, pp.202-203).

Registration procedure. Application for compulsory as well as voluntary registration must be made on application form called "application for VAT registration" on application for sale and the authority is required to register the person in the VAT register and issue a certificate of registration within 30 days of the registration containing details of.

The full name and other relevant details of the registered person

- The date of issuance of the certificate
- The data from which the registration takes effect and
- The registered person's tax payer identification number

If registration is disallowed FTRA will have to notify the applicator and the reasons for the refusal. The tax authority many deny the application for voluntary registration if the person:

- Has no fixed place of residence or business
- Does not keep proper accenting records
- Has no bank account
- Has previously been registered for VAT purposes but failed to perform his duties under the VAT law (Gebrie, 2008, p.203).

Time of application: A person who carries on taxable activity and is not registered is required to file an application for VAT registration it shall fill an application for registration on later than the last day of the month after the end of the period if:

1. At the end of any period of 12 calendar months the person made during that period, taxable transactions with a total value exceeding 500,000.00 birr or the last day of the month of the period if taxable transactions with a total value exceeding 500,000.00 birr.
2. At the beginning of any period of 12 calendar months when there is reasonable around to expect that the total value of taxable transactions to be made by the person during that period will exceed 500.000 birr (Gebrie, 2008, p. 203).

Time of registration: Registration takes place on one of the following dates depending up on which date comes first.

- In case of obligatory registration on the first day of the accounting period following the month in which the obligation to apply for registration arose.
- In case of voluntary registration on the first day of the accounting period following the month in which the person applied for registration or
- On the date selected by the registered person on his application for a registration person who conducts taxable activity in a branch or division shall be registered only in the name of the registered person to register one or **more of its branches** or divisions as separate registered person. The tax authority allows when it's satisfied on such case that divisions or branches maintains and independent accounting system and can be identified by the nature of its activities or location (Gebrie, 2008, p. 204).

Cancellation of registration: VAT registered person can apply for cancellation of registration

- If tax payer ceased to make taxable transactions.
- At any time after a period of 3 years of the date of his most recent registration for VAT if the registration persons total taxable transactions in the period of 12 months then beginning reasonable are expected to be not more than 500,000.00 birr.

The cancellation of VAT registration takes effect

- At the time the registration person ceased to make taxable translation for example, if one close down or sell his business. However, if one has more than one business and is not closing down or selling them all he may not be able to cancel it will depend on the level of taxable turn of remaining businesses.
- If the registered person has not ceased to do so at the end of the accounting period during which the person applies to the authority for cancellation of VAT registration.

When registered of VAT is cancelled, the authority is required to remove the person's name and all other details from the VAT register and the person is required to return back the issued certificate of registration. VAT registered person cannot charge VAT or issue tax invoices for any supplies made and cannot claim are fund of VAT incurred on any goods or services purchased from the date of the registration is cancelled (Gebrie, 2008, p. 209).

Types of VAT: The VAT can be determined in different forms. It may way depend up on the form of tax base. The forms may differ on the items to be included in the tax base.

The common type of VAT is given below:-

A. Consumption VAT: in the type of VAT the firm is allowed to deduct from gross value of its product not only the non- capital input purchased from other firm but also the capital equipment purchased.
B. Production VAT ; in the production type VAT the value of the input purchased by the firm from other firms is not dedicated in full only the value of non-capital purchases in dedicated.
C. Income type: - according to this form the firm is allowed to deduct the depreciation the capital goods (during the years) a part of the full value of its non capita purchase. Here, firms cannot deduct the entire value of its capital goods purchased during the year but they can deduct the respective amount of depreciation attributable to that year (Dr. R. parameswaran, 2005 p.106).

VAT administration

The VAT replaced the current sales tax on manufactured and imported goods and service on January 1/2003. The responsibility for the correct calculation and timely payments of VAT rests on the Tax payers himself. The VAT is a broad based tax on the consumption of goods and service. It is collected at all the stages in the production and distribution process beginning with the importers and producers of raw materials and ending with retailers cascading of the tax (i.e. tax on tax is avoided by providing for a credit for the tax paid at the preceding level unlike the sales tax system , where by relief is granted only to raw materials used directly in the production of goods under a VAT relief is granted for tax paid on capital goods, distribution and administration inputs. Sales of exported goods are not subject to the VAT.

Removing the tax content (on input) from exported goods makes the goods more competitive in international markets. VAT is a tax on consumer expenditure. It is collected on business transaction and imports. Most business transaction involve supplies of goods or service and VAT is payable if they are supplies made in Ethiopia, made by a taxable person, made in the course of furtherance of a business are not specifically exempted of zero – rated (Gebrie, 2008, pp. 190-191) .

Advantage of VAT: The following are some of the advantages of VAT

a. It avoids cascading effect of tax (tax on tax): VAT works on the principle of that when the raw material passes through various manufacturing stages and manufactured products through various distribution stages, tax should be levied on the incremental value at each stage and not on the gross sale price. This insures that some commodity does not get taxed again and again, and this there is no cascading effect. Putting the concept in simple terms, in VAT system, each input is taxed only once (Misrak, 2008, p. 310).
b. It is major comprehensive and equitable tax system: Even though the ultimate burden of VAT full on the final customer, VAT is collected by the government from all sectors

that is from import manufacturing, whole sale and retail sectors. Therefore, it is a more compressive and equitable taxes system. On the contrary, sales tax is normally levied at one stage of whole marketing (Misrak, 2008, p. 310).

c. It reduces the possibility of the tax erosion: In the case of VAT the taxes are divided into several parts depending on the number of stage of production and sales. In each stage every transaction is made using VAT invoice approved by tax authority. In addition each VAT registered person (supplier) has to maintain appropriate records on their sale and purchase transaction. Those obligations make tax evasion difficult (Misrak, 2008, p. 310).

d. It has less tax burden: Under VAT system, the tax is collected is small fragments at different stage of production and sale. Hence, the VAT payers feel the burden of the less (Misrak, 2008, p. 310).

e. It is neutral: Regardless of the number of stage of production and distribution, VAT is collected in each stage, therefore; VAT is expected to be perfectly neutral in the location of resources in the form of production and commercialization (Misrak, 2008, p. 310).

f. It improves productivity: In VAT system, a firm has to par tax even though it van in to loss. The firm cannot claim any exception for loss because it pats taxes on the value produced and not on profits. So, firms will always try to improve their performance and reduce the cost of production. As a result, the overall productivity of the country will be improved (Misrak, 2008, p. 310).

g. It promotes capital investment and saving: VAT is a consumption tax since one pays VAT on its expenditure and has the option to sure so as not to be taxed. Furthermore, relief from tax on capital goods may encourage investment. Potential investors also consider tax legislation as one of the factors in making investment decision (Misrak, 2008, p. 311).

h. It enhances exports: Exports of goods and services in most countries that implement VAT are liable to VAT. At zero rates this may make exports internationally competitive and thus encourage exports (Misrak 2008, p. 311).

The value added tax (VAT) proclamation provides exemption for basic necessities and domestic transportation and zero rating to encourage export and investment. Up until May 2006, 17,223 tax payers where registered for VAT. The enhanced functionality of this system includes the automatic computation of penalties and interest that apply to payers who fail to comply with VAT.

III. CONCLUSION

Tax is very important for each and every Government. As we are all know that taxation can be classified into direct and indirect taxes.Every Government need revenue to lead the economic, infrastructure, medical, transport, education, telecom, electricity, staff, research, to concession, subsidies, free facility for the unable sector community in the country. To generate the income Government has a constitution as a law to charge a tax for different sectors of people which brought into different categories of the people. No Tax, No Income; No Income, No Revenue; No Revenue, No Government. Government is a public which is common to the all of the people in the country. Whether the direct or indirect tax, the tax must be charged on the basis of the effort of the people income. Some people earn money with their hard work. Some people earn money easily. The easily earned income must be taxed more than the hard earned money. Ethiopian Taxation system is very important for raising income of the Government.

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