



## International Law

*Elixir Inter. Law 130 (2019) 53188-53196*

**Elixir**  
ISSN: 2229-712X

# Principle of Equity and Convenience under the Federal Income Tax Regime of Ethiopia

Alemu Taye Enyew

LL.B-Mekelle University, LL.M in Business and Corporate Laws Bahir Dar University, Dean of Debre Markos University School of Law

### ARTICLE INFO

#### Article history:

Received: 30 March 2019;

Received in revised form: 20 May 2019;

Accepted: 30 May 2019;

#### Keywords

Convenience,  
Equity,  
Income Tax,  
Principle

### ABSTRACT

A tax system refers to a legal system put in place by a government to assess and collect taxes from taxpayers. Governments have a desire to collect as much money through taxes as possible from their taxpayers to finance their various programs. On the other extreme, taxpayers would want to avoid paying taxes as much as possible as this reduces their wealth without receiving a direct benefit. To strike balance between these divergent interests of the government and the taxpayers, Adam Smith in his famous books "The Wealth of Nations" enunciates four main principles of taxation for the first time that a sound tax system should incorporate. The principles relate to the rate, fairness, method of levy and collection of the tax. This article mainly focuses on assessing employment and business income tax under the Federal Democratic Republic of Ethiopia (hereinafter FDRE) income tax laws against the principle of equity and convenience. This article does not directly address issues of the principle of equity and convenience in rental income taxation and other income taxation although these are part of the income tax laws. The paper culminated with a short conclusion and recommendations on the matters discussed under the main body. Accordingly, the employment income tax (schedule A) lacks equity since it only considers income as a base to impose tax regardless of other circumstances of the taxpayer. However, it is convenient to pay tax for the government since there is a withholding system. The business income tax (schedule C) on the other hand is neither equitable nor convenient due to assessment and other defects.

© 2019 Elixir All rights reserved.

### 1. Introduction

Any government in the world, past and present, cannot discharge its responsibilities and exercise its powers without raising public finance. Tax is the central concern of public finance and it is the first sources of public revenue for almost all modern governments. To cope with the revenue constraints of governments, increasing expenditures and resulting fiscal limitations, tax remains primary means. It also serves as for financing public goods such as maintenance of law and order and public infrastructure (OECD, 2014). To collect tax from the taxpayers and to raise the revenue of government of a particular country, the tax system should uphold the principles of good tax system like equity, certainty, convenience, economy, productivity, buoyancy, flexibility, simplicity, and diversity (Bhatia, 1994). Among these principles, the principle of equity and principle of convenience are at the hearts of tax policy and citizens are keenly sensitive to these principles. A tax system should go well with the known principles of taxation and live up to the widest objectives of taxation (financial, economic, social or political) (Adam Smith). The principles indicate that a tax system that satisfies these basic criteria for the design of taxes and tax structures can be termed a good one.

Despite the fact that most would agree that taxation should be equitable, what makes tax fair and equitable is a debate among different disciplines (Committee, 2015). The benefit principle and the ability to pay principle are the two

principles, which are recognized by Adam Smith, to assess the equitability of taxation (Ibid). The first principle of fair taxation draws a conclusion that the burden of taxes should be distributed among the taxpayers in relation to the benefits enjoyed by them from government goods and/or services. Those who get more benefits should pay more taxes in proportion to the utility derived from public goods and services. The second one on the other hand believes the burden of taxation should be shared among the members of the society and for the interests of equity and tax burden shall be apportioned according to their relative ability to pay. This ability to pay can be measured based on taxpayers income, property or consumption though difficult to design and administer a tax system that is absolutely fair and equitable.

Tax equity is comprised at least two distinct dimensions such as horizontal, and vertical equity (equal). The principle of horizontal equity demands that similarly situated individuals face similar tax burdens. However, "similarly situated," does not mean "identically situated. It states that similarly situated taxpayers should pay the same amounts of taxes because they have the same ability to pay (Kaplow, 2008). On the other hand, those taxpayers with less ability are treated favorably relative to those with greater ability (Kaplow, 2008). It expresses that those who are "better off" should bear a larger proportion of the tax burden while those who are "worse off" should bear less. The vertical equity concept in taxation is based on the conception of marginal

Tele:

E-mail address: [alextye20@gmail.com](mailto:alextye20@gmail.com)

© 2019 Elixir All rights reserved

utility of income. Moreover, there are procedural and substantive equity in taxation that requires the impartial application of the tax laws regardless of their status, origin, political affiliation and equal treatment of people in equal circumstances and unequal treatment of people in unequal circumstances.

Like any other countries tax systems, the Ethiopian income taxation has tried to uphold the principle of "tax equity" even though the income tax laws are not critically examined in light of the normative aspects of "tax equity." The new income tax proclamation (979/2016), the new income tax regulation (410/2017), the nearest repealed income tax proclamation (286/2002) and regulation 78/2002 contain provisions that indicate the incorporation of "tax equity" in its conventional sense. The current and the previous income tax laws appear to recognize both horizontal and vertical tax equity since they imposed progressive income tax rates upon the major sources of income of the individuals. Most of the income, which categorized from different schedules, applied the progressive rate of taxation for individual taxpayers and it seems "tax equity" is accepted as a norm in the Ethiopian income tax system literally. Not only in the laws, but also in its policy, Ethiopia conventionally endeavored to inculcate tax equity as a primary principle of taxation (Ethiopia, 2016).

The Ethiopian tax legal regimes tried to consider the principle of tax equity taking income as a parameter. Individuals with the same amount of income may be in equal situations if we consider their income per se only, but they may be different and unequal in many other scenarios (id).

On the other hand, the principle of convenience indicates that tax should be collected in a convenient manner from the taxpayers. The taxpayer should not be supposed to suffer in the discharging of tax liability. The government should worry about the suitability of the taxpayer at the time of tax collection. Adam Smith stresses, "Every tax ought to be levied at the time or in the manner in which it is most likely to be convenient for the contributor to pay it. In recent years, efforts have made to make the Ethiopian income tax convenient to the taxpayers by introducing a withholding system particularly, for employment income tax. Even the current Ethiopian tax regime is a little bit convenient to the business income taxpayers providing alternative tax accounting system like accrual or cash base accounting system. This also makes the income tax system convenient. Business income taxpayers declared their tax liability in the annual base and have a tolerable time for payment depending on their annual transaction (category). This gives room to declare and pay their tax liability in a time that is suitable for them. However, there is a lot of harassment of the taxpayers as they are asked to come to the income tax office several times during a year for appeal of tax liability due to assessment and other related problems.

Hence, this article questioned is how far the principle of equity and convenience indoctrinated under Ethiopian employment and business income tax laws and what circumstances of individuals is the income tax laws should have considered to distributed tax burden an equitable manner.

This Article has an objective to sketch these crucial questions and demonstrate the convenience and equitability of the Ethiopian business and employment income taxation. To this end, a brief discussion on general principles of taxation with its conceptual and historical discourse will be made. More importantly, the tax equity and convenience

under the two types of income tax is critically assessed. The last part of the paper concludes by summarizing the major discussions of the main body and postulate possible courses of action that can facilitate the policymakers and legislator to make the Ethiopian income tax system in general and business and employment income taxation, in particular, more equitable and convenient.

### **1. General Principles of Taxation**

Taxes must be levied with great care and rationality. In order to practice this rationality and care, the lawmaker when enacting tax laws and the tax authority when it administers tax must follow a certain code of conduct in the form of principles of taxation. The various principles, which have been developed since Adam Smith's days to guide the state are levying the taxes, are called the principles or canons of taxation (Lencho, 2014). On what basis should tax revenues be collected from the public and establishing the ground rules for the distribution of this public burden is known as principles (canons) of taxation.

To attain the different functions of taxation, tax laws and tax administrations should look at basic principles set to build a good tax system. The principles try to strike a balance between the interest of the taxpayer and that of tax authorities. A government shall take money like a bee that makes honey without causing pain to the plant. Adam Smith, the Scottish economist in his famous book "The Wealth of Nations", is the first writer to enunciate four main principles (canons) of taxation that a sound tax system should incorporate. With the change in time and governance expansion economists such as German economists, Adolph Wagner and Neumark forward some additional modern principles of taxation (Id).

Adam Smith developed four-canon of taxation like Canon of Equality (equity), Canon of Certainty, Canon of Convenience, and Canon of Economy. Moreover, Adolph Wagner developed another nine principles, which are principles of sufficiency, flexibility, choice of sources upon which tax is applied, choice of kind of tax, generality, fairness, certainty, comfort and cost of efficiency (Perdices, 2011). Furthermore, Neumark extended the principles of taxation into four major categories: such as budgetary and fiscal Principles, socio-political and ethical principles, political, and economic principles and legal and technical principles (Id). Though there are many principles of taxation, which developed by different economists as stated above, now we will be glimmered further below to some of the selected principles.

#### **1.1. Principle of Equity (Equality)**

The subjects of every individual ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective ability; this is in proportion to the revenue, which they respectively enjoy under the protection of the state (Adam Smith). That is to say, things that are alike should be treated alike, and things that are unlike should be treated unlike in proportion to their unlikeness. Equality does not mean an equal amount of tax, but equality in tax burden the rate of sacrifices. The rich should pay higher taxes because without the protection of the government authorities they could not have earned and enjoyed their income. It stresses that taxation must ensure justice and fairness. Equity or social justice demands that the rich people should bear a heavier burden of tax and the poor a lesser burden. According to this principle of taxation, instead of the proportional or flat rate of taxation progressive tax rates is better to ensure equality. The rate or percentage of

taxation should increase with the increase in income and decrease with the decrease in income. Hence, a tax system should contain based on the taxpayer's ability to pay and sacrifice.

Horizontal equity and vertical equity are the two faces of equity. Horizontal equity requires that those with equal status whether measured by ability or some other appropriate scale should be treated the same (Steuerle). They should pay the same amount of tax and receive the same amount of benefits. Consequently, those who start out as equals before any governmental action would end up as equals after the government acted. In this case, those starting with the same before-tax income should end up with the same after-tax income. Vertical equity, on its part, generally requires that those with less ability be treated favorably relative to those with greater ability.

Horizontal and vertical equity are different sides of the same coin. The contention that those who have less should therefore pay less and receive more reflects the same concern that those with equal status be treated equally. This belief derives partly from a concept of equity whereby people are placed on a single scale so that the appropriate tax or expenditure is a simple function of what is measured on that scale.

### 1.2. Principle of Certainty

According to Adam Smith, the principle of certainty implies that the taxpayer should be well informed as to the time, amount and the method of the payment of tax and there should not be any embarrassment and confusion about the payment of tax. The taxpayer should know in advance how much, at what time and in what form he has to pay the tax-amount, the rate, type and manner of payment. The government should also be certain about the amount and procedure of tax collection. Tax laws and administrations shall not be vague or unclear, which open room for confusion, discretion, harassment, corruption by tax officials and this may further create impulsiveness and non-compliance in the minds of taxpayers. In other words, the tax system would be corrupt if the principle of certainty is missing (Adam Smith). Certainty about the amount of the tax and its time of payment helps the taxpayer to adjust his income to his expenditure in advance. Adam Smith has further pointed out that even a very small degree of uncertainty is a matter of great importance than a considerable degree of inequality in taxation. If the tax is 'certain' the taxing authority cannot exploit the taxpayer in any manner. Uncertainty and arbitrarily are the greatest evil thing in taxation. A tax system, which gives a lot of discretionary power to tax officers will high likely to, abused. As a result, there is a lot of harassment of the taxpayers and corruption is rampant in the income tax department. A good tax system should be secure against unpredictable taxes levied on their wages or other incomes.

Thus, the tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid ought all to be clear and plain to the contributor and to every other person. A successful function of an economy requires that the people must be certain about the sum of tax that they have to pay and place of payment where they have to pay on their income from work

### 1.3. Principle Convenience

As per this principle, the tax should be collected in the manner, place and time as convenient to the taxpayers and it should give the maximum of suitability to the taxpayer. Meaning, taxation should not create unnecessary trouble.

According to Adam Smith, "Every tax ought to be levied at the time or in the manner in which it is most likely to be convenient for the contributor to pay it". For example, land tax collected at the time of harvest is inconvenient. The manner of payment, as well as time and place of payment, should also be convenient. The rationale is a convenient tax system will encourage people to pay tax and will increase tax revenue.

Modern governments are supposed to pay special attention to the convenience of the taxpayers while collecting taxes from them. Withholding system of taxation is convenient for a taxpayer to pay a tax. For instance, the employer is responsible to withhold employment income tax at the time of payment of the salary of the employee. Most of the countries, which adopt scheduler types of income taxation including Ethiopia, introduce withholding system of taxation for the convenience of the taxpayer and tax collector. The taxpayers make a sacrifice at the time of payment of the tax and consequently, the government should see to it that the taxpayer suffers no or least inconvenience because of the payment of the tax. This principle is important for both the taxpayers and the government. The taxpayers feel least inconvenience in the payment of a tax and the government comes to know the incidence of taxation and gets a higher income by way of taxes as the tendency to evade taxation may be reduced largely.

### 1.4. Principle of Economy

For a collection of taxes, there are always costs and no tax comes with zero cost except perhaps the lump-sum tax (Adam Smith). The purpose of these principles is to reduce these costs. The cost of collecting a tax should not be exorbitant but be the minimum. Extravagant tax collection machinery is not justified and acceptable. If the collection costs of a tax are more than the total revenue yielded by it, it is not worthwhile to levy it. Adam Smith boldly stated, "Every tax has to be contrived as both to take and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state." As much as possible the government should minimize the cost of tax collection. When we compare the cost to collect the tax and the revenue derived from the tax, the cost of tax collection should not only be lower than the amount of tax collected but also the tax after revenue shall be significantly different from the cost. More complicated a tax system, more elaborate administrative machinery will be employed to collect it and consequently, collection costs will be relatively larger. For instance, if there are a number of tax officers whose salary is huge and if their salary and the revenue they collected do not have a significantly different, the tax system is not good tax system.

Generally, the cost of collection should be low compared to the tax collected. Tax collection should be efficient taking no more from the taxpayer than is necessary to defray the cost of providing services. The amount collected should cover the full cost of providing governmental services (Budget).

### 1.5. Principle of Co-ordination

This principle of taxation implies that there must be coordination between different taxes that are imposed by the various tax-levying authorities. It specifically applies in a federal setting and according to this principle, federal and state governments (both vertically and horizontally) should design their tax systems in a similar and non-competitive manner in the interests of national economy. It may also apply intra-jurisdictionally so that countries' tax laws would not be contradictory and competitive. Overall, in

the democratic set-up, although the taxpayers are the same, yet the central and local governments impose various taxes. In such a scenario, instead of competition, they should work in coordination for the interest of the taxpayers and the tax collectors.

### 1.6. Principle of Neutrality

All taxes by nature exert an income effect since they compel the withdrawal of revenues from the sector and reduce the level of sector purchasing power. All taxes tend to exert a substitution effect because they interfere with private sector allocation decisions. Traditionally, tax neutrality has been defined as the imposition of taxes in such a manner that they do not change private sector behavior. A tax measure is considered neutral when it does not distort individual choices. This principle commands that taxes avoid distortions in the market (Smith). Tax rules interfere with the way taxpayers do their business or go about their affairs, and the goal of taxation should be to minimize the level of interference in taxpayers' decision-making. It advocates in a pure sense that a tax should not influence the market decisions either of satisfaction-motivated consumers or of profit-motivated businesses.

All taxable activities should be treated equally by the tax system (that is, taxed at the same effective marginal rate) in order to avoid as far as possible the excess burdens that will arise as taxpayers substitute towards relatively lightly taxed activities (OECD, 2014). The tax system should be free from biases and should leave economic behaviors unaffected. A tax should not create inflation or deflation in the market. A government should not collect too much tax to finance its operations and too little tax to favor taxpayers (OECD, 2014). However, there are types of taxes which designed to interfere and when this is considered as the aim of policy. For instance, in the Ethiopian context there are excise taxes on luxuries, tobacco and alcohol are consciously designed to influence the consumption of these products by making these products more expensive. Since the consumption of these products is generally regarded as undesirable, the use of taxation to reduce the consumption of these products is generally accepted. Nevertheless, the norm of "neutrality" remains one of the major principles of taxation today.

### 1.7. Principle of Fiscal Adequacy

The well-known economist Charles F. Bastable developed the principle of fiscal adequacy. According to him, the systems of taxation should be based on considerations of productivity. This stated that taxes must be levied in order to accumulate enough revenue for the government to run its administration efficiently. If a tax yields poor income, it cannot be considered as a productive tax. The tax system should be able to yield enough revenue for the treasury to enable the government to discharge its duties and the government should have no need to resort to deficit financing. The tax base should be diversified with taxes collected from a variety of sources to prevent fluctuations in total revenue. Tax system's yield should be sufficient to balance the state budget and meet the needs of the state's highest priorities and it should grow at the same rate as government spending and the growth rate in the state's economy. This is possible through touching tax rates and tax bases. Taxes need to be productive and dynamic so that it should not discourage the productive capacity of individuals or organizations. This is a good principle to follow in a developing economy.

## 2. Definitions of Equity in Taxation and Distribution of Tax Burden

### 2.1. Definitions of Equity in Taxation

The term equity is difficult even some would argue impossible to give a comprehensive meaning. Judgments as to whether or not a rule or action is equitable can be personal (Institute, 2007). Aristotle equated equity/ fairness with justice. In a just system "equals are to be treated equally and un-equals to be treated unequally." The differential treatment of un-equals is not to be arbitrary but is to be based on some relevant factor(s). The challenge in designing a just or fair system is determining what factors should be used to define equity and to allocate rights and duties (Institute, 2007).

There is no agreement about what is "equitable" and most scholars use interchangeably with "fair." The reason is what is equitable in general is not a scientific one capable of being reduced into some rule applicable in all scenarios relevant for all situations. Equity implies giving as much advantage, consideration, or latitude to one party as it is given to another. It is preferable to define equity taxation as working definition. Hence, *tax equity implies imposing the same tax duty on taxpayers in similar circumstances and imposing different tax duty on taxpayers in different circumstances by considering various factors like income, health condition and dependency*. It means a different taxation burden to different people. When we impose a tax upon the rich and poor, the rich should contribute more to the state as they stand to lose more from its absence than the poor do (Mill, 1991).

### 2.2. The Development of Equity in Taxation

According to Aristotle, equity was the measure of justice; the unjust is unequal, the just is equal. Justice is about determining and giving individuals their due. He perceived equity as a mean that is a point between two extremes of what was unjust finding what was just to be a species of the proportionate. A person's just share of money or honor could be equal or unequal to that of others since what is just in distribution must be according to merit in some sense. Hence, a well-known maxim developed from Aristotle ideology is that "*Things that are alike should be treated alike, and things that are unlike should be treated unlike in proportion to their unlikeness*".

Locke's natural state describes a state of nature was a state of perfect liberty and equality governed by natural laws that require a man to preserve the life and goods of others. Equity is a notion of justice by which each is treated according to his just desserts. Yet, taxation in an eighteenth-century sense allows the state to share in the fruits of civil society. A tax must recognize the equity of men in civil society, confront the question of rights, and just.

An important cause of the American Revolution was the perceived unfairness of British taxation. The slogan of "*no taxation without representation*" was inspired by John Locke's maxim of just taxation that suggested, "Legislators must not raise taxes on the property of the people without the consent of the people, given by themselves or their deputies". He also acknowledged a citizen's duty to pay taxes. This Lock sentiment was reflected in several American states' constitutions as if, in 1776, Pennsylvania's Constitution declared, "every member of society hath a right to be protected in the enjoyment of life, liberty, and property, and therefore is bound to contribute his proportion to the expense of that protection..."

The primary purpose of equity in taxation was to secure a fair distribution of tax burden to society. In ancient regimes, there were members of the society who has privilege treatment like exemptions from taxation; on the contrary, there were enormous people who have duty to pay the bulk of the taxes. Shifting from a monarch to a legislature was not sufficient to guarantee fair taxation. The modern tax system in the world tried to be equitable relatively with the ancient taxation system. When we see the Ethiopian experience, before the Ethiopian People Revolution Democratic Front come to power there was a high rate of income taxation particularly on the Derg regime. When the EPRDF came to power in 1991, income tax rates were reduced to address issues of vertical equity.

When we see the rate, until 1992, the maximum employment tax rate was 85 percent at a graduating level above the threshold of Birr 50 monthly (Abdella, 2010). In the same year, the highest tax rate was reduced from 85 to 50 percent while the threshold was raised from Birr 50 to Birr 105 monthly. The highest rate was subsequently further reduced to 35 percent and the threshold level raised to Birr 120 monthly. In the Derg regime, the business income tax rate was 89 and it reduced to 59 percent in 1990 and then to 40 percent in 1995. The business income rate in 1996 was further reduced to 35 percent to encourage business development and equity. The dividend tax rate was 25 percent until 1992. Consequently, the rate decreased from 25 percent to 10 percent to encourage private sector participation in share companies. Royalties were taxed at 40 percent in the Derg regime later in the EPRDF regime reduced to the current rate of 5 percent (Abdella, 2010). This has encouraged sectors that make royalty payments, particularly the mineral extraction sector. Despite the fact that the current EPRDF made intense tax reforms to make taxation that is more equitable. It considers only income to measure the similar circumstance of individuals regardless of other possible consideration.

### **2.3. Distribution of Tax Burden**

Despite the fact that most Scholars from different disciplines would agree that taxation should be equitable, they vary as to what constitutes a tax is equitable (Committee, 2015). Economists and political philosophers have recognized two broad principles to distribute tax burden inequitable manner. The first principle is known as the benefit received principle, under which taxes should be levied in proportion to the benefits received from the public sector. Meaning, the burden of taxes should be distributed among the taxpayers in relation to the benefits enjoyed by them from the government. Those who get more benefits should pay more taxes in proportion to the utility someone derived from the public goods and services. This principle derived from Adam Smith's statement, which stated that taxes should be equal or equitable and most scholars interpreted that the burden of taxation should be apportioned to a person based on the benefits he received from government goods and services (Adam Smith). Therefore, it advocates that the tax for each individual should approximate the price that an individual would willingly pay for the government service if it were provided in a market. Those of people who are most secure in their property, lives, and prospects presumed to get the most benefit from government (Mill, 1991).

However, it is difficult to measure benefits enjoyed by an individual from public services since there are public goods, which satisfy collective wants and are not subject to voluntary exchange principle. It is insurmountable determine

the price of the government service like how much someone gains from the national defense of a country. Moreover, a blind application of this principle will cause great injustice as a poor person gets more benefit from low-cost housing provision by the government can be required to pay more tax.

The second principle is known as the ability to pay principle. It focuses only on the tax side of the budget, and views taxation as imposing an aggregate cost that must be apportioned in a manner that taxes those with equal ability to pay equally, and imposes greater burdens on those with greater ability to pay (Committee, 2015). The burden of taxation should be shared among the members of the society and for the interests of equity; tax burden shall be apportioned according to their relative ability to pay.

The notion of ability to pay is commonly applied to determine equity, though there is no general agreement regarding the appropriate standard by which to assess a taxpayer's ability to pay. This ability to pay tried to be measured by considering income, property or consumption of taxpayers, yet it is difficult to measure equity (Committee, 2015).

Generally, most citizens perceive that tax burdens and benefits are distributed in a fair and equitable manner. In a complex economic and social environment, it may not be possible to design and administer a tax system that is fair and equitable in an absolute sense. However, a tax system that is generally perceived as fair and equitable is a desirable and achievable goal of governments.

### **3. Tax Equity and Convenience under the Federal Income Tax Laws of Ethiopia**

As stated above, the principle of equity in taxation is all about how much one has to contribute to the government in comparison to other persons. It is unthinkable to enact and administer a tax system that absolutely is equitable. Treating people equally according to their ability to pay requires three elements. These are the proper assessment of their means, that is, the resources available to them, there must also be an assessment of their needs according to societal standards reflecting society's values and finally, the system must reflect a value judgment as to the proper rate structure. The first one requires practical economic judgment coupled with social choices as to which system of taxation best reflects societal values. The second one on the other hand requires economic judgment in the context of debatable decisions concerning need. The last one determines how the government's need for revenue will be distributed among people based on social choice or philosophy as to what constitutes an equal sacrifice. Most priorities progressive taxation is relatively preferable to secure tax equity by which the rate raises with a rise in income. However, by the mere fact of progressivity of taxation, hard to conclude the tax system is equitable.

In a recent analysis of the Ethiopian tax system by the leading party, tax equity features as one of the goal of the Ethiopian tax system: The government has revised tax laws and reformed tax administration to ensure that the Ethiopian tax system is equitable (Gashaw, 2015). The preamble of the current income tax proclamation (979/2016) and regulation (410/2017) explicitly recognizes "equity" or "fairness" as one of the norms of the Ethiopian income tax system. The current income tax law is perhaps more equitable in spirit than any of the previous income tax laws of Ethiopia. The preamble of the previous income tax proclamation (286/2002) does not explicitly recognize "equity" as one of the norms of the Ethiopian income tax system. Detail assessment on the equitability and convenience of both employment and

business income tax in Ethiopia has made in the following discussion.

Before assessing the equitability of the employment income tax in Ethiopia, better to deal with what elements should fulfill to impose employment income taxation is very imperative. To kick off employment income tax in Ethiopia; two conditions need to be met cumulatively. These are an employment relationship, and generate income from the employment relationship. This suggests that the existence of an employment relationship is a necessary, but not sufficient condition for the imposition of employment income tax. The employee is supposed to be directed and controlled by the employer to get the status employee. The income tax law does not recognize the incomes, which come from self-employment or independent contract as employment income (Income Tax Proclamation, 2016). Employment income tax in Ethiopia includes, without limitations, salaries, wages, allowances, directors' fees, and other personal emoluments save the income that is clearly exempted under article 65 of the income tax proclamation (Federal Income Tax Proclamation, 2016). Every person deriving income from employment is liable to pay tax on that income as per the federal income tax laws of Ethiopia (Federal Income Tax Proclamation, 2016). The rate is provided under Article 11 and it is the combination of progressive and proportional rates. As the schedule clearly depicts, the first 600 Birr is not taxable income. Such exclusion may be justified on two important grounds. The first reason is attributable to the fact that this amount is so small that the government should not take a certain portion of it. If the government takes a certain portion from an employee who earns 600 Birr, this would not serve the purpose of social justice as the purpose of taxation, among other things, is the distribution of wealth. Secondly, it would not be economical or cost effective for the government to levy and collect taxes on such a negligible amount of money. The amount of money to be spent by the government for the collection of these taxes would be greater than the amount of money to be collected from such a source.

The minimum rate imposed from the employment income tax is 10 percent on incomes falling from 601 Birr to 1650 Birr. Whereas, the maximum rate provided in the schedule is 35 percent for all incomes from employment that are above 10900 Birr per month (Federal Income Tax Proclamation, 2016). By and large, the Ethiopian employment income tax system adopts a progressive rate of taxation. Many economists accepted a progressive tax as more equitable in point of a sacrifice than a proportional one. On this scenario, the current federal income tax law tried to be equitable.

The current employment income tax law is better than the previous repealed law in two things. The first one is that the current income tax laws exempt an employment income up to 600 ETB that was 150 ETB in the repealed tax laws. Moreover, the higher rate 35% applied on the employment income with a salary of above 10900 ETB that was 5000 ETB in the repealed tax laws. Generally, though, both the repealed and the active tax laws follow a progressive rate of taxation, as a rule, the current laws are more equitable than the previous tax laws.

Fringe benefits are taxable under the Ethiopian employment income tax (Federal Income Tax Proclamation, 2016). Fringe benefits are varying from one workplace to another in Ethiopia and it may include company cars, fuel, housing, meals, clothing, discount goods and services, free medical services, free entertainment and fitness services, free

training and educational opportunities, etc (Federal Income Tax Proclamation, 2016). Even though, the laws do not exempt fringe benefits from employment income tax, lack of proper valuation rules have effectively resulted in their exemption. An employee who receives a commuting allowance in the form of cash is taxable; an employee who gets transportation service is not. An employee who receives housing allowance in cash is taxable; an employee who is provided housing is not taxable as we experienced as an employee of the government. The practical exemption of fringe benefits is a subsidy to those employees. Some clever employers are able to provide certain benefits free of tax to their employee. As usual, the low-income people lose out in this game of fringe benefits. Only highly qualified employees can negotiate for fringe benefits in Ethiopia situation. Thus, the Ethiopian employment income tax system is harsh against those employees who receive their income in cash and this affects the tax equity in employment income tax in Ethiopia though equity has been used as a rallying policy of the government.

The other most important thing is that the Ethiopian employment income tax considers only income as a measurement to assess the equality and inequality of taxpayers and ultimately to impose an employment income tax (Repetti). This means two individuals with the same amount of income is considered as equal circumstance since the income tax law ponder only their income per se. Two individuals may be subject to the same tax rate schedule as long as their incomes broadly fall in the same income bracket category in Ethiopia. However, as a matter fact they may be quite different and unequal in many other situations like health conditions, marital status, and the number of dependents. Some modern tax systems like France and USA have contemplated these individual circumstances and attempted to consider individual and family circumstances in distributing tax burden in addition to income. In Ethiopia, there may be civil servants who have dependents and there may be civil servants who do not have dependent at all. The law imposes the same tax from those two individuals so long as their income is the same. However, these two individuals are similar in their income only but they are unequal in other scenarios. The effect of their taxation is not at all the same since the one who has no dependent may have the chance to save and the other one may consume all his income. Hence, the Ethiopian employment income tax laws do not strictly consider the circumstance of the individual to impose a tax so that it is treating the unequal equally and it is against the principle of tax equity.

The Ethiopian income tax laws uphold the principle of convenience to the employment income tax. Method and timing of tax payment is an indicator for connivance as stated above. The tax should be collected at the time the income is earned and it must be withheld by the employer to make the task convenient for the taxpayer as well as the tax collectors. The employer deducts tax on income from employment every month (Federal income tax proclamation, 2016). As a rule, the employer collects the employment income tax at the time of payment through withholding system and it is an indication for recognizing the principle of convenience. Discharging employment income tax is the simplest task in the Ethiopian tax system for the employee. No any contact between the taxpayer and the tax administrator as far as employment income tax is concerned. The income tax laws make the employer liable if he/she/it failed to withhold tax at the time

of payment from the employee (Federal Income Tax Proclamation, 2016).

In fact, there are exceptional cases in which employees are required to pay income tax themselves to the government in case of the employees who derive income from two or more and the tax authorities rely upon the goodwill of some employers who aggregate income from multiple employments. Moreover, non-diplomatic employees of embassies and international organizations report their income themselves and the Authorities have yet to devise a scheme for enforcing the income tax against these employees. One of the most exasperating and maddening features of Ethiopian income tax system is that Ethiopia has not been able to collect tax from most highly-paid employees of embassies and international organizations. Generally, the writer can safely conclude that the principle of convenience is respected by the Ethiopian tax laws regime to employment income taxation though there are few scenarios, which indicates a kind of inconvenience.

When we see the principle of equity to business income taxation under Ethiopian tax laws, somehow hard to say it is equitable. There are three categories of business taxpayer in Ethiopian tax regime based on their annual transaction. These are represented alphabetically A, B and C. Category A represent all companies and other businesses with an annual volume of turnovers above a million ETB. Category B represents any business (other than companies) with annual turnovers of less than a million ETB but more than 500, 000 ETB. On the other hand, category C represents any business (other than companies) with annual turnovers of less than 500, 000 ETB (Federal Income Tax Proclamation, 2016). Save category C other are duty bound to maintain books and records and declare their tax liability accordingly. The two categories are followed self-assessment to discharge tax burden. Theoretically, category C has the option to maintain books and records, but the Authorities accept these books and records only when the tax due from the books and records is greater than the tax due under the standard assessment methods. In fact, there is a possibility of neglecting self-assessment that is declared by the two categories (A & B). The rate, which is imposed on business income taxation, is progressive which extends from 10 to 35 per cent like employment income tax. In Federal tax regime in general and in regional tax laws in particular, recognize much deduction in the form of expenses to all categories including category C. Standard 50% of gross income deductions is allowed for category C on the other hand actual deductions for category A and B is allowed (Federal Income Tax Proclamation, 2016). This means, from the category C taxpayer gross income, half of it is deductible in the form of expenses. This makes their tax liability minimal and equitable.

The equity problem lays on assessment of business taxation, not the rate. Particularly, it is unfair to category C, which follows presumptive (standard assessment). Standard assessment theoretically means the tax is based on type, size, and location of the business. The type of business affects the profitability rate; size obviously shows the size of the income in some respects, and the location is, of course, critical to income generation.

Standard tables must be developed based on adequate research about the profitability rate of businesses, and if possible, the tables must show not just the type of business, but also the size and location of the business. Unfortunately, tables in practice only show the types of businesses, the profitability rates and the number of days in which businesses

are assumed for business. A standard table developed by Addis Ababa City Administration in 2003 identifies 103 types of businesses with sub-categories in each type, fixes profitability rates and the number of days it is assumed the business is open for business.

The tables mask a number of assessments, which are estimations location, is left out; size is left out. Estimators (assessors in the past, committees, and recently by fresh graduates) gather these numbers. It is these estimations that cause rancor among taxpayers, as they are extremely subjective and at times corrupt. The estimators go around literally every business and gather daily sale numbers and multiply that by the number of days for which the business is assumed to be open, and the taxable income is determined to be the profitability rate for that business in the tables. Ethiopian income tax assessment for small businesses, therefore, remains estimated assessments, not standard assessment. It is the failure of the authorities to develop standard tables of assessment with complete information about the type, size, and location of the businesses. The failure of scientific standard assessment coupled with the attitude of corruption on the side of the tax authority exposes small traders like category C taxpayers to pay beyond their ability. Hence, the incorporation of the principle of equality in business income taxation under Ethiopian income tax regime is questionable due to the above problem. However, the self-assessment methods that applied for category A and B business taxpayer make the tax system equitable only for these two categories of business income taxpayers.

Come back to the principle of convenience in business income tax payer in the federal income tax regime of Ethiopia, still hard to say the laws and the practical implementation recognizes the principle of convenience. The tax deceleration, as well as the tax payment system is inconvenient for all types of categories of business income taxpayers. Even though, the time of payment is flexible depending of their category, the taxpayer themselves supposed to appear before the tax authority and pay after long lasting tiresome procedure. Absence of automation and technology system makes the tax payment system full of cumbersome and inconvenient. Taxpayers are required to have generally accepted financial accounting reporting standards for expenses and income to be done. The problem is that nobody really knows what these generally accepted financial accounting reporting standards is in practice. They are preparing generally accepted financial accounting reporting standards by consulting licensed professional accountants in Ethiopia and this exposes the taxpayers for unnecessary costs as well as inconveniences. Moreover, lack of well-equipped staffs at the side of the tax authority and, literacy problem on the side of the business taxpayers makes the tax payment more cumbersome. Generally, due to different harassment, which has done by the tax officers, unnecessary itinerary, absence of technology and withholding system makes the business income tax inconvenient under the federal income tax regime of Ethiopia.

#### **4. Conclusion**

The paper has tried to analysis tax equity under the current federal income tax regime of Ethiopia. Taxes are most important revenue sources for every government in this world. To collect tax from the taxpayers and to raise the revenue of a government of a particular country, the tax system should uphold the principles of good tax system. Among the principles of taxation, principle of equity and



convenience are very vital. Principle of equity states that every individual ought to contribute towards the support of the government as nearly as possible in proportion to their respective ability. That is to say, things that are alike should be treated alike, and things that are unlike should be treated unlike in proportion to their unlikeness.

Vertical equity and horizontal equity is the two dimension of equity. The concept of horizontal equity asks whether taxpayers who otherwise are similarly situated bear the same tax burden. Their notation is persons in like circumstances should be taxed equally (horizontal equity) and the persons differently situated should be taxed differently (vertical equity). However, it is not easy to determine whether the two individuals are similarly situated or not. Horizontal equity is all about the treatment of equals equally and vertical equity on the other hand is all about the treatment of unequal unequally. If income were the only measure of a person, for example, then horizontal equity demands that two persons with equal incomes be treated as equals. Alternatively, vertical equity is based on the premise that someone with little or no income will have difficulty paying the same amount of income tax as someone who is rich.

The Ethiopian government claimed that tax equity is one of the features and goal of the Ethiopian tax system. Due to this effect, the government has revised tax laws and reformed tax administration to ensure that the Ethiopian tax system is equitable. The preamble of the current income tax law (979/2016) explicitly recognizes “equity” or “fairness” as one of the norms of the Ethiopian income tax system. Moreover, the close analysis of the income tax proclamation as well as regulation show that the current income tax laws are perhaps more equitable in spirit than any of the previous income tax laws of Ethiopia conventionally.

Employment income tax and business income tax are among the types of income tax, which are categorized under schedule A and C respectively. The employment income tax is applicable when employment relationship and income elements are cumulatively met. Employment income tax in Ethiopia includes, without limitations, salaries, wages, allowances, directors’ fees, and other personal emoluments. Though the laws do not exempt fringe benefits from employment income tax, lack of proper valuation rules has effectively resulted in their exemption even though the Council of Ministers has enacted regulations for taxation of fringe benefits. Due to this reason, the Ethiopian employment income tax system is harsh against those employees who receive their income in cash than those who receive in kind. Obviously, in Ethiopia, most of the time the lower employed received their income in cash than the higher employed. It makes the Ethiopian income tax in general and the employment income tax in particular inequitable.

Moreover, the Ethiopian employment income tax considers only income as a measurement to assess the equality and inequality of taxpayers. Two individuals may be subject to the same tax rate schedule as long as their incomes broadly fall in the same income bracket in Ethiopia. However, as a matter of fact they may be quite different and unequal in many other situations like, health conditions, marital status, and number of dependents. To this effect, simple to conclude that the Ethiopian employment income tax is not treating equal circumstances taxpayers equally and unequal circumstances taxpayers unequally. However, the employment income tax recognizes the principle of convenience since the tax laws introduce withholding system.

Relatively, the business income taxation is equitable in Ethiopia save category C taxpayers. The standard (presumptive) assessment makes inequitable tax liability for category C business income taxpayers in Ethiopia. The tax authority in Ethiopia failed to develop standard tables of assessment with complete information about the type, size, and location of the businesses. Due to this failure, tax imposes on category C taxpayers not in presumptive way instead it is estimation. This thing makes the taxation system in equitable for category C business income taxpayers particularly. However, the self-assessment methods that applied for category A and B business taxpayer make the tax system equitable only for these two categories of business income taxpayers. convenience issue for both A and C

### **5. Recommendations**

Principles of taxations are very vital to develop and design a good tax system which is equitable and convenient. In fact, it may not be possible to design and administer a tax system that is absolutely convenient and fair. The principles of equity and convenience in taxation are a relative term and it imposes an obligation upon a government to enact equitable and convenient tax laws and tax administration.

As stated above in the main body of this paper, the income tax laws of Ethiopia recognize fringe benefits as taxable income. The income tax proclamation gives the mandate to enact regulation for the proper administration of fringe benefit to the Council of Minister. Accordingly, the Council of Minister enacted regulation which state detail about taxation of fringe benefit. However, fringe benefit is most of the time given to the employee who are in a better position and due to valuation problem; it is not yet implemented so that it affects vertical equity in taxation. Therefore, fringe benefits should be properly taxed in Ethiopia for the sake of equity in taxation and for the interest of the government.

The FDRE income tax proclamations as well as regulation consider only income as a precondition to measure the equality and inequality of taxpayers and to assure equity in taxation. However, as stated in the main body of this article, modern income tax laws supposed to consider other factors like marital status, age, dependency, health conditions and income to consider the similar circumstances of taxpayers. The writer strongly believes that the Ethiopian employment income tax laws should consider at least dependency (family size) as a measure to assess the equality and non-equality of taxpayers in addition to income. No wonder in Ethiopia scenario there are so many taxpayers who have dependents due to the culture of the society and the religious ideology that recommend having number of children and due to the rise of unemployment rate that happen in Ethiopia even children after graduation might get back dependent on their family. If the goal is to tax all taxpayers in equal circumstances equally, how one-person families should be compared with four-person families. Thus, to assess whether the employment income tax taxpayers are in similar circumstances or not and to taxed in equitable way besides income the tax laws should consider family size (dependency) of taxpayers in to account. The employment taxation is most convenient due to withholding system, which is important to strengthen and enlarge in other types of income taxation.

Principle of equality and connivance are not incorporated in full-fledged way in business income tax under the FDRE income tax regime. Though, the rate is fair enough, due to the practical challenges to carry out presumptive (standard)



assessment for category C business income taxpayers, still the principle of equity is questionable. Hence, the tax laws as well as the tax authority should develop standard tables which help to make standard assessment scientific.

Principle of convenience is a big loophole of the tax laws of Ethiopia for business income taxpayers. The manner as well as time of payment is not suitable for business taxpayers in Ethiopia. Unnecessary burden are imposed upon the taxpayers in addition to tax liability as stated in the main body. Hence, the tax authority should introduce automation system, which facilitates online tax declaration, and payment system as well as reduce unnecessary bureaucracy to maintain principle of convenience.

## 6. References

### I. Books and Articles

Adam Smith, the Wealth of Nations  
 American Institute of Certified Public Accountants (2007), Guiding Principles for Tax Equity and Fairness, New York  
 Amin Abdella and John Clifford (2010), the Impact of Tax Reform on Private Sector Development, Addis Ababa, November  
 Bhatia, (1994), Public Finance, New Delhi, Vikas publishing house, 18<sup>th</sup> rev.ed,  
 John A. Miller. (2000) "Equal Taxation: A Commentary," Hofstra Law Review: Vol. 29: Issue. 2, Article 4  
 Joint Committee on Taxation, Fairness and Tax Policy (JCX-48-15), February 27, 2015  
 Kaplow, Louis. (2008). the Theory of Taxation and Public Economics, Princeton: Princeton University, Press.  
 Marcus C. Berliant, Robert P. Strauss, (1966-1977), the Horizontal and Vertical Equity Characteristics of the Federal Individual Income Tax,  
 Mill, John Stuart, (1991). On Liberty and Other Essays, Oxford World's Classics. Edited with an introduction and notes by John Gray. Oxford University Press.

Misganaw Gashaw, (2015), Tax Reform Discourse and Its Implication on Development: Evidence from the VAT Introduction in Ethiopia, Mekelle University Law Journal Vol.3 No. 1

OECD (2014), "Fundamental principles of taxation", in Addressing the Tax Challenges of the Digital Economy, OECD Publishing, Paris

Perdices de Blas and Revuelta Lopez, (2011), Markets and Taxation: Modern Taxation Principles and School of Salamanca, Esic Market, vol. 138

Repetti, James. "United States," in Comparative Income Taxation: A Structural Analysis. Edited by Hugh J. Ault and Brian J. Arnold. 3rd edition

Gest, Guy, "France," in Comparative Income Taxation: A Structural Analysis, 3rd edition

Taddese Lencho, (2014), the Ethiopian Income Tax System: Policy, Design and Practice, Dissertation, Tuscaloosa, Alabama

Tiley John, (2005).Revenue Law. 5<sup>th</sup> edition. Oxford, Hart Publishing.

### II. Laws

Council of Ministers Federal Income Tax Regulation No .410/2017, 23rd Year, No. 82 Addis Ababa

Federal Democratic Republic of Ethiopia, Growth and Transformation Plan II (GTP II) (2015/16-2019/20), Volume I, National Planning Commission, May 2016, Addis Ababa

Federal Income Tax Proclamation No. 979/2016, Federal Negarit Gazeta , 22nd Year, No. 104, Addis Ababa, 18th August, 2016

Federal Income Tax Proclamation No. 286/2002, Federal Negarit Gazeta, 8th year, No. 34, Addis Ababa, 4th July