

ACCOUNTING AND FINANCE

LEVEL – II

Based on November 2022, CURRICULUM version 2



Module Title: Developing understanding of Taxation

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Introduction to the module

This unit describes regarding performance out comes; skills and knowledge required to correctly interpret and apply to understand the role of Taxation in the Ethiopian economy. Including why and how tax is levied and collected .types of taxes paid by business and individuals and its impact on investment choices unit one introduce introduce about purpose,/objective, principle of tax. the way of tax collection system, the role of ERCA and explain the use of tax revenue in Ethiopia.

in the second unit there is detail discussion of key terms ,type of direct tax ,and it's assessment, rate and in the 3rd and 4th unit you will see types of indirect tax like value added Tax, turn over tax, custom duty Excise tax and stamp duty with their declaration form calculation .unit five how each Taxpayers calculate their own tax payment

The module covers the units:

- The role of taxation in Ethiopian economy
- Identifying and discussing Direct tax
- Identifying and discussing Indirect tax
- Identifying and discussing stamp duty
- . Managing tax liability

Learning objective of the module fter completing this competency the trainees will be able to :

- discuss the role of taxation in the Ethiopian economy
- Identify and discuss direct tax
- Identify and discuss indirect tax
- Identify and discuss stamp duty tax
- Manage tax liability

Module instruction: for effective use the module trainees are expected to follow the following module instruction

1. Read the information written in each unit
2. Accomplish the self-checks at the end of this unit
3. Perform operation sheets which were provided at the end of this units
4. Read the identified reference book for examples and exercis

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Unit one: The role of taxation in Ethiopian economy

The learning guide is developed to provide you the necessary information regarding the following content coverage and topics:

- purpose of taxation
- the various ways of tax collection
- Discussing the role of Ethiopian revenues and custom authority
- Explain the use of tax revenue

This guide will also assist you to attain the learning outcomes stated in the cover page specifically, up on completion of this learning guide, you will be able to

- purpose of taxation
- Understand various ways of tax collection method
- Explain the role Ethiopian revenues and custom authority/ERCA/
- Utilization of tax revenue

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1.1. Purpose of taxation in the Ethiopian at the local, Regional and Federal level

1.1.1 Definition of taxation

Taxes are mandatory contributions levied on individuals or corporations by a government entity—whether local, regional, or national. Tax revenues finance government activities, including public works and services such as roads and schools, or programs such as Social Security and Medicare.

Tax is defined in many ways

- Tax is compulsory levy by the state on persons without quad pro quoy obligation it is obligatory contribution from individual/ entities ir private property for the maintenance and defense of government, so that it may perform its functions and provisions public goods and service .I
- It is the process by which the sovereign/state ,through its low making body, generates revenue to defray expense of government /expenditure.it is a means of government in increasing its revenue under the authority of the law. purposely used to promote welfare and protection of its citizenry
- -An amount of money that a government requires people to pay according to their income ,value of their property, etc ,and there is used to pay for the things done by the government
- Tax is a compulsory contribution to state revenue levied by the government on workers income and business profit ,or added to the cost of some goods ,service and transaction

Taxation is the imposition of compulsory levies on individuals or entities by governments in almost every country of the world. Taxation is used primarily to raise revenue for government expenditures, though it can serve other purposes as wel

Every Government imposes two kinds of taxes:

- (1) Direct taxes, and (2) Indirect taxes

A tax, in the modern times, therefore is a compulsory levy and those who are taxed have to pay the sums irrespective of corresponding return of services or goods by the government.

It is not a price paid by the tax-payer for any definite service rendered or a commodity supplied by the government. The tax-payers do get many benefits from the government but no tax-payer has a right to any benefit from the public expenditure on the ground that he is paying a tax. The benefits of public expenditure

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may go to anyone irrespective of the taxes paid. Therefore, we may say that taxes are compulsory payments to government without expectation of direct return or benefit to the tax-payer.

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1.1.2 .The purpose of taxation

The goal of taxes is to provide social welfare through funding governmental services, property protection, defense costs, and economic infrastructure. The revenue generated from the tax is of vibrant significance for the sustainability of development in both advanced and emerging nations.

The most basic function of taxation is to fund government expenditures. Varying justifications and explanations for taxes have been offered throughout history. Early taxes were used to support the ruling classes, raise armies, and build defenses. Often, the authority to tax stemmed from divine or supranational rights

The main purpose of taxation is to raise revenue for the services and income supports the community needs. Public revenues should be adequate for that purpose.

Hence, some of the specific purposes of taxation in Ethiopia can be summarized as follows:

- Financing government activity
- Maintaining equity in the national economy
- Promoting efficiency where markets fail to control pollution or health dangers
- Social infrastructure
- Social services

1.3 Objectives of Taxation

1.3.1 Objectives of Taxation:

The primary purpose of taxation is to raise revenue to meet huge public expenditure. Most governmental activities must be financed by taxation. But it is not the only goal. In other words, taxation policy has some non-revenue objectives.

Truly speaking, in the modern world, taxation is used as an instrument of economic policy. It affects the total volume of production, consumption, investment, choice of industrial location and techniques, balance of payments, distribution of income, etc.

1. economic development
2. full employment

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3. price stability
4. control of cyclical fluctuations
5. advertisements:
6. reduction of bop difficulties
7. non-revenue objective

1.1.3. The general objective of taxation

Initially, governments impose taxes for three basic purposes: to cover the cost of administration, maintaining law and order in the country and for defense. But now government's expenditure pattern changed and gives service to the public more than these three basic purpose and it restore social justice in the society by providing social services such as public health, employment, pension, housing, sanitation and other public services. Therefore, governments need much amount of revenue than before. To generate more revenue a government imposes taxes on various types.

In general objective of taxation are:

- A. **Raising revenue:** to render various economic and social activities, a government needs large amount of revenue and to meet this government imposes various types of taxes.
- B. **Removal of inequalities in income and wealth:** government adopts progressive tax system and stressed on canon of equality to remove inequalities in income and wealth of the people.
- C. **Ensuring economic stability:** taxation affects the general level of consumption and production. Hence, it can be used as effective tool for achieving economic stability. Governments use taxation to control inflation and deflation
- D. **Reduction in regional imbalances:** If there is regional imbalance with in the country, governments can use taxation to remove such imbalance by tax exemptions and tax concessions to investors who made investment in under developed regions.
- E. **Capital accumulation:** Tax concession or tax rebates given for savings or

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investment in provident funds, life insurance, investment in shares and debentures lead to large amount of capital accumulation, which is essential for the promotion of industrial development.

- F. Creation of employment opportunities :** Governments might minimize unemployment in the country by giving tax concession or exemptions to small entrepreneurs and labor intensive industries.
- G. Preventing harmful consumption :** Government can reduce harmful things on the society by levying heavy excise tax on cigarettes, alcohols and other products, which worsen people's health.
- H. Beneficial diversion of resources::** Governments impose heavy tax on non-essential and luxury goods to discourage producers of such goods and give tax rate reduction or exemption on most essential goods. This diverts produce's attention and enables the country utilize to utilize the limited resources for production of essential goods only.
- I. Encouragement of exports :** Governments enhance foreign exchange requirement through export-oriented strategy. These provide a certain tax exemption for those exporters and encourage them with arranging a free trade zones and by making a bilateral and multilateral agreement
- J. Enhancement of standard of living:** The government also increases the living standard of people by giving tax concessions to certain essential goods.

1.1.4 Characteristics of Taxation

Tax is a Compulsory Contribution A tax is a compulsory payment from the person to the Government without expectation of any direct return. Every person has to pay direct as well as indirect taxes. As it is a compulsory contribution, no one can refuse to pay a tax on the ground that he or she does not get any benefit from certain public services the government provides.

The Assesses will be required to pay Tax if is due from him No one can be forced by any authority to pay tax, if it is not due from him.

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Taxes are levied by the Government: No one has the right to impose taxes. Only the government has the right to impose taxes and to collect tax proceeds from the people.

common Benefits to All :The tax, so collected by the Government, is spent for the common benefit of all the people. In other words, when the government collects a tax, its proceeds are spent to extend common benefits to all the people. The Government incurs expenditure on the defense of the country, on maintenance of law and order, provision of social services such as education, health etc. Such benefits are given to all the people- whether they are tax-payers or non-taxpayers. These benefits satisfy social wants. But the Government also spends on subsidies to satisfy merit wants of poor people.

No Direct Benefit In the modern times, there is no direct relationship between the payment of tax and direct benefits. In other words, there is absence of any benefit for taxes paid to the Governmental authorities. The government compulsorily collects all types of taxes and does not give any direct benefit to tax-payers for taxes paid. For example, when taxable income is earned by an individual or a corporation, he or it simply pays the tax amount at the specified rate cannot demand any benefit against such payment

Certain Taxes Levied for Specific Objectives: Though taxes are imposed for collecting revenue for the government to meet expenditure on social wants and merit wants, certain taxes are imposed to achieve specific objectives. .

Attitude of the Tax-Payers The attitude of the tax-payers is an important variable determining the contents of a good tax system. It may be assumed that each tax-payer would like to be exempted from tax paying, while he would not mind if other bears that burden. In any case, he would want his share to be within the general level of tax burden being borne by others.

Good tax system should be in harmony with national objectives A good tax system should run in harmony with important national objectives and if possible should assist the society in achieving them. It should try to accommodate the attitude and problems of tax-payers and should also take into consideration the goals of social and economic justice. It should also yield adequate revenue for the treasury and should be flexible enough to move with the changing

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requirements of the State and the economy.

Tax-system recognizes basic rights of tax-payers A good tax system recognizes the basic rights of the tax-payers. The tax-payer is expected to pay his taxes but not undergo harassment. In other words, the tax law should be simple in language and the tax liability should be determined with certainty.

1.1.5 Principles of Taxation

A tax system (that is, the set of all taxes) for achieving certain objectives chooses and adheres to certain principles which are termed its characteristics. A good tax system therefore, is one of which designed on the basis of an appropriate set of principles, such as equality and certainty. Mostly, however, objectives of taxation conflict with each other and a compromise is needed. Therefore, usually economists select some important objectives and work out the corresponding principles which the tax system should adhere to.

The first set of such principles was enunciated by Adam Smith (which he called Canons of Taxation) **Canons of Taxation**

The four canons of taxation as prescribed by Adam Smith are the following:

1. **Canon of Equality** This canon proclaims that a good tax is that which is based on the principle of equality. In other words subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion of their respective abilities, that is, in proportion to the reserve which they respectively enjoy under the protection of the State. It implies what the income which a person enjoys under the protection of the State, should be taxed on the proportional rate of taxation. But modern economists do not agree with Adam Smith. They advocate **progressive taxation** to observe the canon of equality. In other words, they advocate progression should be the basis for imposing taxes.

2. **Canon of Certainty** It implies that the tax-payer should be well informed about the time, amount and the method of tax payment and not arbitrary. Adam Smith was also of the view that the government must also be certain of the amount which it derives from a particular tax. Thus this canon is equally important both for the individual and the state.

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3. **Canon of Convenience** According to Adam Smith, “every tax ought to be so levied at the time or in the manner in which it is most likely to be convenient for the contributor to pay it.” In other words, taxes should be imposed in such a manner and at the time which is most convenient for the taxpayer, i.e., the best time for the collection of land revenue is the time of harvest. Similarly, taxes on rent of houses should be collected when it is most convenient for the contributor to pay
4. **Canon of Economy** This canon implies that the administrative cost of tax collection should be minimum, i.e., the difference between the money, which comes out of the pockets of people and that which is deposited in the public treasury, should be as small as possible. In addition to the above four canons given by Adam Smith, the following other canons have been advanced by Batiste and other economists
5. **Canon of Productivity** The canon of productivity advocated by Batiste implies that taxes should be productive. The productivity of a tax may be observed in two ways. In the first place, a tax should yield a satisfactory amount for the maintenance of a government. In other words, the tax should be such that it procures a considerable amount of revenue for the expenditure of the government, Secondly, the taxes should not obstruct and discourage production in the short as well as in the long run.
6. **Canon of Elasticity** Batiste also laid stress on the principle of elasticity. The canon of elasticity implies that yields of taxes should be increased or decreased according to the needs of the government. The government may need funds to face natural calamities and other unforeseen contingencies. It may need funds to finance a war or for development purposes. The government resources can be raised quickly only when the system is elastic.
7. **Canon of Diversity** The canon of diversity put forward by Batiste implies that the tax system should be diverse in nature. In other words, in a tax system, there should be all types of taxes so that everyone may be called upon to contribute something towards the revenues of the state. Thus, the governments should adopt multiple tax system.

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8. Canon of Simplicity The canon of simplicity implies that a tax should easily be understood by the tax-payer, i.e., its nature its aims, time, of payment, method and basis of estimation should be easily followed by each tax-payer.

Canon of Expediency This canon implies that the possibilities of imposing a tax should be taken into account from different angles, i.e. its reaction upon the tax- payers. Sometimes it is seen that tax may be desirable and may be productive and may have most of the characteristics of a good tax, yet the government may not find it expedient to impose it, for example, progressive agricultural income tax, but it has not been imposed. So far in the manner it should have been imposed.

1.2 The various ways of tax collections

1.2 .1 .Tax collections in Ethiopia

Tax collections is the process of the government getting money from people and business required to pay tax and the amount of tax the government gets from this activity. Tax collections revenue is one of the most important domestic sources of revenue. Taxes are compulsory payments to government without expectation of direct return or benefit to tax payers. It imposes a personal obligation on the taxpayer. Taxes received from the taxpayers, may not be incurred for their benefit alone. In Ethiopia, government collects various types of taxes revenue through direct tax and indirect tax.

The main direct tax collected in Ethiopia include:-

- Tax on Income from Employment / Personal Income Tax /
- Business Profit Tax
- Tax on Income from Rental of Buildings
- Tax on Interest Income on Deposits
- Dividend Income Tax
- Tax on Income from Royalties
- Tax on Income from Games of Chance
- Tax on Gain of Transfer of certain Investment Property

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- Tax on Income from Rental of Property
- Rendering of Technical Services outside Ethiopia
- Agricultural Income Tax ☐ Land Use Tax

The main types of indirect tax collected in Ethiopia may include:-

- Turnover Tax
- Excise Tax
- Value Added Tax
- Customs Duty

Note: Detail of direct and indirect tax will be learn in next two units

1.3. The role of the Ethiopian Revenues and Customs Authority (ERCA)

1.3.1.Ethiopian Revenues and Customs Authority(ERCA)

The Ethiopian Revenues and Customs Authority(ERCA) was established by proclamation No.587/2008 on 14 July 2008, by the merger of the minster of revenue Ethiopian Customs Authority and the Federal Inland Authority for the purpose of enhancing the mobilization of government revenue, while providing effective tax and Customs administration and sustainability in revenue collection. The main objective of the establishment of ERCA was to streamline the public revenue generation function by bringing the relevant agencies under the umbrella of the central revenue collector body. This structuring aimed at improving service delivering, facilitating trade, enforcing the tax and customs laws and thereby enhancing mobilization of Government revenue in sustainable manner.

The Authority shall have the roles to:

- establish and implement modem revenue assessment and collection system;
- provide, based on rules of transparency and accountability, efficient, equitable and quality service within the sector; properly enforce incentives

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of tax exemptions given to investors and ensure that such incentives are used for the intended purposes;

- implement awareness .creation programs to promote a culture of voluntary compliance of taxpayers in the discharge of their tax obligations;
- carry out valuation of goods for the purpose of tax assessment and determine and collect the taxes
- conduct study and research activities with greater emphasis to Improve the enforcement of customs and tax laws, regulations and directives and the collection of other revenues; and based on the result of the study and research initiate laws and policies and implement the same up an approval

collect and analyze information necessary for the control of import and export goods and the assessment and determination of taxes; compile statistical data on criminal offence relating to the sector, and disseminate the information to others as may be necessary;

1.4.1 Tax revenue

Sources of public revenues Government has played an important role in the sociolect economic development of society. Social development may be in the form of raising the level of living and social welfare in the form of providing social amenities to the people. Social amenities are in the form of education, health and sanitation, utilities like electric supply, water supply etc, and recreation facilities.

The process of socioeconomic development requiring huge expenditure cannot be carried unless the government has the perennial source of income.

The Ethiopian government has two important sources of revenue. These are:

- (a) Tax revenues, and
- (b) Non-tax revenues.

Tax revenue is one of the main sources of revenue in public finance. Sources of tax revenues in Ethiopian include:

Direct taxes: Examples

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- Personal income tax
- Rental income tax
- Business tax
- Capital gain tax
- Interests income tax
- etc.

Indirect tax: Examples

- Turn over tax
- VAT
- Excise tax
- Customs duty
- cultural and artistic resources and support

defense and border protection

✓ education

✓ environmental protection

essential infrastructure such as:

- roads
- transport systems
- public building
- sport and recreation amenities
- public housing
- foreign representation and trade
- e promotion for Ethiopia health care
- justice systems
- public safety
- scientific and other research
- Welfare, income and community support system

Self check 1 : Answer the following questions

1 Define the meaning of tax

2.list relevant documentation for taxation

3Identify: a) the purpose of taxation in Ethiopia

b. Objective of taxation

C. Describe Characteristics of tax in Ethiopia

E. Discuss principle of Taxation in Ethiopia

F. identify utilization of tax revenue in Ethiopia

UNIT TWO: Identifying and Discussing Direct Tax

The learning guide is developed to provide you the necessary information regarding the following content coverage and topics: Discussing key terminologies

- Key terms in direct tax
- Prepare tax declaration form ,and TIN
- Tax return
- Source of on – on going information about direct tax In Ethiopia

This guide will also assist you to attain the learning outcomes stated in the cover page specifically, up on completion of this learning guide, you will be able to

- Understand terms used in direct tax in Ethiopia
- prepare tax declaration form,
- Perform Tax return
- Understand Source of on - going information about direct tax

2.1 Terms related to direct tax.

A direct tax : It is paid by a person on whom it is levied. In direct taxes, the impact and Incidence fall on the same person. If the impact and incident of a tax fall on the same person, it is called as direct tax. It is borne by the person on whom it is levied and cannot be passed on to others. For example, when a person is assessed to income tax, he has to pay it and he cannot shift the tax burden to anybody else.

Income means every sort of economic benefit including gains in cash or in kind, from whatever source derived and in whatever form paid, credited or received. Taxable income” means the amount of income subject to tax after deduction of all expenses and other deductible items allowed under this Proclamation 286/2016 and Regulations 78/2016 issued. Sources of Income Income taxable under this proclamation shall include, but not limited to:

- A. Income from employment;
- B. Income from business activities;
- C. Income derived by an entertainer, musician, or sports person from his personal activities;
- D. Income from entrepreneurial activities carried on by a non-resident through a permanent establishment in Ethiopia;
- E. Income from immovable property and appurtenances thereto, income from livestock and inventory in agriculture and forestry, and income from usufruct and other rights deriving from immovable property is much property is situated in Ethiopia;
- F. Dividends distributed by a resident company;
- G. Profit shares paid by a resident registered partnership;
- H. Interest paid by the national, a regional or local Government or a resident of Ethiopia, or paid by a non-resident through a permanent establishment that he maintains in Ethiopia;

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

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

Schedule : 'A' **Income from employment;**

Schedule : 'B' **Income from rental buildings;**

Schedule: 'C' **Income from business;**

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Schedule : 'D' Income from other sources including

Schedule 'A' Income: Employment Income

Any remuneration paid by an employer to his employee in consideration of his services is called salary. It includes the values of fringe benefits provided by the employer. Any payment received in cash or in kind in the source of employment by an individual is taxable. This provision is very extensive and includes the following

- Salaries
- Allowances
- Bonus
- Car benefits
- Housing benefits

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

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

Employment Income Tax Rates

The rates of employment income tax are:

Schedule 'A'			
Employment Income(per month)		Tax Rate (in %)	Deduction (in Birr)
over Birr	to Birr		
0	600	Exempt threshold	
601	1,650	10%	60.00
1,651	3,200	15%	142.50
3,201	5,250	20%	302.50
5,251	7,800	25%	565.00
7,801	10,900	30%	955.00
over 10, 900		35%	1,500.00

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

2. Deduction methods

Deduction is computed by this formula $\text{Deduction} = \text{upper taxable income previous tax bracket tax rate of given bracket-cumulative threshold}$.

Example:- Assume that Ato Amare Lemma earned an amount of Birr 11,000 .00 subject to income tax ,his employment income tax is calculated as follows.

Earning	×	Tax Rate (%)	=	Income tax
600	×	0	=	00
1050	×	10	=	105.00
1550.00	×	15	=	232.5
2050.00	×	20	=	410
2550.00	×	25	=	637.5
3100	×	30	=	930
100	X	35	=	35
Total Br.11,000				Br.2350

No	Name of employess	basic salary	monthly allowance	ot hrs worked	duration of hrs worked
1	Lema	12600	2200		
2	Alemayehu	8700	1700	8	wekend
3	Zeberga	4500		12	public holiday
4	Asya	2500		18	1o ;00pm to 6;00 am

ADDITIONAL INFORMATION

1. employed worked hours weekly 40
2. allowance up to birr 1500 exempted
3. all employee are permanent
4. pension contribution by employee and employer 7%and 11%respectively
5. all employee are contributed 10% of their less salary be credit union accepted alemu who 5% of less basic salar

Ordinary hourly rate=Basic salary/total work Hr per month

OT= OT Hr. worked* ordinary hourly rate* Orate

$$\begin{aligned}
 1/\text{Lema} &= 0 * 78.75 * 0 = 0 \\
 2/\text{Alemayehu} &= 8 * 54.38 * 2 = 870 \\
 3/\text{Zeberga} &= 12 * 28.13 * 2.5 = 843.9 \\
 4/\text{Asya} &= 18 * 15.66 * 1.50 = 421.88
 \end{aligned}$$

Gross earning= basic salary + Allowance + OT

$$\begin{aligned}
 1.\text{Lema} &= 12600 + 2200 + 0 = \text{br } 14800.00 \\
 2.\text{Alemayehu} &= 8700 + 1700 + 870 = \text{Br.}11270.00 \\
 3.\text{Zeberga} &= 4500 + 0 + 843.90 = \text{Br.}5343.90 \\
 4.\text{Asya} &= 2500 + 0 + 421.88 = \text{Br.} 2921.88
 \end{aligned}$$

Deduction

/Income tax/

IT = (GE - D) * TR- DEDUCTION

$$\begin{aligned}
 1.\text{LEMA} &= (14800 - 1500) * 35\% = \\
 &13,300 * 35\% = 4655 \\
 &4655 - 1500 = \text{Br.}3155
 \end{aligned}$$

pension contribution PC= BS * 7%

$$\begin{aligned}
 \text{Lema} &= 12600 * 7\% = 882 \\
 \text{Cr.Assn.} &= 12,600 * 10\% = \underline{1260} \\
 \text{Total deduction} &= \underline{3574.00} \\
 \text{Net pay} &= 14800 - 3574 = \text{Br.} 11,226.00
 \end{aligned}$$

GE- D * TR- AD

$$\begin{aligned}
 2.\text{Alemayehu} &= (11,270 - 1500) = 9,770 \\
 &9,770 * 30\% = 2931
 \end{aligned}$$

$$\text{PC} = 8700 * 7\% = 609$$

$$\text{CA} = 8700 * 5\% = \underline{435}$$

$$\text{Total deduction} = \underline{3975}$$

$$\text{Net pay} = \text{GE- TD} = 11270 - 3975 = \text{Br.} \underline{\underline{7295}}$$

$$3.\text{Zeberga} = (5343.90 * 25\%) = 1330.98 - 565 = 765.98$$

$$\begin{aligned} \text{PC} &= 4500 * 7\% &= \text{Br.315} \\ \text{C.Assn} &= 4500 * 10\% &= \text{Br.450} \\ \text{Total deduction} &&= \underline{1530.98} \\ \text{Net pay} &&= \text{Br.3812.92} \end{aligned}$$

$$\begin{aligned} 4. \text{Asya} &= (2921.88 * 15\%) - 142.5 &= 295.79 \\ \text{PC} &= 2500 * 7\% &= 175 \\ \text{CA} &= 2500 * 10\% &= \underline{250} \\ \text{Total deduction} &= 295.79 + 175 + 250 &= \text{Br.720.79} \\ \text{Net pay} &= 2921.90 - 720.79 &= \text{Br. } \underline{2201.09} \end{aligned}$$

Example 2

Ato Mulu received a salary of ETB 2500.00 PM during the year January 2005. Compute the tax liability and the amount received by him after the withholding of tax by the employer from his salary.

Solution

Method 1

$$\begin{aligned} \text{Given} &= 2500.00 \text{ salary} \\ &= 600.00 \text{ free} \\ 1650 - 600 &= 1050.00 \times 10\% = 105 \\ 2500 - 1650 &= 850.00 \times 15\% = 127.5 \\ \text{Tax liability} &= 232.5 \end{aligned}$$

Net Salary received Ato Mulu $2500.00 - 232.5 = 2267.5$

Method 2

$$\begin{aligned} \text{Given} &= 2500.00 \text{ salary} \\ &= (2500 \times 15\%) - 142.5 \\ &= 375 - 142.5 = 232.5 \\ \text{Tax liability} &= 232.50 \end{aligned}$$

Net salary received Ato Mulu $= 2500 - 232.50 = 2267.5$

Assume that Dalul company is service providing company and the company has the following permanent employees

No	Name of employee	Basic salary	Taxable allowance	Total taxable income	Income tax
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1	Aynalem Solomon	6000.00	150.00	6150.00	972.5
2	Daniel Seifu	3000.00	200.00	3200.00	337.5
3	Israel Gelaw	2000.00	200.00	2200.00	187.5
4	Abebch Nadew	1500.00	100.00	1600.00	100
5	Genet Girma	400.00	150.00	550.00	-
Total income tax					1597.5

Aynalem Solomon.....($6000+150=6150$)

Employement income tax= $(6150*0.25)-565$

972.5

Daniel Seifu.....($3000+200=3200$)

Employement income tax= $(3200*0.15)-142.5$

337.5

Israel Gelaw.....($2000+200=2200$)

Employement income tax= $(2200*0.15)-142.5$

187.5

Abebch Nadew.....($1500+100=1600$)

Employement income tax= $(1600*0.1) - 60$

100

Genet Girma.....($400+150=550$)

Employement income tax=tax free

Schedule”B”: RENTAL OF BULDING

Rental Income Tax Rates

1.The rate of rental income tax applicable to a body is 30%.

2.The rates of rental income tax applicable to an individualare:

Exempted incomes

The following categories of income shall be exempt from payment of income tax hereunder

- Income form casual employment
- Contribution or retirement benefits by employers
- Specifically Exempted Income
- Exempted Income by Regulations

f. Payments as Compensation

Note: EIT = (Taxable income)rate - deduction

TI = GE - NTA , Example none taxable allowance, desert allowance

Employment Income

1/ Subject to sub-articles (2) and (3) of this Article, employment income means the following:

- a) salary, wages, an allowance, bonus, commission, gratuity, or other remuneration received by an employee in respect of a past, current, or future employment;
- b) the value of fringe benefits received by an employee in respect of a past, current, or future employment;
- c) an amount received by an employee on termination of employment, whether paid voluntarily, under an agreement, or as a result of legal proceedings, including any compensation for redundancy or loss of employment, or a golden handshake payment.

2/ Employment income shall not include exempt income.

3/ If an employer pays the employment income tax payable by an employee, in whole or part, without withholding tax from the employment income of the employee, the amount of tax paid by the employer shall be included in the employment income of the employee.

4/ The Council of Ministers shall make Regulations for determining the value and taxation of fringe benefits.

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

Assessable income: Income of any kind is subject to income tax, provided than you earn more than the tax free threshold hold amount. Assessable income is comprise of any amount that is Ordinary income, referring to income that is drive directly or indirectly from all sources, in or out of Ethiopia during a financial year. Some Examples of ordinary income, your salary

Statutory income, referring to all amounts that are not ordinary income, but are included in your Assessable income by way of a specific rule in tax law. Example, capital gain, dividend etc

Interest on deposits When you deposit money in some form of saving account with a bank or other financial institution, you get paid for their use of the money.

Allowances Tax free amount (such as hard ship allowance). It is amount paid to employee as a part of salary package, or to defray their out of pocket expense incurred on the behalf of firms

Gross income The total amount of income received in tax period. Income before tax and expense

Deductions A fixed amount or percentage permitted by taxation authorities that taxpayer can subtract from his or her adjusted gross income to determine the taxable income.

Exemption threshold It is the maximum amount on which tax will not be levied. For example, in Ethiopia, a person earning as salary less than birr 600per month will not be leviled tax. Individual business earning less than 7200per tax year will not be levied tax. A person received $\frac{1}{4}$ of his or her basic salary or not

Withholding Taxes As per income tax proclamation no979/2016, Withholding Taxes is a tax on an income which is required to be withheld by the Withholding agent. Withholding agent means a person liable to Withhold a tax from a payment made to a person and includes a person required to self - Withhold tax. Rate of Withholding Taxes :-(not updated) On imported good at 3% of the sum of cost, insurance and freight (CIF). On payments made to taxpayers at 2% on cost of supply goods involving more than Birr10, 000 in any one transaction or contract and services involving more than Birr500 in one transaction. In additions a withholding agent who makes payment to a person who has not supplied a TIN is required to withholding 30% of the amount payment.

Who is Withholding agent? Organization or company government owned enterprise, Share co., Private Limited co., partnership; etc incorporated under the law of Ethiopia, private Non-profit organization and Non Government Organization (NGO) having legal personality.

Determination of Gross employment income: all type of income like Basic salary, allowance, overtime, bonus and other. Overtime is the work done in the excess of the normal daily hours work. If a workers beyond stipulated working hours during the weak day, i.e., 8 hours a day and 48hours a weak, he/she is entitled to an overtime income as follows:

- 125% of normal hourly rate for overtime work b/n 06a.m to 10p.m
- 150% of normal hourly rate for overtime work b/n10 pm to 06 am
- 200% of normal hourly rate for work on a weekly rest day;
- 250% of normal hourly rate for work on public holyday

Overtime income is calculated :as follows:

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OTI= Basic salary/hours*rate* duration of overtime worked

- I. Every person deriving income from employment is liable to pay tax on that income at the rate specified in Schedule “A”, shown bellow. The first Birr 600 (six hundred Birr) of employment income is excluded from taxable income.
- II. Employers have an obligation (Liability) to withhold the tax from each payment to an employee, and to pay to the Tax Authority the amount withheld during each calendar month. In applying preceding income attributable to the months of Nehassie and Pagumen shall be aggregated and treated as the income of one month.
- III. **Exemptions** The following categories of income shall be exempted from payment of income tax.
 - I. **Income from casual employment** Income from employment received by casual employees who are not regularly employed provided that they do not work for more than one month for the same employer in any twelve months period.
 - II. **Contribution of retirement benefits by employers:** Pension contribution, provident fund and all forms of retirement benefits contributed by employers in an amount that does not exceed 15% (fifteen percent) of the monthly salary of the employee.
 - III. **Income from Diplomatic and consular representatives,** and Other persons employed in any Embassy, Legation, Consulate or Mission of a foreign state performing state affairs, which are national of that state and bearers of diplomatic passports or who are in accordance with international usage or custom normally and usually exempted from the payment of income tax..
- IV. **Payments as compensation** Payments made to a person as compensation or gratitude in relation to:
 - (i) Personal injuries suffered by that person;
 - (ii) The death of another person.

V. Allowable Deductions

The following payments, made to an employee by an employer, are allowed as deductions to determine taxable income. Transportation allowance (if it fulfill the criteria for tax exemption) 25% of basic salary or not more than Br 2,200

- Hardship Allowance
- Desert Allowance (if it fulfill the criteria for tax exemption)

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- Reimbursed traveling expense (incurred on duty)

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

Taxable Rental Income

1/ The taxable rental income of a taxpayer for a tax year is the gross amount of income derived by the taxpayer from the rental of a building for the year reduced by the total amount of deductions allowed to the taxpayer for the year.

2/ Subject to sub-articles (3) and (4) of this Article, the gross amount of income derived by a taxpayer from the rental of a building for a tax year shall include the following:

all amounts derived by the taxpayer during the year under the lease agreement, including any lease premium or similar amount;

all payments made by the lessee during the year on behalf of the less or according to the lease agreement;

the amount of any bond, security, or similar amount that, during the year, the taxpayer is entitled to retain as a result of damage to the building and that has not been used by the taxpayer in repairing the damage to the building;

the value of any renovation or improvement made under the lease agreement to the building when the cost was borne by the lessee in addition to the rent payable to the taxpayer.

3/ If a taxpayer leases a furnished building, the gross amount of income derived by the taxpayer from the lease of the building shall include any amount attributable to the lease of the furniture or equipment.

4/ The gross amount of income derived by a taxpayer from the lease of a building shall not include exempt income.

5/ In computing the taxable rental income for a tax year of a taxpayer who does not maintain books of account, a deduction shall be allowed for the following amounts:

any fees and charges, but not tax, levied by a State or City Administration in respect of the land or building leased and paid by the taxpayer during the year;

an amount equal to fifty percent (50%) of the gross rental income derived by the taxpayer for the year as an allowance for the repair, maintenance, and depreciation of the building, furniture, and equipment.

6/ The provisions of sub-article 5 of this Article shall not be applicable for taxpayers who are required to maintain books of account under this Proclamation, for any reason what so ever.

7/ In computing the taxable rental income for a tax year of a taxpayer who maintains books of account,

a deduction shall be allowed for any expenditures to the extent necessarily incurred by the taxpayer in deriving rental income and paid during the year including:

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- A. the cost of the lease of land on which the building is situated;
- B. repairs and maintenance;
- C. depreciation of the building, furniture and equipment;
- D. interest and insurance premiums; and
- E. fees and charges, but not tax, levied by a State or City
- F. Administration in respect of the land or building leased.

Sub-leases 1/ The taxable rental income of a sub-lessor of a building for a tax year shall be the difference between the total rental income received by the sub-lessor during the year and the total rental income paid to the lessor of the building plus other expenses to the extent necessarily incurred by the sub lessor to generate the income.

2/ The owner of a building who allows a lessee to sub-lease the building shall be liable for the rental income tax payable by the lessee if the lessee fails to pay the tax.

3/building and the builder shall notify the kebele administration or local administration in which the building is located about the completion and the name, address, and TIN of the person liable for rental income tax with respect to the building.

/ The Kebele Administration or Local Administration shall communicate the information contained in the notification to the Authority.

Illustration

1. Ato Belay has a house property in Addis. He has let out the house for the residential purposes. The following are the details of the property let out.
 - i. Actual rent received birr 900 per/month
 - ii. Fair rental value of the house birr 1200 per/month
 - iii. He has paid 15% of the rent received as land taxes and 2% as others taxes to the regional government.
 - iv. He spent birr 1560 for repairs of that house
 - v. He does not maintain any book of accounts in this regard.

Compute the income from house property tax payable for the year 2012-2013 Ec

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Solution

Actual rent $900 \times 12 \text{ months} = 10,800.00$

Land tax $10,800 \times 0.15 = (1620.00)$

Other taxes $10,800 \times 0.02 = (216.00)$

Repair $10,800 \times 1/5 = (2160.00)$

Income from house property 6,804.00

Taxable income $= 6804.00 \times 10 \% \text{ tax rate} = 680.40 \text{ Birr}$

$= 680.40 \text{ Birr} - 180.00 \text{ Birr}$

Tax payment $= 500.40 \text{ Birr}$

2. Ato Amaha owns four houses. The details regarding which are as follows:-

- i. The first house of the annual rental value of birr 4400 was occupied by him for his own residence.
- ii. The second house of the annual rental value of birr 5600 was let out at birr 400 pm. He paid birr 600 as interest on money borrowed for the construction of the house, birr 80 as land tax and birr 200 as insurance premium of the house.
- iii. The third house is birr 1600 pm and its actual rent is 1400 birr pm. But in respect of this house maintenance charge of birr 1600 per year including repaint charges.
- iv. The fourth house of which is birr 6000 par year was let out at 600 pm. It remained vacant for 4 months. The unrealized rent in respect of this house during the year was birr 1200, which satisfies the conditions for claiming this loss.

Find out the income from house property and tax payable for the year 2012-2013 E.C

Solution

i. Not taxable

ii. Actual rent $400 \times 12 = 4800.00$

Land tax (80.00)

Interest (600.00)

Repair and maintenance $4800 \times 1/5$ (960.00)

Taxable income 3160.00

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Taxable income 3160.00 birr x 10% Tax rate = 316.00 birr

316.00 birr – 180.00 birr = 136.00 birr

Tax payment = 136.00 birr

iii. Actual rent 1400 x 12 = 16,800.00

Repair & maintenance 16800 x 1/5 (3360.00)

Taxable income 13,440.00

Taxable income 13,440.00 birr x 15% Tax rate = 2016.00 birr

= 2016.00 birr – 570.00 birr = 1446.00 birr

Tax payment = 1446.00 birr

iv. Actual rent 600 x 8 = 4800.00

Repair & maintenance 4800 x 1/5 = (960.00)

Taxable income 3840.00

Taxable income 3840.00 x 10% Tax rate = 384.00 birr

= 384.00 birr – 180.00 birr = 204.00 birr

Tax payment = 204.00 birr

ax authorit

SCHEDULE 'C' –INCOME FROM BUSINESS

POSITION OF BUSINESSES INCOME TAX

Business Profit Tax

This is the tax imposed on the taxable business income / net profit realized from entrepreneurial activity. Taxable business income would be determined per tax period on the basis of the profit and loss account or income statement, which shall be drawn in compliance with the generally accepted accounting standards. Corporate businesses are required to pay **30%** flat rate of business income tax. For unincorporated or individual businesses the business income tax ranges from 10% - 35%. Unincorporated or individual businesses are taxed in accordance with the following schedule below: Tax rate of schedule “C”

Taxable business income/ net profit per year		Tax rate (in %)	Deduction (in Birr)
Over Birr	to Birr		
0	7200	Exempt Threshold	—
7201	19,800	10	720
19,801	38,400	15	1,710
38,401	63,000	20	3,630
63,001	93,600	25	6,780
93,601	130,800	30	11,460
Over 130,800	∞	35	18,000

Self check

1. Ato wogiries – is a merchant in Asayta town. He worked in his retaining shop in 03 kebele, and his annual profit for 2013 is birr, 200,000 – calculate amount of tax expected to collect from him based on tax rate of schedule ‘B’ /business profit tax/

➤ /hints / - tax rate more than birr 130,800 at 35 % and deduction is birr 18000

A. 50,000 B. 52,000 C. 45000 D.30,500

2. If ABC company is a soap manufacturing business in Adama Town and if the company paid out Br. 2000,000 VAT inclusive to purchase input, and sale the product Br.4,500,000 with total employee salary

of Br.25,000 and selling and administrative expense of Br 50,000 calculate the profit of ABC company .
calculate Direct

Categories of Taxpayer

1/ For the purposes of this Proclamation there shall be the following categories of taxpayers:

a)category “A” taxpayer being

1/a body ; or

2/ any other person having an annual gross income of Birr 1,000,000 or more;

a)category ‘B’ taxpayer being a person, other than a body , having an annual gross income of Birr 500,000or more but less than 1,000,000;

c)category ‘C’ taxpayer being a person other than a body, having an annual gross income of less than Birr 500,000

Deductible expenses

The following expenses shall be deductible from gross income in calculating taxable income.

- The direct cost of producing that income, such as the direct cost of manufacturing, importation, selling and such other similar costs.
- General and administrative expenses connected with the business activity
- Premiums payable on insurance directly connected with the business activity
- Expenses incurred in connection with the promotion of the business inside and outside the country, subject to the limits set by the directive issued by the minister of revenue.
- Sums paid as salary, wages or other emoluments to the children of the proprietor or member of the partnership shall only be allowed as deduction if such employees have the qualifications required by the post.

Non-allowable expenses

All those expenses which are not wholly or exclusively incurred for the business activity are not allowable deductions from gross income. Therefore, in computing taxable income the following expenses should be added back, only if the taxpayer has deducted them in determining the business income

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- i. Voluntary pension or provident fund contributions over and above 15% of the monthly salary of the employee.
- ii. Damages covered by insurance policy
- iii. Representation expenses over and above 10% of the salary of the employee
- iv. Personal consumption expenses
- v. Entertainment expenses
- vi. Donation and gift other than those permitted by regulation.

Example:- Computation of business profit tax

Business net profit per year / Taxable income = 70,500.00 Birr

Business profit tax = 70,500 * 25% tax rate

= 17680 Birr

= 17680 – 6780 (deduction fee)

Tax payment = 10845.00 Birr

In the determination of business income subject to tax in Ethiopia, deductions would be allowed for expenses incurred for the purpose of earning, securing, and maintaining that business income to the extent that the expenses can be proven by the tax payer.

IV Schedule ‘D’ income from other sources including:-

- ✓ Income paid form services rendered outside of Ethiopia
- ✓ Income from games of chance
- ✓ Dividends
- ✓ Income from casual rental of property
- ✓ Interest income
- ✓ specified non- business capital gains

• **Tax on Interest Income on Deposits**

- ✓ Every person deriving income from interest on deposits shall pay tax at the rate of 5%.
The payers are required to withhold the tax and account to the Tax Authority
- ✓ Example :Mr kelemu earn an interest of 1500.00ETB for the deposit of money at commercial bank in 2009E.C
- ✓ Question 1:compute interest income tax for the year?

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- ✓ 2.who is liable to pay tax to the tax authority?

- **INCOME FROM DIVIDENDS**

- ✓ The taxable income received in the form of dividend from a share company or withdrawals of profits from a private limited company. Dividend income is subject to tax at the rate of 10%. The withholding agent (payer) shall withhold or collect the tax and account to the tax authority. This tax is a final tax in lieu of income tax.
- ✓ Example 1:XYZ Company declared dividend to shareholders birr 0.5 millionat the end of the year 2010.
- ✓ Re:determine the evidenced income tax for the year?

Tax on Income from Royalties

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

Tax on Income from Games of Chance Every person deriving income from winning of games of chance (e.g., lotteries, tombola, and other similar activities) shall be subject to tax at the rate of 15%, except for winning of less than 1000 Birr. The payer shall withhold or collect the tax and account to the Tax Authority.

Tax on Gains of Transfer of Certain Investment Property This is the tax payable on gains obtained from the transfer (sale or gift) of building held for business, factory, office, and shares of companies. Such income is taxable at the following rates:

- Building held for business, factory, and office at the rate of 15%;
- Shares of companies at the rate of 30%. Gains obtained from the transfer of building held for residence shall be exempted from tax provided that such building is fully used for dwelling for two years prior to the date of transfer. Any person authorized by law to accept,

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register or in any way approve the transfer of capital assets shall not accept, register or approve the transfer before ascertaining that the payment of the tax has been duly effected.

Tax on Income from Rental of Property

The taxable income under this category is income derived from casual rental of property (including any land, building, or moveable asset) not re Rendering of Technical Services Outside Ethiopia All payments made in consideration of any kind of technical services rendered outside Ethiopia to resident persons in any form shall be liable to tax at a flat rate of 10% which shall be withheld and paid to the Tax Authority by the payer. The term “ technical service” means any kind of expert advice or technological service rendered All income which cannot be subject to either schedule A, B or C shall be subject to tax according to

Schedule D of the Income Tax Proclamation.

Particular of income	Resident	Non- resident
Insurance premium or royalty	5%	5%
Dividends	10%	10 %
Interest	5%* and 10%**	5% * and 10%**
Management or technical fees	2%	15 %
Entertainment	-	10 %
Income from casual rentals of property	15%	15 %
Supply of goods (exceeding ETB10,000)	2%	2%
Supply of services (exceeding ETB3,000)	2%	2%
Payment to a person without	30%	30

a Tax Identification Number (TIN)		%
Imported goods for local consumption	3%	3%
Income from games of chance (exceeding ETB 1000)	15%	15%

*interest from saving deposits from a financial institution

**any other interest

Other Income Taxes

a. Capital gains tax	
— Building held for business, factory or office	15%
— Shares of companies and bonds	30%
b. Deemed distribution of profits	

Where a body has undistributed profits to the extent that it is not reinvested, a tax shall be paid at 10% of the net undistributed profits.

c. Repatriation of profits by a non-resident company

Any profits repatriated out of Ethiopia by a non-resident company carrying out business through a permanent establishment shall be liable to tax at 10%.

d. Mining and Petroleum operations

Business income at 25% shall be applicable to licensee and contractors. Payments made by licensee to non-resident subcontractors shall be subject to WHT at 10%.

Treatment of losses

Business enterprises (registered investments) that suffer losses during a tax holiday period can carry forward such losses for a period equivalent to half of the income tax holiday period. However, this period of carrying forward of losses is capped to 5 years.

In addition, a loss incurred in a tax period may be set off against taxable income in the next five tax periods, provided that ownership of a body does not change by more than 25% in that tax

period. If there has been two tax years in which a taxpayer has incurred and each of those losses has been carried forward the, taxpayer shall not be permitted to carry forward any further losses. For companies in the mining sector, they can carry forward losses for a period of 10 years.

Anti- Avoidance Provisions

Transfer pricing

The Income Tax Proclamation provides that the Authority may, in respect of any transaction that is not an arm's length transaction, distribute, apportion, or allocate income, gains, deductions, losses, or tax credits between the parties to the transaction in accordance with the Directive issued by the Minister to reflect the income, gains, deductions, losses, or credits that would have been realized in an arm's length transaction.

The transfer pricing guidelines may also apply to in-country transactions.

Miscellaneous Taxes

Stamp and transfer duty

Stamp duty is payable on a broad class of legal instruments, including:

Memoranda and Articles of Association of any business organization:

- upon first execution a flat ETB 350; and
- upon any subsequent execution a flat ETB 100.

Memoranda and Articles of Association of a cooperative

- upon first execution – a flat ETB 35; and
- upon any subsequent execution – a flat ETB 10
- Contracts and agreements and memoranda a flat ETB 5;
- Security deeds 1% on the value of the deed;
- Contract of employment 1% of a month's salary;
- Register of title to property 2% of the value;
- Lease and sub-lease thereof – 0.5% of the value; and

Bonds including warehouse bonds – 1% of the value.

Double tax treaties and reduced rates

Ethiopia has signed double tax agreements (DTAs) with several countries such as United Kingdom, China, India, Netherlands, South Africa, Czech Republic, Egypt, Turkey, Tunisia,

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Iran, Algeria and Seychelles.

Country	Dividends (%)	Interest (%)	Royalties (%)*
Domestic WHT rate	10	10	5
China	5	7	5
France	10	5	7.5
India	7.5	10	5
Israel	5	5	5
Kuwait	5	5	5
Romania	10	10	5
Russia	5	5	5
South Africa	10	8	5
Tunisia	5	10	5
Turkey	10	10	5
United Kingdom	10	5	7.5
Netherlands	5*	5	5
Saudi Arabia	5	5	7.5
Ireland	5	5	5
Cyprus	5	5	5
Italy	10	10	10
United Arab Emirates	5	5	5
(Not yet in force)			

* Upon holding at least 10% shareholding

Agricultural Income Tax According to Proclamation No. 152 of 1978 individual farmers and agricultural producer cooperatives earning up to Birr 600 per annum are required to pay 10 Birr. The tax rates on every additional income vary from 10% to 89% for income above 600 Birr. In line with the economic policy and structural set up of the Federal Democratic Republic of Ethiopia, the former tax on income from agricultural activities and the land use rent was revised in 1995. Since income tax from this source is allocated to Regional States in consonance with the provisions of the new constitution of 1994, each Regional State is entitled to issue a Proclamation providing for such a tax and rent.

A state farm shall pay 40% of the taxable income it realizes from its agricultural activities. Income from agricultural activities is said to be determined by estimating the price, in the area, of the crop before harvest. If the crop is sold, the price declared shall be the basis for the assessment of income. • **Land Use Tax** According to Proclamation No. 77/1976 and No. 152 /1978 individual farmers, who are not members of producer“ s cooperatives, are required to pay a land use fee of Birr 10 per hectare per annum. Whereas government agricultural organizations are paying 2 Birr per hectare per annum. Presently regional states have their own land use rent systems. For instance, according to the Proclamation No. 8/1995 of Oromiya, rural land held for agricultural activities is subject to land use rent payment on annual basis. The annual land use rent payable by a farmer shall be Birr 10 for the first hectare and Birr 7.50 for each extra hectare of land. Meanwhile state farming enterprises shall pay Birr 15 for each hectare of their land holdings. Land use rent is to be collected between the 1st of Hidar and the 30th of Miazia of the year.

2.2Tax declaration forms

2.2.1 Forms of tax declaration in Ethiopia

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Is used to determine the correct tax liability of the taxpayer and must be completed and lodged with taxpayer. Declaration and Payment of Tax The following is the procedures for the declaration of taxable income by taxpayers.

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

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

C) Category “C” taxpayers shall declare taxable income within one month i.e. between July 07 and August each year. Tax declaration forms in Ethiopia include but not limited:

- Employment tax forms
- Business income tax forms
- Withholding income tax forms, and other forms, Ethiopian Revenue Customs Authority (ERCA) issues all Tax declaration forms to the taxpayers.
- Taxpayer registration In any tax system identifying and registering actual and potential taxpayers is a primary function unless, the tax office has reliable and easily identifiable taxpayers registration system, tax assessment and collection will be difficult. Thus, the use of tax payer’s identification number to identify taxpayers is a first step in the management of tax collection. The TIN system provides the foundation for the tax administration to independently identify taxpayers, control evasion, and create a dependable database for efficient and effective tax collection.

Moreover, it is expected that the use of a unique taxpayer registration number will enable the tax collectors to strengthen their capabilities in identifying every person whose income is subject to tax, and those who deliberately understate declarations or fail to disclose income

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To that effect the government issued proclamation no 227/2001 which marked the introduction of tax identification number the tax system, the proclamation obliged any taxpayer to have a tax identification number (TIN) according the proclamation any person or organization looking for a license to carry on a business occupation is required to supply the TIN to the licensing authority in this case all public bodies and institutions issuing a business or occupational license is not allowed to issue or renew such license unless the taxpayer has supplied the TIN.

2.4. Tax returns

2.4.1 Assessing tax returns tax returns is stranded form provided by the tax authorities on which a taxpayer report taxable income with permitted deductions and exemptions, and compute his or her tax liability. Tax returns can be completed by:

- accountant
- an individual
- tax agent
- On-line or in written form Apply for Tax returns

You will start by registering as a tax payers at nearby tax office in your area of operation:- In this case, you go to nearby tax office and obtain an application for registration form and fill it in completely; • Accompanied with proof of identity, submit the filled form to the tax office; • Up on submission of documents, your passport photo and finger prints shall be captured by the tax officers; • Upon verification of submitted details, a taxpayers identification number (TIN) is issued to you. Thereafter you can proceed with filling the appropriate tax return under the self Assessment Regime.

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

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that may be necessary for the declaration of income or for supporting the books of accounts.

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

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

If the taxpayers keep no records, or if the income tax authority does not accept the submitted books, or if the taxpayer fails to declare tax within the time specified, the income tax authority estimates tax by the use of certain indicators. Category “C” should pay tax at fixed rate on the income estimated by the income tax authority. Tax assessors will be assigned by the tax office to estimate the daily sales of the taxpayers. The estimates will be done using the best of their judgment and objectivity. The estimated daily sales will be converted to annual income using the number of working days. Tax on annual sales is determined on the basis of presumptive value assigned to each activity.

Assessment Notification Every assessment notification should contain the following elements:

- a) Gross income and deductions applicable;
- b) Taxable income;
- c) Rates applicable or percentage;
- d) Taxes paid and due;
- e) Any penalty or interest;
- f) Taxpayer’s name, address, and TIN; and

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g) Brief explanation of the assessment and a statement of the taxpayer's rights

The tax authority is assessing the tax through:

- Business Activity Statements
- payroll
- allowable deductions
- capital gains

Financial adjustments such as:

- Write-offs
- Revaluations
- Profits and losses
- Superannuation payments
- Fringe benefits assessment

2.5 Sources of information about direct tax In Ethiopia

2.5.1. Sources of tax information Sources of ongoing information about direct tax may include:

Accountants and other financial services professionals They can provide information about the accounting works

Ethiopian Revenues and Customs Authority (ERCA)

ERCA which has a mandated authority for revenue collection and tax administration in Ethiopia has formulated a multi-sector change and tax modernization framework. The Authority has adopted strategic directions and has been actively engaged and committed for its implementation. Registration of tax payers (finger prints) and issuance of tax Identification numbers (PIN), broadening the VAT tax base, improvement in tax administration and trade facilitation were some of the measures taken by ERCA.

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- Industry associations and professional organizations Are akin to revenue ruling in that they show how the ERCA would apply the law to a specific set of facts.
- Federal and Regional governments agencies
- Taxpayers it is important to understand the federal, state, and local tax requirement. This will help you file your taxes accurately and make payment on time

1 Techniques of determining employment income tax

Method of determining employment income tax

Step1. Gathering the necessary data. All the relevant information about every employee should be gathered.

Step 2- Determine the gross employment income. Include all types of income like

Basic salary, allowance, over time and other

Step 3- Determine taxable employment income. By subtract exemption from gross employment income.

Step 4- compute the employment income tax by multiplying the given tax rate on taxable employment income. . 2 Techniques of determining business income tax

Method of determining business income tax

Step 1- Determine all source of business income within the tax year. Includes sales,

interest income, rent income and other.

Step 2- Determine all allowable deductions and exemption that are prescribed by Ethiopian tax law.

Steps3- Compute taxable business income by subtract all deductions and exempt from gross business income.

Step 4-Compute business income tax or business profit tax by multiplying the

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given tax rate on taxable business income.

The following expenses shall be deductible from gross income in calculating taxable income:

- The direct cost of producing the income, such as the direct cost of manufacturing, purchasing, importation, selling and such other similar costs;
- General and administrative expenses connected with the business activity;
- Premiums payable on insurance directly connected with the business activity;
- Expenses incurred in connection with the promotion of the business inside and outside the country, subject to the limits set by the directive issued by the Minister of Revenue; Commissions paid for services rendered to the business;
- Sums paid as salary, wages or other emoluments to the children of the proprietor or member of the partnership shall only be allowed as deduction if such employees have the qualifications required by the post.
- The following categories of income would be exempted from payment of business income tax:
 - Awards for adopted or suggested innovations and cost saving measures;
 - Public awards for outstanding performance;
 - Income specifically exempted from income tax by the law in force in Ethiopia, by international treaty or by an agreement made.

2Information sheet1. Ertale is a merchandise business enterprise engaged in the buying and selling of products .the enterprise with Br.172000and Br.230000 respectively the enterprise has two permanent employees

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Number of employees	Basic salary	Overtime	
Zelalm Wunetu	3000	600	
Ayana Muleta	1600	800	

Required: calculate :Task 1.direct of the month

Task 2.calculate indirect tax

Solution.

Direct tax=EIT

Ato Zelalem taxable income =basic salary +OT

$$= 3000 + 600 = \text{Br.}3600$$

$$\text{EIT} = 3600 * 20\% - 302.50 = \underline{415.5}$$

Ato Ayana : Taxable income =1600 +800 = 2400

$$\text{EIT} = 2400 * 15\% - 142.50 = \text{Br.} \underline{217.5}$$

Calculate Business profit tax based on rate of business profit tax ?

Sells revenue – cost of good sold

$$\text{Br. } 23000 - \text{Br } 172\,000 = \text{GP} = \text{Br.}58000$$

$$58000 * 20\% - 3630 = 7970$$

$$\text{Total Employ income tax} = \text{Br.}415.5 + 217.5 = \text{Br.}633$$

$$\text{DT} = 7970 + 633 = \underline{8603}$$

Task 2- indirect tax= output vat – input vat

$$\text{Out put vat} = 230000 * 15\% = \text{Br.} \underline{34500}$$

$$\text{Input VAT} = 172,000 * 15\% = \underline{25800}$$

$$\text{Indirect tax} = 34,500 - 25,800 = \text{Br.} \underline{8700}$$

Self check: 1-Define the term Direct Tax =

UNIT-THREE IDENTIFYING AND DISCUSSING INDIRECT tax

The learning guide is developed to provide you the necessary information regarding the following content coverage and topics: Discussing key terminologies Discussing key terminology

- Accounting terms used in Indirect Tax
- Discusses legal structure of business and their effect on taxation
- Assessment and payment of indirect Tax in Ethiopia
- source of on-going information about indirect tax in Ethiopian

This guide will also assist you to attain the learning outcomes stated in the cover page specifically, up on completion of this learning guide, you will be able to

- Define terms related indirect tax
- understand structure of business and its affect Taxation
- understand Assessment and payment of indirect tax
- identify Source of on-going information about indirect Tax

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3.1 Key terminology used in indirect tax

3.1.1. Accounting Terms used in indirect tax

Indirect tax An indirect tax is a tax collected by an intermediary (such as a retail store) from the person who bears the ultimate economic burden of the tax (such as the customer). An indirect tax is one that can be shifted by the taxpayer to someone else. An indirect tax may increase the price of a good so that consumers are actually paying the tax by paying more for the products. Under Indirect taxes, the impact and the incidence fall on different person. It is not borne by the person on whom it is levied and can be passed on to others. For example, when the excise tax is levied on the manufacturer of cement, he shift the burden of the tax to the consumers by raising the selling g price. Here the impact of excise taxes falls on the manufacturer and the incidence on the ultimate consumers. The person who is required to pay the tax does not bears its burden. Thus, indirect taxes can be shifted.

Taxable person: A person who pay or collect taxes on any activity carried on continuously or regularly in Ethiopia, wholly or partly, whether or not for a profit.

- **Taxable transaction** : Transaction falling within the scope of the tax is taxable. Not all Taxable transactions are taxed but can be exempt.
- **Tax evasion** It is the general form for efforts by individual, firms, and other entities to evade the payment of taxes by breaking tax law. Tax evasion means fraudulent action of on the part of the taxpayer with a view to violate civil and criminal provisions of the tax laws. it can be defined as “ tax evasion implies the activities involving an element of deceit, mis-representation of facts, falsifications of accounts”. Examples for Tax evasion:
 - Under-invoicing of sales and inflation of purchase
 - A trader makes a sale for birr20,000 and does not account it, in his books under sales
 - Interest earned from lending of money does not includes on total income

A manufacturing business employs 30 workers but includes 2 more additional namesake

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workers (not in actual) in payrolls.

- Cause of Tax evasion:-
- High rates of taxation
- Complexity of tax laws
- Inadequate information as to source of revenue.
- Moral and psychological factors
- Lack of integrity
- **Tax avoidance** It is the method of reducing ones tax liability by making use of loopholes in a tax law. Therefore, tax avoidance is not illegal. It is the art of escaping taxes without breaking the law.
- **Duty paying value** It is the actual total costs of any import or export of goods or services.
- **The impact of a tax** Is on the persons who pay the money in the first instance. In other words, the man who pay the tax to government in the first instance.
- **Shifting of tax** It refers to the process by which the money burden of a tax is transferred from one person to another.
- **Incidence of a tax** It refers to the money burden of a tax on the persons who ultimately bears it. In other words, when the money burden of a tax finally settles or comes to rest on the ultimate taxpayer is called Incidence of a tax.

Indirect tax In Ethiopian

3.1.2 Identifying Indirect tax. The main types of Indirect tax In Ethiopian are:-

- Turnover Tax
- Excise Tax
- Value Added Tax
- Customs Duty

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Turnover tax /TOT/ Turnover tax is payable on goods supplied and services rendered by persons not registered for VAT. It's an equalization tax that came into force to tax persons below the VAT registration threshold of Birr 1000 0000.

TOT is charged at 2% on goods locally sold and 10% on services, except contractors, grinding mills, tractors and combine harvesters which are taxed at 2%. The basis of the tax is the gross receipts of goods and services sold.

Excise tax The excise tax is charged on ad-valorem rate on certain consumer goods on importation and on similar products locally produced. It is believed that this tax should be imposed on luxury goods and basic goods, which are demand inelastic. It is also believed that imposing the tax on goods that are hazardous to health and which are causes to social problems will reduce the consumption thereof. The excise tax would be imposed on goods imported or either produced locally in accordance with the given in Excise Tax Proclamation No. 307/2002.

In Ethiopia, both the federal and regional governments collect excise tax. ERCA is responsible for collecting excise tax for the Federal government and collects excise tax levied on locally produced and imported items into the country. The minimum excise tax rate applied to excisable goods is 10% while the maximum is 100%. Excise tax has 10 bands or groups of rates at which excise can be charged. These band rates are 10%, 20%, 30%, 33%, 40%, 50%, 60%, 75%, 80% and 100%. These rates are used to calculate the payable excise tax. **Rate of Excise tax:**

The excise tax would be imposed on goods imported or either produced locally in accordance with the following schedule, given in Excise Tax Proclamation No. 307/2002.

Type of Product	Excise Tax Rate (%)
1. Any type of sugar (in solid form) excluding molasses	33
2. Drinks	
2.1 All types of soft drinks (except fruit juices)	40

2.3 Water bottled or canned in a factory	30
2.4 Alcoholic Drinks	
2.4.1 All types of beer	50
2.4.2 All types of wine	50
2.4.3 Whisky	50
2.4.4 Others alcoholic drinks	100
4. Tobacco & Tobacco Products	
4.1 Tobacco Leaf	20
4.2 Cigarettes, cigar, cigarillos, pipe tobacco, snuff and Other tobacco products	75
5. Salt	30
7. Perfumes and Toilet Waters	100
10. Dish washing machines of a kind for domestic use	80
15. Motor passenger cars, Station Wagons, Utility cars and Land Rovers, Jeeps, Pickups, similar vehicles (including motorized caravans), whether assembled together with their appropriate initial equipment:	
15.1 Up to 1,300 C.C.	30
15.2 From 1,301 up to 1,800 C.C.	60
15.3 Above 1,800 C.C.	100
16. Carpets	30
17. Asbestos and Asbestos products	20
18. Clocks and watches	20
19. Dolls and toys	20

Illustration

Lem Sugar Factory incurs the following costs and expenses for the production of sugar in the month of Sene 2002.

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Raw material used	Br 1,200,000
Labor used	80,000
Repair and maintenance of factory machinery ...	16,000
Utility expenses (Applicable to production Dept.)..	36,000

Required: Compute excise tax for the month

Solution:

Total cost of production = Br 1,332,000

Excise tax rate 33%

Excise Tax Br 439,560

Value Added Tax VAT is a consumption of tax charged by VAT registered traders on all taxable goods and services at a standard rate of 15%. The VAT is a multistage tax levied at each stage of production and distribution up to the retail stage. The tax is also levied on taxable imports made by persons whether or not registered for VAT. Some goods and services are taxed at Zero-rate while some are exempted from the tax.

All traders or businesses whose taxable turnover exceeds Birr 1000,000 per year are obliged to make an application for registration. However person may voluntarily apply for registration, if he regularly is supplying or rendering at least 75% of his goods and services to registered persons.

Most business transactions involve supplies of goods or services. VAT is payable if they are:

Supplies made in Ethiopia;

- Made by a taxable person;
- Made in the course or furtherance of a business;
- Are not specifically exempted or zero-rated.

The **Value Added Tax** would be levied at the rate of 15% of the value of:

- Every taxable transaction by a registered person;

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- Every import of goods, other than an exempt import; and Import of services

Determination of VAT payable in Ethiopia

Output tax:- is a VAT that is calculated and charged on the sale of goods or services from your business, if you are vat- registered person.

Input tax:- is a VAT that is added to the price when goods or services are purchased that are liable to VAT, if the buyer a VAT- registered person.

VAT payable: if VAT on sales exceed VAT on purchase in a given period. The difference will positive and payable to government.

VAT refund:- if VAT on purchase exceed the VAT on sales in a given period, the difference will negative and refunded to the register person/. Example, During the VAT period, shop X (which is vat registered person purchase goods worth of birr 62,000, including VAT with a 15% VAT rate and sales goods at birr 65,000, excluding VAT with a 15% VAT

Example, During the VAT period, NAAHUD shop (which is vat registered person purchase goods worth of birr 82,000, including VAT with a 15% VAT rate and sales goods at birr 95,000, excluding VAT with a 15% VAT rate.

Find the VAT payable/refund

Solution:

Output VAT: . $95,000 \text{Birr} \times 15\% = 14250.00$

Input VAT: Purchase amount, inclusive VAT $\times (15/115)$

$82,000 \times 15/115 = 10695.65$

VAT payable- Br. 3554.35

Note: If sales or purchase is made excluding VAT, the vat amount will be multiply the sales or purchase price by 15%.

- If sales or purchase amount is made inclusive VAT, the vat amount will be multiply sales or purchase amount by $(15/115)$.

Computation of VAT at each stage of transaction The computation of the VAT liability from the manufacturer to the final consumer is presented as follows. Manufacturer stage

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Birr Purchases of raw materials.....Br 4000
 VAT paid on raw material (15% x 4,000)..... 600
 Sells to the wholesaler the finished goods.....Br8,000
 – VAT (8,000 X 15%)..... 1200
 • VAT liability of the manufacturer (1200-600).....Br 600

 Wholesaler stage – Sells to the retailer at a price14,000
 – VAT (14000 X15%)..... 2100 •
 VAT liability of the wholesaler (2100-600) 1500
 Retailer stage – Sells to the final customer at a pricebr.20000.....
 – VAT (20000X 15%)..... 3000
 • VAT liability of the retailer (3000 – 1500)1500
 Total VAT paid to Tax authority---(600+1500+1500).....**Birr 3600**

III Computation of VAT

Example 1

The computation of the VAT liability from the manufacturer to the final consumer is presented as follows.

Manufacturer	Birr	Tax
Purchases of raw materials VAT inclusive	Br 2,000	
VAT paid on raw material (2,000/1.15) 15%		260.86
Sells to the wholesaler the finished goods VAT exclusive	4,000	
VAT (4,000 X 15%)		600
VAT liability of the manufacturer (600-260.86)		Br 339.14
Wholesaler		
Sells to the retailer at a price after VAT	5,600	
VAT((5,600/1.15)15%)		730.43
VAT liability of the wholesaler (730.34-600)		130.34

Retailer

Sells to the final customer at before VAT	8,400	
VAT (8,400 X 15%)		1,260
VAT liability of the retailer (1,260 – 730.43)		529.57
Total VAT paid to ERCA		Br 999.05

Example 2

Kebede company purchased office equipment for birr 120,000.00 exclusive VAT. The company has five employees to provide service and the employment income tax is 11,000.00 per month. During the year 2016 the company earned birr 800,000.00 inclusive VAT. Profit tax of the year is birr 50,000.00

Required: calculate direct and indirect tax liability for the year 2016

Direct tax = employment income tax + business profit tax

$$(11,000.00 \times 12) + 50,000.00$$

$$132,000.00 + 50,000.00$$

$$\mathbf{182,000.00}$$

Indirect tax = VAT output - VAT input

$$\text{VAT output} = (800,000 / 1.15) \times 0.15$$

$$695,652.20 \times 0.15$$

$$= 104,347.80$$

$$\text{VAT input} = (120,000 \times 0.15)$$

$$18,000$$

$$\text{Indirect tax} = 104,347.80 - 18,000 = \mathbf{86,347.8}$$

Option to Register

According to section 5 of the proclamation “any person” (to be defined later) conducting a “commercial enterprise” (to be defined later) or intending to conduct a commercial enterprise may apply to be registered for VAT. However, if the taxable turnover of the enterprise that is

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gross income for 12 calendar months exceeds or is likely to exceed Birr 500,000, the person conducting the enterprise must register for VAT with FIRA / VAT

Turnover related to exempt supplies as listed in the law is not to be included in the total for deciding if VAT registration is compulsory. The term *any person* for purposes of VAT registration includes sole proprietor, company, partnership, estate of the deceased, trust, incorporated body or unincorporated body, and club or association. The term a *commercial enterprise* refers to any business of whatever nature and it includes examples such as ordinary business (e.g. shop, contractors, manufactures, wholesales, etc), trades and professions (e.g. builders, engineers, accountants, lawyers, etc), and activities of non-profit making bodies (e.g. societies, associations, sporting clubs, etc).

Thus, there are two types of VAT registration: obligatory and voluntary.

Obligatory Registration

A person is obliged by law to register if one is doing any business, which is likely to have taxable turnover in 12 months exceeding Br 500,000. Thus to know whether a person must register for VAT it is sufficient to consider the business turnover for the past 12 months. If during the past 12 months its gross sales exclude tax exceeds Br 500,000 then it has to register for VAT. Besides, if one reasonably expects that during the next 12 months the total value of taxable supplies excluding tax is likely to exceed Br 500,000 then the person needs to register for VAT

Customs Duty Unless exempted by law, items imported into Ethiopia are subject to a number of taxes. Government levies five kinds of taxes on import items. These taxes are assigned priority levels and are calculated in a sequential order. These taxes, in their sequential order, are customs duty, excise tax, VAT, surtax and withholding tax. Taxes on imported goods are collected by the Ethiopian Revenues and Customs Authority (ERCA). These taxes provide considerable revenue to the government.

- Customs Duty and its Rates

The first of the five taxes levied on

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import items is customs duty. The term customs duty denotes taxes imposed on goods entering or leaving the country. ERCA collects customs duty only on import items as no tax on export is levied. Customs duty has 6 bands or groups of rates which are applied to imported goods. These bands of rates are 0%, 5%, 10% 20%, 30% and 35%. From these bands of rates one can see that the minimum customs duty rate is 0(zero) while the maximum is 35 percent of the CIF (Cost + Insurance + Freight) value (Duty Paying Value) of an imported item.

To calculate the customs duty, the CIF is multiplied by tariff rate applicable to each imported item. ERCA collects customs duty on a great variety of goods which can be classified into two categories. The classification is based on the primary purpose of the imported goods. Those import items used for productive purpose, items to be re-exported and for public use are classified in category one while import items for all other (nonproductive) purpose are classified in category two.

3.3The structure of business

3.3.1 Legal structure of business organization

Your business structure affect how much you pay in taxes, your ability to raise money, the paper work you need to file, and your personal liability. You will need to choose a business structure before register a business with the state. Most business will also need to get a tax ID number and file for the appropriate license and permits. The most common business structures includes:-

A sole proprietorship is a business owned by one person and usually managed by the owner. No special legal requirements must be met to start a sole proprietorship and usually only a limited investment is required to begin operations. A sole proprietorship is a separate entity for accounting purposes but it is not a separate legal entity from the owners. That is, from the legal point of view, the owner and the business are treated as one and the same. The owner will be held personally responsible for the debts and actions of the business.

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How will sole proprietorship affect taxes? Personal income tax must be paid on all business profit. (Single taxation)

Partnership is an association of two or more persons as co-workers of a business for profit. According to the commercial code of Ethiopia (1960) article No 211; a partnership agreement is identified as follows:

A partnership agreement is contracts where by two or more persons who intend to join together and to cooperate undertake to bring together contributions for the purpose of carrying out activities of an economic nature and of participating in the profits and losses arising out there of, if any.

How will partnership affect taxes? Personal income tax must be paid by all partners on their individual share of the business profits. (Single taxation)

A company/ corporation is a voluntary association of persons, recognized by law, having a distinctive, name, a common seal, formed to carry on business for profit, with capital divisible into transferable shares, limited liability, a corporate body and perpetual succession.

How will company/ corporation affect taxes? It is taxed twice. First there is tax on the amount of the business profits. Then the owners are also taxed on any dividends they may receive. (Double taxation)

3.3 Assessing indirect tax in Ethiopian

3.3.1. Assessment of indirect tax Assessment of the Tax •

If after review by the Tax Authority, it appears that a person has understated his tax obligation, the Authority can issue an additional assessment; If, for any reason, the books of account are unacceptable to the Tax Authority, or if the tax payer fails to submit same when

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requested by the Authority, or if no books of account and supporting documents are maintained, the Tax Authority would assess the tax on the basis of information available;

- A presumptive turnover tax would be payable by Category “ C” taxpayers who are not required to keep records. The base for the presumptive turnover tax would be the total turnover used as base for the income tax;
- The assessment made would be prepared in an assessment notification and be delivered to the taxpayer;
- If the Authority makes an additional assessment and within 30 days of notice the person assessed does not pay the additional assessment or appeal the assessment the person is in default;
- If the Tax Authority fails to assess the tax and notify the taxpayer of the amount still due within five years from the date of declaration and payment of the tax by the taxpayer the tax so paid would be final and conclusive. In case where the taxpayer has not declared his income or has submitted a fraudulent declaration, no time limit provided in any other law shall bar the assessment of the tax by the Tax Authority.

3.4 Sources of ongoing information about indirect tax in Ethiopia

3.4.1 Sources of tax information Sources of ongoing information about indirect tax may include:

- Accountants and other financial services professionals They can provide information about the accounting works.
- Ethiopian Revenues and Customs Authority (ERCA) ERCA which has a mandated authority for revenue collection and tax administration in Ethiopia has formulated a multi-sector change and tax modernization framework. The Authority has adopted strategic directions and has been actively engaged and committed for its implementation. Registration of tax payers (finger prints) and issuance of tax Identification numbers (PIN), broadening the VAT tax base, improvement in tax administration and trade facilitation were some of the measures taken by ERCA.

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- Industry associations and professional organizations Are akin to revenue ruling in that they show how the ERCA would apply the law to a specific set of facts.
- Federal and Regional governments agencies
- Taxpayers it is important to understand the federal, state, and local tax requirement. This will help you file your taxes accurately and make payment on time Key terminology used in stamp duty taxation

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UNIT FOUR: IDENTIFYING AND DISCUSSING STAMP DUTY

This learning guide is developed to provide you the necessary information regarding the following content coverage and topics: –

- Terms used in stamp duty tax
- Assessing stamp duty tax
- Sources of ongoing information about stamp duty tax in Ethiopia

This guide will also assist you to attain the learning outcome stated in the cover page. Specifically, upon completion of this Learning Guide, you will be able to:-

- Understand terms used in stamp duty tax
- Identify chargeable stamp duty
- Understand the sources of ongoing information about stamp duty tax

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5.1. Terms related to stamp duty tax

Stamp duty is payable on certain (13 items) legal and financial instruments. The charge is made at specific or ad valorem rate. The basis of the duty is the cost, which the instrument contains (bears)

Stamp duty Is a tax that is levied on documents historically this included the majority of legal documents such as cherubs, receipts, military emissions marriage is a tax on executed documents relating to properties or interests in properties and share or interest in shares is an ad valorem or that rate charged up on certain documents

- **A devalue tax:-** is a tax based on the assessed value of real estate or personal property in other words An ad valorem tax can be property tax or even duty on imported items the word ad valorem is Latin for according to value
- **Award:-**means decision in writing rendered by an arbiter rotors on artiness made otherwise than by order of court in the course of suit by parties to compromise, conciliation or arbitral submission or other similar matters.
- **Bond:-** includes any instrument where by a person obligation shall be paid
Collective agreement:- means an agreement relating to the condition of work concluded in writing between one or more employees or agents or represent actives of employees organization
- **Instrument:-** means written document by which any right or obligation purpose to be created reorders transferred extinguished or by which its scope is limited or extended
- **Contract of employment:-** means an argument formed where a person agrees directly or indirectly, to perform work for a definite or indefinite period or piece work interterm for reminder actions

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- **Notaries act:-** means an act of attestation and certification performed by persons authorized to perform such acts Security deeds:- means any instrument where by a borrower or granter gives to a lender a charge up on apart or the whole of these property.

4.2.Assessing stamp duty tax

Chargeable stamp duty instrument Stamp duty tax is assessed through:

- Memorandum and articles of association of any business organization, cooperative or any other form of association;
- Award;
- Bonds;
- Warehouse bond;
- Contract and agreements and memorandum;
- Security deeds;
- Collective agreement;
- Contract of employment;
- Lease, including sub-lease and transfer of similar rights;
- Natural acts;
- Power of attorney;
- Documents of title to property

Rate and mode of valuation of stamp duty The rates might be flat or they may be depend on the value of the property. .The stamp duty on each instrument to be charged levied and collected at the following rates: No. Instrument chargeable with stamp duty base of valuation rates of stamp duty

1 Memo random & article of association of Any business organization

a, Up on first execution

b, Up on subsequent execution flat FLAT Birr350 Birr100

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2 Memorandum & articles of association of cooperatives

a, Up on 1st execution

b, Up on any subsequent execution flat flat 35 10

3 Award On value

a) determinable value 1%

b) undeterminable value Birr 35

3 Bonds on value 1%

5 Warehouse bond on value 1%

6 Contracts and agreements and memoranda flat 5

7 Security deeds on value 1%

8 Collective agreement a) on 1st execution b) on any subsequent execution flat Birr350

Sources of ongoing information about stamp duty tax in Ethiopia

4.3..Sources of stamp duty tax information

4.3.1 The source of ongoing information about stamp

Accountants and other financial services professionals They can provide information about the accounting works.

Ethiopian Revenues and Customs Authority (ERCA) ERCA which has a mandated authority for revenue collection and tax administration in Ethiopia has formulated a multi-sector change and tax modernization framework. The Authority has adopted strategic directions and has been actively engaged and committed for its implementation. Registration of tax payers (finger prints) and issuance of tax Identification numbers (PIN), broadening the VAT tax base, improvement in tax administration and trade facilitation were some of the measures taken by ERCA.

- Industry associations and professional organizations Are akin to revenue ruling in that they show how the ERCA would apply the law to a specific set of facts.
- Federal and Regional governments agencies

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- Taxpayers it is important to understand the federal, state, and local tax requirement. This will help you file your taxes accurately and make payment on time.

1 .Calculate and determine Value Added Tax

Method of determination of VAT in Ethiopia:

Step 1- a person or taxpayer must be register for VAT. Either obligatory or voluntary registration

Step 2- **calculate input VAT.** It involves purchase of goods or services in Ethiopia or imported from outside country with the exception of exempted .

. Step 3- **calculate step Three-output VAT.** it involves sales of goods or rendering of services in Ethiopia or with the exception of exempted supplies

Step 4- calculate VAT payable/ refund.

Step-5- Depends on Step-4 either payable to government or refund to you .

Self check: .CHOSE THE BEST ASNSWER FROM THE GIVEN FOUR ALTERNATIVE

1.a tax that one can be shifted by the tax payer to some one else

a)direct Tax b)in direct tax c)employ income tax d)business income tax

2. efforts by individual firm and other entities to evade the payment tax by breaking the law

a)tax evasion b)tax avoidance c) both A and B d)None

3)the Tax payable on goods supplied and service rendered by persons not register for VAT

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a) Turn over Tax b) Value added tax c) custom duty d) excise tax

4/ the tax imposed on luxury goods and basic goods

a) Value added tax b) Turn over tax c) excise tax d) custom duty

5. consumption of tax charged by registered trader on all taxable goods or service at a standard rate of 15%

a) value added tax b) custom duty c) turn over tax d) stamp duty

6/ A vat that is added to the price when goods or service from some one business of a registered person

a) output vat b) input vat c) vat payable d) vat refund

7) a tax payable on certain legal and financial instrument

a) turn over Tax b) stamp duty c) excise tax d) custom duty

8) a Tax imposed on product that is hazardous for the consumer

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UNIT FIVE- Manage Tax liability

This learning guide is developed to provide you the necessary information regarding the following content coverage and topics –

- Determining tax liability
- Implication of Under or over payment of tax

This guide will also assist you to attain the learning outcome stated in the cover page.

Specifically, upon completion of this Learning Guide, you will be able to: –

- Understand tax liability of taxpayers
- Analyze the implication of under or over payment of tax Learning

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5.1 Determining tax liability

5.1.1 How taxpayer can determine their tax liability

A tax liability is the total amount of tax debt owed by an individual, corporation or other entity to taking authority like Inland revenue authority. It is the total amount tax you are responsible for paying to the tax authority. Tax liability are incurred due to earning, a gain on the sale of an asset or other taxable event. No tax liability means the taxpayer's total tax liability was zero in the prior year, or they did not have to file a tax return.

- Tax payers can determine their tax liability by: assessing income:
- capital gains
- employment
- foreign
- investment
- rental property income assessing deductions:
- allowable medical expenses and health insurance rebates
- capital losses
- dependent rebates
- gifts and donations
- rental property expenses
- tax offsets
- work related clothing expenses
- work related education expenses
- work related travel expenses
- zone and overseas forces allowances lodging returns and paying governments:
- land tax where applicable

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- payroll tax (rate varies by jurisdiction and depends on size of payroll so many small business operators are exempt)
- stamp duty on:
 - hire purchase agreements
 - insurance policies

5-2 .Under or over payment of tax

5-2..1 Involving of under or over payment of tax An over payment of tax happens when you have paid more tax than you were liable to pay. If you have overpaid tax you will get a tax refund An under payment of tax is when you have paid less tax than you were liable to pay. If you paid too little tax you will owe Revenue the difference b/n what you actually paid what you should have paid. You may not know that you have paid too little tax, but you are still responsible for paying Revenue if an underpayment of tax occurred.

Penalty for understatement of tax:

If the amount of tax shown on a declaration understates the amount of tax required to be shown, the taxpayer is liable for a penalty in the amount of 10% of the understatement or 50% if the understatement is considered substantial. The understatement is considered substantial if it exceeds 25% of the tax required to be shown on the return or 20,000 Birr; The penalty shall continue to apply until, the Appeal Commission or a Court, as the case may be shall have rendered its final decision. Claiming

- interest on early payments that may be possible for certain tax categories such as:
 - income tax
 - Higher Education Contribution Scheme
 - amended assessments of earlier years
 - paying interest on overdue amounts

SELF CHECK 5: QUESTION

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1. XYZ manufacturing imported material 2,500,000.00 purchase local / br 1000,000.00 before vat for production of glove in 2014. The local custom duty charges are birr 200,000.00 birr paid to tax authority. The factory sales 30,000.00 glove at birr 150.00 each before vat including 2% of sales commission. The company Paid 53,000.00 administrative expense and employee income tax of 30,000.00 imported martial are exempted from vat and withholding tax business profit tax is 30%

- A. Calculate VAT payable
- B. Required business profit tax
- C. Calculate net profit
- D. Calculate direct tax and indirect tax

Solution: - A. VAT payable = output VAT (point of sale) – input VAT (point of purchase)

Note: value added tax (VAT) may be either inclusive or exclusive during the point of transaction.

1. **Inclusive vat/ after vat / within vat/ including vat = amount * 15% / 100% + 15%**
2. **Exclusive vat /before vat / without vat / excluding vat = amount * 15%**

XYZ manufacturing

$$A. \text{ VATP} = (30,000.00 * 150.00) * 0.15 - 1,000,000.00 * 0.15$$

$$\text{VATP} = 4,500,000 * 0.15 - 1,000,000 * 0.15$$

$$\text{VATP} = 675,000.00 - 150,000.00$$

$$\text{VATP} = \mathbf{525,000.00}$$

$$B. \text{ BPT} = \text{net income before tax} * 30\% , \text{ for corporation company}$$

- $\text{BPT} = \text{net income before tax} * \text{rate} - \text{deduction for unincorporated company (sole proprietorship or individual company and partnership company)}$

Note: BPT determined by income statement

Income statement for XYZ Company

Revenue

Sale (30,000*150).....4,500,000.00

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Less, sales commission (4,500,000*0.02 / 1.02).....	88,235.294
Net sale (sale – sales commission)	4,411,764.706
Less, cost / purchase (2,500,000 + 1, 000,000 + 200,00)	3,700,000
Gross profit (net sale – cost)	711, 764.706
Less, other expense	
- administrative expense	53,000
- NIBT (GP – total expense).....	658,764.706

Project one

IHLAS trading plc. Is a registered and licensed supplier of enjera to different universities in Ethiopia. During the year 2010 the company earns an income of birr 1,500,000 and 1,800,000 from Adama and AAU respectively including vat. The total cost of the product is 1,980,000 before vat. In addition the company earns birr 160,000 per year from other source of income. With zero vat rates. In the other hand the company incurred birr 300,000 general and administrative expenses for the year. During the last month of 2010 the company with holds birr 65,000 for employment income tax and the company is expected to pay 30% BPT.

Task 1.1 calculates direct tax liability for the year?

Task 1.2 Determine indirect tax liabilities for the year?

Answer

Task 1.1 Direct Tax

Direct tax = BPT + Employment income tax

Sales = 1,500,000 + 1,800,000 = **3,300,000**

Output vat = 3,300,000 x 15/115 = **430,434.78**

Net sales = 3,300,000 – 430,434.78

=

Net 2,869,56

sales 5.22

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=

Less (1,980,000)

CGS 00)

=

Gross 889,565.

profit 22

Less =

expen (300,000

se)

Net =

Incom 589,565.

e 22

Add other income = 160,000

Total income before tax = 749,565.22

BPT = 749,565.22 x 30% = 224,869.56

Net	
profit	=524,6
t	95.65

= 224,869.56 + 65,000 = **289,869.56**

Task 1.2 required indirect tax

Indirect tax = output vat – input vat

Output vat = 430,434.78

Input vat = $1,980,000 \times 15\% = 297,000$

Indirect tax = $430,434.78 - 297,000 = 133,434.78$

Project Two

ABC is merchandising business enterprise engaged in the buying and selling of products. The enterprise purchase and sell with birr 86,250 and birr 115,000 respectively. The enterprise has two permanent employees.

Name of Employees	Basic salary	Over time
Getachew	1500	300
Behailu	800	400

Task 2.1 calculates direct tax of the month?

Task 2.2 calculates indirect tax of the company?

Answer

Task 2.1 direct tax = EIT

Getachew taxable income = Basic salary + Over time

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$$= 1500 + 300 = 1800$$

$$\text{EIT} = 1800 \times 15\% - 142.5 = 127.50$$

$$\text{Behailu taxable income} = 800 + 400 = 1200$$

$$\text{EIT} = 1200 \times 10\% - 60 = 60$$

$$\text{Total EIT} = 127.5 + 60 = \mathbf{187.5}$$

Task 2.2 indirect tax = output vat –input vat

$$\text{Output vat} = 115,000 \times 15\% = 17,250$$

$$\text{Input vat} = 86,250 \times 15\% = 12,937.50$$

$$\text{Indirect Tax} = 17,250 - 12,937.50 = \mathbf{4,312.5}$$

Project one

Pyramid company acquire IT equipment service of birr 150,000 before vat. The company has five permanent employees. The basic salary and allowance of each employees is shows below.

Name of employees	Basic salary	Taxable Allowance
Hailu tesfa	4000	600
Wubalem getaw	2900	500
Shiferaw tzazu	3200	300
Zeritu kebede	2500	300

Weynuwa kasa	1500	200

On 2011 the company earned revenue of birr 540,500 VAT inclusive.

Task 1.1 calculate Direct tax and indirect tax liability for the year

Answer

Task 4.1 five Employees income tax as follow:

A. Hailu tesfa taxable income = 4000 + 600 = 4600

EIT = 4600 x 20% - 302.5 = 617.5

B. Wubalem taxable income = 2900 + 500 = 3400 EIT

= 3400 x 20% - 302.5 = 377.50

C. Shiferaw taxable income = 3200 + 300 =

3500 EIT = 3500 x 20% - 302.5 = 397.5

D. Zeritu taxable income = 2500 + 300 = 2800 EIT =

2800 x 15% - 142.5 = br277.5

E. Weynuwa taxable income = 1500 + 200 = 1700

EIT = 1700 x 15% - 142.5 = 112.5

Total EIT = 617.5 + 377.5 + 397.5 + 277.5 + 112.5 = **1782.5**

Cost = 150,000 birr

Input vat = 150,000 x 15% = **22,500**

Revenue = 540,500 vat inclusive

Output vat = 540,500 x 15/115 = **70,500**

$$\text{Net revenue} = 540,500 - 70,500 = 470,000$$

$$\text{Net income} = \text{Net sales} - \text{cost}$$

$$= 470,000 - 150,000 = 320,000$$

$$\text{BPT} = 320,000 \times 30\% = \mathbf{96,000}$$

$$\text{Direct TAX} = \text{BPT} + \text{EIT}$$

$$= 96,000 + 1,782.5 = \mathbf{97,782.5}$$

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Indirect TAX = $70,500 - 22,500 = 48,00$

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1. Zebra company work coffee import and export company in Ethiopia 2018 budget year transaction are purchase coffee product for birr 2,400,000 including vat from sidama coffee farmer association and also additional product purchase from oromiya coffee farmer association for birr 1,500,000 before vat and this zebra company import coffee washing machine for birr 600,000 before vat the company export coffee to Saudi arbiya and south Africa birr 4,500,000 and 3,000,000 respectively vat inclusive. Zebra company also paid salary expense 90,000, advertizing expense 80,000, store rent expense 120,000, utility expense 50,000 the company 30% business profit tax payer.

- A. Calculate VAT payable
- B. Required business profit tax
- C. Calculate net profit
- D. Calculate direct tax and indirect tax

1. Redsea and XYZ are VAT registered sole proprietorship companies in Ethiopia. Redsea is a manufacturing company and ABC is a whole seller company. Redsea purchased raw materials from VAT registered suppliers with birr 260,000 VAT inclusive and are sold after processing raw materials into finished products to XYZ company for birr 330,000 before VAT. XYZ company re-sold to retailer with the amount of 460,000 birr. Including VAT. During the fiscal year other expenses and employment income tax paid are respectively birr 48,000 and 13,000 for Redsea and 38,000 and 11,000 for XYZ company (Hint: any purchased and sales transaction is carried out with sole proprietorship)

- A. Calculate VAT payable
- B. Required business profit tax
- C. Calculate net profit Calculate direct tax and indirect tax

REFERENCE

Ethiopia Tax law constitution 2008/2016

KPBG-Ethiopian fiscal guide

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