



**CONDITIONS FOR THE DEDUCTIBILITY OF
BUSINESS EXPENSES UNDER ETHIOPIAN LAW:
CASE ORIENTED ANALYSIS**

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CONDITIONS FOR THE DEDUCTIBILITY OF BUSINESS EXPENSES UNDER ETHIOPIAN LAW: CASE ORIENTED ANALYSIS

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Declaration page

Declaration

I, the undersigned, declare that the thesis comprises my own work. In compliance with widely accepted practices, I have duly acknowledged and referenced all materials used in this work. I understand that non-adherence to the principles of academic honesty and integrity, misrepresentation/fabrication of any idea/data/fact/source will constitute sufficient ground for disciplinary action by the University and can also evoke criminal sanction from the State and civil action from the sources which have not been properly cited or acknowledged.

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List of abbreviations/Acronyms

FDRE :-Federal Democratic Republic Ethiopia

ERCA :-Ethiopian Revenue and Customs Authority

FDI:-Foreign Direct Investment

GTP :-Growth and Transformation Plan

PLC :- Private Limited Company

TIN :-Tax Identification Number

VAT:-Value Added Tax

US IRS :- United States Inland Revenue Service

Abstract

While auditing the self-assessment report of category A and B business income taxpayers, the Tax Authority should relay on the tax policies, tax rules and tax principles of the country. Denying deduction for business expense which are incurred by the business income taxpayer while conducting its business activity by setting additional precondition may adversely affect the taxpayer since by doing so it impose additional obligation and increase not only the tax burden of the taxpayer; but also it obliged the business income taxpayers to pay interest and penalty.

Key words:- Business income taxpayers, Deductions, Business expenses, ERCA

CHAPTER ONE

PROPOSAL OF THE STUDY

1. Historical back ground of the study

Every business income taxpayer except those which are exempted by the income tax law are expected to pay business income tax annually either by self-assessment or by standard assessment set by tax authorities in accordance with the income tax law. It is real that in order to generate income in business, the business person or business organization is expected to incur various expenses such expense may include but not limited to raw material cost, production cost, employee salaries and the like based on the nature of the business. While assessing the taxable income of such business, the taxpayers who are entitled to self-assessment are usually deducts such expenses which are directly or indirectly related to the business and report their tax obligation accordingly to the Tax Authority. The assessment set by the authority based on the Income Tax Proclamation is presumed to consider expected expenses of those businesses by conducting related research before setting the assessment.

In Ethiopia, under the repealed as well as the current Income Tax Proclamation, business income taxpayers are categorized in to three fields. Accordingly business entities which are established as 'body' are always considered as category A taxpayer no matter how much their annual income is. So if a business income taxpayer is established as body, then the Proclamation considers such body as category A taxpayer.¹The other mechanism used by the tax law to categorize the taxpayer is based on the annual gross income of the taxpayer. So if the annual gross income of the taxpayer is Birr 1,000,000 or more, then this taxpayer is categorized as category A taxpayer.²taxpayers whose annual gross income is Birr 500,000 or more but less than 1,000,000 are categorized as category B taxpayers.³ The last category of taxpayers is category C Taxpayers. Such taxpayers are those whose annual gross income is less than Birr 500,000.⁴

¹Income Tax Proclamation, 2016, *Federal Negarit Gazzeta*, Proc. No. 979 22nd year No 104, article 3/a/ /1/ [here in after, Proc. No 979/2016]

²Proc. No 979/2016 article 3/a/2/

³Proc. No 979/2016 article 3/b/

⁴Proc. No 979/2016 article 3/c/

From the above three categories of taxpayers, category A and category B business income taxpayers are expected to assess their income and report their tax obligation to the Tax Authority. Accordingly category A taxpayers are expected to assess and report their taxable business income within four months after the end of each tax year; whereas category B taxpayers are expected to assess and report their taxable income within two months after the end of each taxable year.⁵ The taxable business income of a taxpayer with in one tax year can be determined by assessing all income of the business and deducting deductible expenses and other exemptions which are allowed by the law. Such taxable business income can be determined based on the income statement of the taxpayer which shows profit obtained and loss incurred during the past tax year.

Deductions generally referred as expenses which needs to be deducted from the gross business income in order to reach to the taxable income of the taxpayer. .Until deducting such business expenses, it is not possible to know the financial ability of the taxpayer to pay the business tax. Deduction is also defined as acceptable business expenses which is incurred by the taxpayer in the process of conducting the business in order to generate the taxable income. The reason taxpayer is allowed to deduct those expenses from the gross income of the business which were incurred while conducting the business is, because the underline principle for allowing deduction should be the relationship b/win the expense incurred and the business.

For a business income taxpayer in order to be benefited from deduction for its business expenses, such business expenses should be ordinary and necessary. A business expense considered to be ordinary when it is common and acceptable in relation to the business. If any business income taxpayer who conduct similar business is expected to incur such expense then it is considered as ordinary business expense and therefore entitled for deduction. On the other hand, a business expense should be considered as necessary when it is helpful and appropriate for conducting the business activity.⁶

⁵Proc. No 979/2016, article 83/4/

⁶ US IRS, Publication 334, *Tax Guide for Small Businesses*, Internal Revenue Service Tax Forms and Publications,1111 Constitution Ave. NW, IR-6526,Washington, DC 20224,Internet source, [last accessed on 21April 2017]

There are two categories of deduction namely above the line deduction and below the line deductions. The above the line deductions are concerned on those expenses which are directly related with the business and are necessary to generate the business income expenses like employment salary falls under above the line deduction and are fully deductible. Whereas the below the lined deductions are concerned with expenses of the taxpayer which are not directly related to conduct the business.

While setting criteria for considering certain business expenses as deductible expense, most of the countries including Ethiopia try to check the relationship b/w in the expense incurred and the business conducted and if that expense is a must for conducting the business which generate the taxable income, then such expense of the taxpayer will be deducted from the taxable income of that taxpayer and the taxpayer will be taxed on the net income of the business.

Before denying certain expenses of a business from being deductible, ERCA should consider the very purpose (objective) or the policy reason of the tax law for allowing the taxpayer to deduct its business expenses from the gross business income and finally to reach to the taxable income of the business. Since the decision of the Tax Authority may adversely affect the policy reason of the country in relation to taxation which is economic development policy. For a country which is implementing the second face of GTP, and trying to attract foreign direct investment by offering various tax incentives for the new comer foreign investors is a must. In addition to treating new comer investors by welcoming way, it is equally important to treat those foreign investors which established their business in the country. Furthermore in order to attract international companies to have their branch in Ethiopia, while assessing their tax obligation the country should treat such subsidiary company which have permanent establishment in Ethiopia based on the tax rules of the country. To give some basement for this critics, Even though the Income tax proclamation clearly stipulates that in relation to employment income, for that income to be considered as Ethiopian source, either the employment service should be exercised in Ethiopia or if in case the employer is Ethiopian government, in this case it doesn't matter where the employee exercised his employment service and the income will be considered as Ethiopian source employment income.⁷ So in the above two cases, the employer is expected to (withhold) employment income tax from its employee and submit (deliver) the withhold amount to the Tax Authority by the

⁷Proc. No 979/2016, article.6/1/ a &b.

following month.⁸ But in the case of a subsidiary company which have permanent Establishment in Ethiopia and which's head quarter is located abroad, a controversy may arise when this subsidiary company deduct its business expenses which includes head quarter expenses part of which is paid as salary to head quarter employees; as the head quarter employees are not exercising their employment service in Ethiopia nor the subsidiary company is owned by the government, the employment income of these head quarter employee can't be considered as Ethiopian source income and the expense of the subsidiary company in relation to these head quarter employees should be considered as deductible business expenses. But from the existing practice, it is proved that ERCA is denying the deductibility of such expenses by giving ground that the subsidiary company should withhold employment income tax from head quarter employee otherwise ERCA argues that such expenses are not deductible.⁹

In the case of businesses which are located or established in Ethiopia, they also faces problem on deductibility of certain business expenses. From the income tax proclamation, it is obvious that such business income taxpayers should withheld the employment tax of their employees which are subject to employment income tax law.¹⁰ Failures to withhold such employment income tax have its own consequences. As described in the income tax law, in such a case, the employer will be obliged to pay the amount of the income tax which is expected from the employee.¹¹ Even though the law gives proper remedy for failure of the employer to withhold the employment income tax, for ERCA it doesn't seem enough because ERCA sets additional condition by denying those payment paid as employment salary to the employee of the business not to be deductible from the gross income of the business.

There are also other conditions set by ERCA for permitting deduction for a given business expenses. Sometimes ERCA deny certain expenses incurred by the business to buy certain goods in relation to VAT issue. But it was possible for ERCA to claim VAT related issue from the business income taxpayer separately. Failure to withhold 2% also another reason set by ERCA to deny tax deduction.

⁸Proc. No 979/2016, article 88/1/ & article 97/1/

⁹Dr. Taddese Lencho, *Taxation of business*, lecture note taken at school of law, Addis Ababa University, 29th December 2016.

¹⁰Proc. No 979/2016 article 10 & 88/1/

¹¹Proc. No 979/2016 article 97/3/a.

2. Statement of the problem

Countries based on their tax policy and based on the nature of the expenses, enumerates business expenses which are benefited from deduction. The new income tax proclamation enumerates various business expenses which are going to be deducted from the gross business income. The net taxable income of the business can be reached only after deducting such business expenses. If the business expenses fulfills the criteria listed under the income tax proclamation and other related legislations, then such expense should be deducted without any extra conditions. But the practice shows that not few business income taxpayers are denied deduction for their expenses which is related with the business because of other grounds set by ERCA that the taxpayer have failed to fulfill. Some of the conditions raised by ERCA for denying deduction are:-

- Failure to withhold 2%,
- Failure to withhold employment tax,
- Failure to Tax VAT, and so on.

The practice of ERCA which sets such conditions and denying deduction based on those conditions for business expenses create huge problem on the part of the taxpayer since the taxpayer is obliged to pay penalty and interest in addition to the obligation to return the amount which it have deducted already. This in turn will adversely affect, discourage and throw away from the market those taxpayers which believe the tax laws of the country and spend business expenses which were mandatory to generate the taxable income. What is more, such conduct of the Tax Authority may have adverse effect on attracting foreign direct investment since the foreign investors are very sensitive to such administrative intervention of the Tax Authority by denying deduction unless they are protected by double taxation treaties if any.

So this paper will try to answer the following questions

- Where are the legal basis for accepting or denying deduction for business expense?
- What are the various conditions set by ERCA for denying deduction for business expenses on business income taxpayers?
- What are the adverse effects of the additional preconditions required by ERCA on the deductibility of business expenses?

3. Objective of the study

The main objective of this paper is to test the legality of conditions set by ERCA for denying deduction of business expenses and then to show the importance of establishing proper and efficient tax administration body which accept deduction for business expenses which are incurred by the taxpayer as long as it is based on the tax laws of the country.

4. Significance of the study

This study will help to create effective and efficient implementation of the new tax administration law in relation to deductible expenses by which the taxpayers will be confident enough while expending expenses which are necessary to generate the taxable income. Furthermore it will help as input for further research in the field.

5. Scope of the study

Even though the issue of deduction is related to schedule B and schedule C Taxpayers, this paper is limited to tax deduction in relation to schedule C (business income) taxpayers. Among the three categories of taxpayers, this paper is concerned only with category A & category B taxpayers since category C taxpayers' income is assessed by ERCA based on standard assessment method as they are not expected to keep books and accounts of their business. Furthermore this paper is limited to deduction related cases decided by ERCA Tax Review Committees, the decision of the Tax Appeal Commission and the Federal Supreme Court Cassation Bench decisions with in the last fifteen years. In addition to these, the paper will mainly focus on 'above the line deductions' since the conditions set by ERCA for deducting business expenses are mainly focuses on such type of deductions. Furthermore, from their nature, the 'below the line deductions' are not subject to the conditions set by ERCA.

6. Limitation of the study

This paper is limited to category A and B business income taxpayers which are residents of Addis Ababa. Furthermore from the six types of business organizations and individual traders, this paper is limited only to individual traders, private limited companies and Share companies. The other limitation of the paper is with respect to ERCA offices which are going to be covered. Since there are more than 10 ERCA branch offices in Addis Ababa, I will focus on Addis Ketema Branch Small Level Taxpayer's branch office, Addis Ababa City Large Taxpayers

Branch Office Tax Review Committees and Addis Ababa City Administration Revenue Office Tax Review Committees.

7. Methodology of the study

The study will use both doctrinal as well as non-doctrinal research method. In the doctrinal part, the paper will try to discuss various types of business expenses which are entitled to deduction as per the repealed as well as the existing Income Tax Proclamation and other tax laws of the country. On the non-doctrinal part of the research, I will use qualitative method of data collection and my focus will be on cases decided by ERCA Tax Review committee, Tax Appeal Commission, Addis Ababa City Administration Appellate Courts and Federal Supreme Court Cassation Bench decisions in relation to the subject. Since the focus of the study is to assess the legality of various conditions set by ERCA for permitting or denying deduction for business income taxpayers, I will try to focus on cases which are directly related to such issues.

As far as the technique of data collection is concerned, I will try to discuss the legal provisions which are dedicated to deduction in the existing Income Tax Proclamation and Regulation. Cases decided by Tax review Committee, Tax Appeal Commission, Addis Ababa City Administration Appellate Courts and Federal Supreme Court Cassation Bench division are also the main focus of the study as primary source. As secondary source, I will also try to assess scholar's literatures on the nature and applicability of deduction in tax laws. Interview is another tool which is going to be used in the data collection method. Officers of ERCA are the subjects of this interview.

On the case part I will try to assess the legality of the decision of various organs of the tax authorities as well as various level of Addis Ababa City Administration Courts and Federal Courts. Finally based on the finding in the case part, I will try to come up with my conclusions and recommendations which may contribute something for the proper implementation of the existing Income Tax Proclamation and other tax rules in relation to deduction. Since I believe that any conditions which are set to permit or deny deduction of business income expenses shouldn't infringes the taxpayer's right to deduct those expenses which are permitted to be deducted by tax laws of the country. I also believe that ERCA shouldn't be encouraged to set additional criteria /condition/ to permit or deny deduction of business expenses other than those mentioned in the Income Tax Proclamation and subsequent legislations which are enacted to facilitate the proper implementation of the Income Tax Proclamation.

CHAPTER TWO

GENERAL DISCUSSION

In the business there will be no income without expending money, time, skill and other inputs on the business. So in order to reach to the taxable income of the taxpayer, we need to deduct the business expense incurred by the taxpayer in the tax year. But not all kinds of business expenses are allowed to be deducted from the business income of the taxpayer. Based on the nature of the expenditure, the tax rules may allow or deny the deductibility of certain types of business expenses.

The common way of designing deduction provisions in tax law is using broad language with some exceptions. In such case there are positive rules which will allow deduction for business expenses with some restriction which are negative rules. Usually not few tax laws uses language which can serve as connection factor between the expense incurred and the income generated like business expenses are deductible to the extent that they are incurred in the production of taxable income.¹² If the positive limb is allowed to be applicable broadly it may serve as a tool for tax evasion that is why applying the negative limb in restrictive way becomes necessary. Since it is not possible or easy to anticipate and enumerates each and every list of possible business expenses in tax laws it is usual to use general deduction rules designed with broad positive limbs followed by specific negative provisions which specify the types of the nondeductible expenses.¹³ In addition to this, in tax laws of various jurisdiction it is common to set precondition for the deductibility of certain business expenses and if the expense incurred by the taxpayer fulfills the legal preconditions, then the taxpayer will be allowed to deduct such expense.¹⁴

¹² Lee Burns and Richard Krever, 'Chapter 16, Taxation of Income from Business and Investment', in Victor Thuronyi, ed, *Tax Law Design and Drafting*, volume 2, International Monetary Fund: 1998;, page 10 [Here in after Lee Burns and Richard Krever, *Taxation of income from business and investment*]

¹³ Proc. No. 979/2016, Art 27 and Income tax proclamation, 2002, *Federal Negarit Gazzeta* [Extraordinary issue], Proc.No. 286 8th year No34, Art 21 [here in after Proc. No. 286/2002]

¹⁴ Proc. No. 979/2016, Art 23,24,25,26/30ff, Proc. No. 286/2002 Article 22ff

. From the tax rules business expenditure can broadly be categorized into deductible, non deductible and deductible with preconditions. In the case of deductible business expenses, because of the nature of the expenditure the taxpayer is allowed to deduct such expense. The only thing the taxpayer is expected to fulfill is to prove the existence of the expenditure. So if the business expenses falls under this category, it should be deducted without any other precondition.

Non deductible business expenditure on the other hand is denied the benefit of deduction even though the taxpayer can properly prove the expense. In this case since the law clearly deny the deductibility of such expense, the tax payer can't deduct such expense. The third category of business expenses are business expenses which are going to be deducted from the business income of the tax payer only if the preconditions stated in the tax laws are full filled.

So in this chapter I will focus on the general rules and principles of deduction further more I will try to discuss the type of expenses which are allowed to be deducted without any precondition and business expenses which are denied to be deducted without any precondition. Furthermore I will try to discuss the documentation which needs to be fulfilled to prove the existence of business expenses.

2.1 .Deductible Business Expenses

In principle any business expenses which are ordinary and necessary on the course of conducting a certain business are allowed to be deducted from the gross income of the business in order to reach to the taxable income in a given tax year. The common way distinguishing deductible business expense from the nondeductible one is checking the relationship between the expense incurred and the business. Then if incurring that expense is ordinary and necessary for conducting the business, then such expense is allowed to be deductible. On the other hand if there is no acceptable connecting factor between the type of the business and the expense incurred, then such expense will not benefit the deduction rules. In the absence of clear test, such subjective way of qualifying some business expense as deductible and restricting others which are not considered as ordinary and necessary expenses from being deductible may create uncertainty on the part of the taxpayer since they incurs such expenses by believing that it is

ordinary and necessary to generate the business income. Furthermore it will also open door for the tax authorities to abuse their power since there may not be clear demarcation to check a certain business expenses is ordinary and necessary for that particular business.

According to some tax rules publications certain business expenses are deemed to be ordinary when incurring such expense is common and acceptable expense in relation to the business. If any business income taxpayers who conduct similar business are expected to incur such expense then it is considered as ordinary business expense and therefore entitled for deduction. On the other hand it is believed that a certain business expense is necessary when it is helpful and appropriate for conducting the business activity.¹⁵

Ethiopian tax rules also permits the deductibility of any business expense which is incurred by the taxpayer as long as incurring such expense is necessary to derive, secure and maintaining the business income.¹⁶ The main question which needs to be answered is when (in what situation) can we say a given expense is necessary in deriving, securing and maintaining the business income? A given expense is deemed to be necessary when it is incurred in relation to direct cost of producing the income. Such direct cost may include direct cost of manufacturing, purchasing, important selling and other similar costs which are incurred in order to derive the business income in the tax year.¹⁷ General expenses and administrative expenses which are incurred in relation to the business activity are also considered as necessary expenses to derive the business income and allowed to be deducted from the gross business income.¹⁸ But the problem is administrative costs are broad so in order to qualify the costs which are considered as administration cost it needs to be described in detail otherwise it can leave space for the taxpayers to collect variety of expenses in one basket to consider them as administration cost which may not be considered as administration cost in that particular business. Administration cost may include costs expenses incurred for purchasing stationeries for the office purpose, rent expense of office building for the business, other cost which is used for the business like electric

¹⁵ US IRS Publication 334, **Tax guide for small business** / Internal Revenue Service Tax Forms and Publications, 1111 Constitution Ave. NW, IR-6526, Washington, DC 20224, internet source last accessed on April 21/2017

¹⁶ Proc.No. 979/2016, Art 22/1/a/

¹⁷ Income Tax Regulation, 2002, *Federal Negarit Gazzeta*, Reg. No 78, 8th year, No 37, article 8/1/[here in after, Reg. No 78/2002]

¹⁸ Reg. No 78/2002, article 8/2/

cost internet lease cost and so on. Similarly general costs should be defined clearly otherwise every cost which is incurred by the business income taxpayer by believing that it is incurred for the purpose of conducting business may fall under general costs of business category and so benefits from deduction.

Earlier Australian and Canadian tax laws try to qualify deductible business expenses as expenses which a business person wholly and exclusively spent in order to generate the taxable income. According to tax law scholars, such kinds of language for restricting certain types of business expenses from being deductible may create ways for total denial of deduction for some business expenses like mixed purpose expense.¹⁹ Furthermore such kinds of restrictive language may adversely strength the arm of the Tax Authority since they can easily decides and disregard certain expenses of the taxpayer from being deductible.

The other business expenditure which is allowed to be deducted without any precondition is expenditure incurred by the taxpayer for the disposal of trading stock in the tax year.²⁰ Cost incurred for the purchase of depreciable assets and business intangibles is also considered as business expense and allowed to be deductible. In the case of expense incurred for the purchase of depreciable assets and business intangibles, such expense will be deducted based on straight line deduction method or diminishing value method.²¹ In addition to this the business income taxpayer is allowed to deduct any loss which he incurred on the disposal of business asset in the same tax year in which the loss is incurred as long as the business asset is transferred to persons other than related persons.²² We can say that there is loss on the disposal of business asset when the net book value of the asset at the time of disposal exceeds the amount fixed for that asset at the time of disposal.²³

¹⁹ Lee Burns and Richard Krever, 'Chapter 16, Taxation of Income from Business and Investment', in Victor Thuronyi, ed, *Tax Law Design and Drafting*, volume 2, International Monetary Fund: 1998;. page 9 [Here in after Lee Burns and Richard Krever, *Taxation of income from business and investment*],

²⁰ Proc.No 979/2016, Art. 22/1/b

²¹ Proc.No 979/2016, Art. 22/1/c, Art. 25, Income Tax Regulation,2017, *Federal Negarit Gazzeta*, Reg. No 410, 23rd year, No 37, Art icle36, Art. 37, Art. 38 /[here in after, Reg. No 410/2017]

²² Proc.No 979/2016, Art. 22/1/d

²³ Proc.No 979/2016, Art. 22/3/

2.2 Non deductible expenses

Countries for various policy reasons may fully deny the deductibility of certain business expense. One of the expenditure which is not deductible is an expense which has capital nature. The business person is not allowed to deduct such expenses from its gross income since such expenses should be capitalized as they are parts of the business and are considered as assets of the business.²⁴ Any expenditure which is incurred by the tax payer for increasing the share capital of a company is not deductible. In addition to this an expenditure that is incurred to increase the basic capital of a registered partnership is not deductible.²⁵

In case if the taxpayer pay dividend or paid out profit, such expenditures incurred by taxpayers in relation to dividend payment and paid out profit shares are not deductible.²⁶ In addition to this if the tax payer incurred expenditure for its business and if such expenses is recovered or if it is proved that the cost is recoverable based on the policy of insurance or a contract of indemnity or surety, then such expenditure is not allowed to be deducted from the business income of that taxpayer.²⁷

The other non-deductible expense is an expenditure which is paid by the business income taxpayer as fine or penalty due to its failure to obey any law. If the taxpayer failed to perform his contractual obligation and because of this the concerned body awarded damage against the tax payer, then such expense is not deductible.²⁸

What is more if the taxpayer dedicates some portion of its business income as reserve then such amount is not considered as deductible expense. In addition to this if the tax payer dedicated some portion of the business income for an expenditure or loss which he expect to incur in the future but not yet incurred in the tax year, then the tax law clearly deny the deductibility of such expense.²⁹ Another kind of expenditure which is not allowed to be deducted is any income tax paid by the tax payer based on the tax law of the country or foreign tax law is not deductible. In

²⁴ US IRS, Publication 535, *Business expenses*, Internal Revenue Service Tax Forms and Publications, 1111 Constitution Ave. NW, IR-6526, Washington, DC 20224 [last accessed on June 8/2017]

²⁵ Proc 979/2016 Art. 27/1/a

²⁶ Proc 979/2016 Art. 27/1/d

²⁷ Proc 979/2016 Art. 27/1/e

²⁸ Proc 979/2016 Art. 27/1/f

²⁹ Proc 979/2016 Art. 27/1/g

addition to this value added tax which is paid by the taxpayer is not deductible as long as it is proved that recoverable.³⁰

While deciding on the deductibility of business expenses, care should be taken for mixed purpose expense. Mixed purpose expenses are expenses which have both business nature and personal nature. Personal expenses may include living or family expenses. It is not allowed to deduct the personal expenses of the business income taxpayer from gross income of the business.³¹ But if there are expenses which have both personal as well as business nature, the taxpayer may divide the total cost between the personal and the business part and then deduct the expenses which relates to the business part. If you as a business men use your home for conducting the business, then it may be possible to deduct expenses incurred for your home since it is also used to conduct the business. Such expense may include mortgage interest, insurance, utilities, repairs and depreciations.³² Similarly if the business person uses his/her car for conducting the business, then he can deduct expenses which are incurred for the car like fuel expense, repair, insurance, parking expenses.³³

Similar with mixed purpose expense, boarder line expenses are expenses that have elements of both business expenses and personal consumption. Boarder line expenses are another area on which deduction restriction rule may apply. One of the conditions which can be set as deduction restriction mechanism is on the amount of the expenditure which is incurred on boarder line expenses by the business income taxpayer. In this case the tax law of the country should clearly specify the fixed amount of the expense which is going to be deducted from the gross income of the taxpayer. The other condition which can be set to restrict the deductibility of boarder line expenses is setting some restrictions like; in order to allow deduction for boarder line expenses, such expenses should be considered as income of the beneficiary of the expenditure except the benefits is given to paying customer or given as sample to a broad cross section of the public. Furthermore care should be taken while requiring deduction for expense incurred for repair work

³⁰Proc 979/2016 Art. 27/1/h

³¹ Proc 979/2016 Art. 27/1/l

³²US IRS, Publication 587 *home office deduction business use of your home*, Internal Revenue Service Tax Forms and Publications,1111 Constitution Ave. NW, IR-6526,Washington, DC 20224 Internet source accessed on June 8/2017

³³ US IRS, Publication 463 *Travel, entertainment, gift, car expenses*, Internal Revenue Service Tax Forms and Publications,1111 Constitution Ave. NW, IR-6526,Washington, DC 20224 Internet source accessed on June 8/2017

of a building which serve for personal as well as business purpose. In such a case the depreciation will be calculated and deducted to the extent that the building served for the business.³⁴

2.4 Documentation proving expenditure

While conducting business one of the main activities of the business is purchasing various materials which are necessary to conduct the business. Such materials may include raw materials, administrative goods, and stationeries and so on. Similarly in order to conduct the business, the business men may be obliged to use services like electricity, telephone and water. Such expenses are obviously business expenses and they should be benefited from deduction. But in order to deduct such expenses, there should be a valid document which evidenced such payment. For this reason countries set rules and regulation which govern the acceptability of receipt and other documents as a valid evidence for the business expense.

In Ethiopia, category A and category B taxpayer are obliged to use books and accounts. Furthermore they are expected to use cash register machine. In addition to this category C taxpayers who want to be registered for VAT are expected to use cash register machine. Such business income taxpayers are allowed to use receipts which are printed under the permission of the Tax Authority when the cash register machine is failed/damaged/, when the cash register machine is under maintenance or when the electric power is off. The receipt which is printed under the authorization of the relevant Tax Authority has equal status as that of the cash register machine.³⁵ So business income taxpayer who purchased goods for its business from such suppliers should support its expense using those receipts. The receipt directive clearly stipulated that as long as the receipt which is submitted by the business income taxpayer to evidence business expense is printed under the permission of the tax authorities or other eligible government authorities, it is considered as valid evidence without any additional criteria.³⁶

In case when it becomes necessary to purchase goods from category C suppliers or from traditional suppliers like farmers who are not obliged to use cash register machine. In such a

³⁴ Reg. No. 410/2017, Art. 40.

³⁵ *Final Receipt Directive No 110/2016*, Ethiopian Revenue and Customs Authority, Art 8[unpublished]

³⁶ *Final Receipt Directive No 110/2016*, Ethiopian Revenue and Customs Authority, Art. 18/3/[unpublished]

case the taxpayer is expected to use purchase voucher which is printed by the authorization of the Tax Authority. In Such case the purchase voucher in order to be valid, either it should be supported by contract to prove expense, or the purchase voucher should have the name and address of the supplier. In addition to this, if the supplier is category C taxpayer, the purchase voucher should also show the TIN of that supplier.³⁷

What is more until the enactment of the recent Receipt Directive, there was no clear rule which govern what issues are going to be included in receipts which are used by Fuel Stations, Transportation and Insurance business. The Receipt Directive further says that those issues will be governed by a circular which is going to be developed by the Tax Authority in the future.³⁸ So suppliers who were engaged in fuel station business, Transportation and Insurance business were free to use receipt which was not printed under the permission of the Tax Authority.

To conclude the deductibility of a certain expense should be assessed and tested based on the tax rules. So business expenditures which are discussed under deductible expense should be deducted as long as it is proved by valid documentary evidence without requiring additional criteria. On the Other hand while assessing their tax obligation, taxpayer needs to take care not to deduct expenses which are not allowed to be deducted by the tax rules of the country. In addition to this care should be taken while incurring mixed purpose expenses.

³⁷*Final Receipt Directive No 110/2016*, Ethiopian Revenue and Customs Authority, Art. 12/1/ & /3/[unpublished]

³⁸*Final Receipt Directive No 110/2016*, Ethiopian Revenue and Customs Authority, Art. 32 [unpublished]

CHAPTER THREE

LEGAL PRECONDITIONS FOR DEDUCTING BUSINESS EXPENSES IN ETHIOPIAN TAX SYSTEM

In the previous chapter we have discussed the general rules and principles which are going to be followed to allow or deny deduction for a given business expense. The expenditures which are discussed under the previous chapter doesn't needs additional criteria in order to be deducted or not. If the expenditure is related to the types and nature of expenditure which are described under the provision which allow deduction, then such expense should be allowed to be deducted from the business income. On the other hand if the nature of the expenditure falls under the provisions of the law which deny the deductibility of that expense, then the taxpayer is not going to be allowed to deduct such expense even though he has acceptable ground for that. In this chapter I will focus on provisions of the current as well as the repealed income tax laws of the country which sets precondition on the deductibility of certain business expense.

1. Deducting Interest Expenses

While conducting the business activity the taxpayer may be obliged to pay interest payment. In such case the business income taxpayer other than financial institutions will be allowed to deduct interest payment made to the creditor only if he fulfills two requirements:-

- a. The taxpayer is expected to show that the debt or the proceed of the debt or other agreement which is the ground for interest payment is solely used to derive the business.³⁹
- b. The amount of interest payment which is going to be paid to the creditor shouldn't exceeds the rate which is used between the National Bank and commercial banks by more than two percent,

But if the creditor of the taxpayer is financial institution recognized by the National bank of Ethiopia or if the creditor of the taxpayer is foreign bank which is allowed to lend money

³⁹ Proc.No. 979/2016, Art 24

for Ethiopian, then the interest payment made to such foreign bank is deductible without any limitation.⁴⁰

If the interest is paid or is going to be paid to related person who is Ethiopian resident, in this case in order to allow deduction for the interest payment made by the business income taxpayer to such related person, the interest payment should be included as the income of the related person under schedule D of the income tax proclamation.⁴¹

2. Deductibility of Gift and donation expenses

Now a day corporate social responsibility is an emerging obligation against companies and other persons who are engaged in investment and huge business in the national as well as international level. In Ethiopia one wing of discharging such responsibility is allocating some portion of the business income as charitable donation either to Ethiopian charities and Ethiopian societies.⁴² The business income taxpayer can donate from his annual business income not more than 10% of the taxable income.⁴³ Such donation may be made in response to government call for some development activity like contribution for building infrastructure or preventing man made or natural disaster or epidemic and other similar causes.⁴⁴ According to the income tax regulation such call may be made by the Federal or regional governments including Addis Ababa and Dire Dawa city administrations. The charitable donation may be made in relation to education, health, environment protection or other humanitarian aid.⁴⁵

3. Promotion and advertisement expenses

In the current globalization era, the world becomes village and various trans boundary investors are entering to the local market and competing with these international traders is becomes a serious challenge for local traders and investors. So in order to be competitive in the local as well

⁴⁰ Proc.No. 979/2016, Art. 23/2/a, Proc.No. 286/2002, Art. 21/1/e

⁴¹ Proc.No. 979/2016, Art. 23/2/b, Art.56

⁴² According to proclamation 621/2009 Art.2/2, Ethiopian Charities or Ethiopian Societies means charities or societies which are formed under Ethiopian law and all of its members are Ethiopians and wholly controlled by Ethiopians. Furthermore 90% of their fund should be collected from Ethiopia.

⁴³ Proc.No. 979/2016, Art 24, Proc.No. 286/2002, Art. 21/1/l, , Reg.No. 78/2002, Art 11

But the taxable income can only be reached after deducting the expenditure of the business including the donation made by the business income taxpayer. so it is better to amend Art 24/2/ of the income tax proclamation by saying 10% of the gross income.

⁴⁴ Proc.No. 979/2016, Art. 24

⁴⁵ Reg.No 410/2017, Art.33

as international market, promoting and advertising the product which the business is producing or the service it rendering is becoming mandatory. So if the business income taxpayer incurred cost for promotion and advertisement, the expense incurred for the promotion and advertisement will be deductible subject to the limitation set by the directive which is going to be enacted by Ministry of finance .⁴⁶

4. Declined value of depreciable assets and Business intangibles

The declined value of depreciable assets and business intangibles are considered as expenses and will be benefited from deduction since the depreciable asset and the business intangible lose their value through time. The depreciation value of depreciable assets and business intangible will be calculated using straight line method or the diminishing value method.⁴⁷

Straight line depreciation method is applicable for business intangibles and structural improvement which's cost doesn't include the cost of land on which the improvement is situated. For other depreciated assets of the business the deduction will be calculating based on diminishing value method.⁴⁸ But if the balance of a depreciable asset is not more than two thousand birr, the amount will be deducted fully in the tax year to which the balance of the taxpayer corresponds.⁴⁹

The only precondition which needs to be full filled by the business income taxpayer is showing that the depreciated asset or business intangible is acquired from persons other than a related person who have already benefited and transferred the depreciable asset and the business intangible which's cost is fully depreciated.⁵⁰

When we see the deductibility of loss on disposal of a business asset other than trading stock, it is allowed to be deducted in the tax year on which the business asset is disposed.⁵¹ In the case of a building which is partially used as a business asset, depreciation deduction is allowed only in proportion to the part of the building which is used as business asset.⁵²

⁴⁶ Proc. No. 979/2016, Art 22/1/a 24, and Reg. No 410/2017, Art. 31

⁴⁷ Proc. No. 979/2016, Art 36

⁴⁸ Reg. No 410/2017, Art 36 /2/ &/3/

⁴⁹ Reg. No 410/2017, Art 38

⁵⁰ Reg. No 410/2017, Art 36/4/

⁵¹ Proc. No. 979/2016, Arti25

⁵² Reg. No 410/2017, Art 40

5. Deductions on Loss carry forward

As conducting business always has its own opportunities and risks, the business income taxpayer may tried his best but at the end of the tax year he may incur loss because the business expenditure exceed the business income. In this case the business income taxpayer can carry the loss forward and deduct the loss from the income of the following tax years. The business income taxpayer is allowed to carry forward such loss for the maximum of for the coming five tax years. The precondition which needs to be full filled so as to be benefitted from loss carry for word deduction is the business income taxpayer books of accounts which show the loss should be internally audited and the report should be acceptable by ERCA.⁵³

Another instance by which the business income taxpayer is allowed for loss carry forward deduction is if the books of accounts of the business income taxpayer is audited by external auditor and submitted to the Tax Authority but the Tax Authority failed to audit the taxpayers books of accounts for what so ever reason before the due date for filing the business income taxpayers tax declaration for the following tax year. If these two preconditions fulfilled, the business income taxpayer will be allowed to loss carry forward deduction even though the audit report is not acceptable by the Tax Authority. But the Tax Authority is allowed to audit the loss subsequently if the result shows the amount of loss is lower or no loss at all, the Tax Authority will notify and serve the amended tax assessment to the business income taxpayer.⁵⁴

6. Deducting expense in long term contract

Long term contract is a contract which is entered for manufacturing, installation or construction work or the performance of related service. For a contract to be considered as long term contract, the estimation for the completion of the work shall be more than one year and the work actually needs more than one year for its completion.⁵⁵

In order to deduct expenditure incurred for long term contract, the tax payer should use accrual basis accounting system. Further more the tax payer should include the income which is going to be derived from the long term contract. If the above two preconditions are fulfilled, the taxpayer can claim the deduction of the expenditure which he incurred in the tax year by taking in to consideration the percentage of the completed work based on the contract. This percentage of

⁵³ Reg. No 410/2017, Art 42/1/

⁵⁴ Reg. No 410/2017, Art 42/3/ &/4/

⁵⁵ Proc. No. 979/2016, Art. 32/6/

the contract completed can be determined by calculating the total cost the taxpayer incurred for the long term contract during the tax year with the total estimated cost of the contract including variation if any.⁵⁶

In the case of long term contracts, at the final year of the contract if the estimated taxable income to be made under the contract based on the calculated percentage for each year exceeds the actual taxable income and the excess amount is greater than the difference between the business income derived and deductible expenses incurred at the tax year in which the contract is completed, then it is said the business income taxpayer has a final year loss. So such loss can be deducted from the preceding year's taxable income of the taxpayer by way of loss carry backward only if the business income taxpayer can't take loss carry forward because it ceases its business operation in Ethiopia at the end of the contract period.⁵⁷

7. Deducting bad debts

Bad debt is a monetary amount which needs to be paid to the creditor but the debtor failed to pay because of various reasons. In order to be allowed to deduct bad debt, the business income taxpayers other than financial institutions are expected to fulfill the following preconditions cumulatively.

First the taxpayer has to show that the amount of the debt has been included in the business income of the taxpayer previously. Second, the whole debt or part of it is written off in the financial account of the taxpayer based on the financial accounting standard for the tax year. Finally the taxpayer has taken legal action against the debtor to collect the debt but the debt is proved to be irrevocable. If these three requirements are fulfilled, the business income taxpayer is allowed for deducting such bad debt to the extent to the written off debt amount.⁵⁸

But if the expenditure which is incurred in one tax year is considered as non recoverable in that tax year but recovered in the following tax year, then the recovered amount for which deduction was allowed in the past tax year will be considered as income derived by the taxpayer in the tax year in which it is received. This rule also applies to bad debts which were written off in the past

⁵⁶ Proc. No. 979/2016, Art. 32/1/,/2/

⁵⁷ Proc. No. 979/2016, Art. 32/3/,/4/,/5/ and Reg. No 410/2017, Art 43

⁵⁸ Proc. No. 979/2016, Art. 30, Proc. No. 286/2002, Art. 25

tax year and because of that benefitted from deduction but consequently the debt recovered and the business income taxpayer received the payment.⁵⁹

8. Deducting expenses in relation to reserve fund of Banks and Insurance Business

In banking Business it is usual to deposit loss reserve fund so as to protect the depositor in case if loss materialize. Among the whole loss reserve fund which is deposited by the bank in the tax year, 80% of it is allowed to be deducted from the gross income of the bank. But in order to be benefitted from this deduction, the bank is expected to be consistent with financial reporting standard and also needs to fulfill the criteria of the National Bank of Ethiopia.⁶⁰In the case of Banks, they are allowed to deposit 25% of their annual net profit as reserve fund in legal reserve account until it reaches the capital of the bank. When the reserve fund deposited reaches the capital of the bank, the bank will be allowed to deposit only 10% of its annual net profit.⁶¹

Deducting reserve fund for unexpired risk of general insurance companies is allowed. A general insurance policy is any kind of insurance policy other than life insurance.⁶²The reserve fund which is deposited by Ethiopian resident for converting unexpired risk which is created by an insurance policy in the tax year is allowed to be deducted from the business income of the insurance company. The only precondition which needs to be fulfilled for the deductibility of such expenses is fulfilling financial reporting standards.⁶³ Unexpired risk is a risk which is not yet materialized and is not expired at the end of the tax year in which the insurance policy was established. In order to allow deduction for the reserve fund expense for nonresident insurance company, which have permanent establishment in Ethiopia, in addition to the above criteria the company needs to prove that the reserve fund is deposited for the benefit of unexpired risk in Ethiopia.⁶⁴

⁵⁹ Proc. No. 979/2016, Art. 73

⁶⁰ Reg. No 410/2017, Art.45

⁶¹ *Legal reserve directive No SBB/4/95*, National Bank of Ethiopia, August 1996

⁶² Reg. No 410/2017, Art.46/4/

⁶³ Proc. No. 286/2002, Art.26 and Reg. No 410/2017, Art.46/1/

⁶⁴ Reg. No 410/2017, Art.46/2/

9. Deduction in mining or petroleum Operation Business

Companies which are engaged in mining or petroleum operation business are allowed to deduct the expenditure they incurred in undertaking the mining operation in a given license area during the tax year. Such deduction is permitted only from the income which is derived in the tax year from the mining operation in the licensed area. This means the business income taxpayer who have two or more licensed mining area can't deduct the expenses he incurred in one licensed area against the income which he derived from another licensed area. Similarly the loss incurred in one licensed area in one tax year can only be forwarded to the following tax year and the loss can be deducted from the following year income of that licensed area. Such loss can be forwarded for a maximum of the following 10 tax years.⁶⁵ We can say the licensee has a loss when the total amount of deduction exceeds the total amount of the business income of the licensee in the licensed area in a given tax year.⁶⁶

Another area of expenses which are allowed to be deducted from the gross income of business persons who are engaged in mining or petroleum operation is the reinvestment expenditure. In order to be benefited from such deduction the expense (the amount allocated for reinvestment) must not exceed 5% of the gross income of the mining business in the tax year. Farther more the business income taxpayer is expected to show that the reinvestment is for development project which is authorized by the concerned (the licensing) authority. But if the licensee fails to reinvest the deducted amount in the following tax year, then it will be considered as part of taxable income of the taxpayer for the following tax year.⁶⁷

10. Expenses for repairs and improvement

Another area where deduction of business expenses are subject to precondition is in relation to cost which is incurred for repairing or improving depreciable business asset. The law permits deduction for such expenses as long as it doesn't exceed 20% of the net book value of the depreciable business asset at the end of the tax year. But if the cost of repair or improvement

⁶⁵ Proc. No. 979/2016, Art. 38 /1/-/3/

⁶⁶ Proc. No. 979/2016, Art. 38 /4/

⁶⁷ Proc. No. 979/2016, Art. 42

incurred by the taxpayer exceed 20% of net value of the depreciable asset, in such case instead of deduction, the cost will be added to the net book value of the depreciable business asset⁶⁸

On the other hand if the taxpayer uses leased business asset for conducting his business and if he incurs expense for the maintenance, repair work or improvement work of the leased business asset, even though the taxpayer was not obliged to conduct such maintenance and repair work under the terms of the contract concluded with the lesser and he conduct such repair work by his own will, the taxpayer is allowed to deduct the expense which is incurred for such maintenance, repair or improvement work without any limitation.⁶⁹

11. Expenses in relation to commission agent

Some business income taxpayer may be obliged to pay commission for commission agents based on their agreement or the business practice (custom). In order to allow deduction for expenses incurred in relation to commission payment, the business income taxpayer is expected to prove two things. The first precondition which needs to be proved is the fact that the commission service is really rendered. In addition to this the amount paid as commission for the service rendered by the commission agent shouldn't exceed the normal rate. This normal rate can be checked by considering the market practice.⁷⁰

12. Parent company expenses

In the case of parent and branch companies in which trans boundary companies open branch in Ethiopia, the payment made by the branch which have permanent establishment in Ethiopia to the nonresident parent company can be deductible only if it is proved that the payment in question was made for the service actually rendered by the parent company to the branch business and such service helps the branch company to derive, secure or maintaining the business income.⁷¹ Furthermore the branch is expected to prove that the support service can't be rendered by other persons or companies in a lower cost.⁷²

⁶⁸ Proc. No. 286/2002, Art. 23/11/, and Reg. No 410/2017, Art. 41/2/

⁶⁹ Reg. No 410/2017, Art. 32

⁷⁰ Reg. No 78/2002, Art 8/5/ A &B

⁷¹ Reg. No 78/2002, Art 8/6/ A ,and , Reg.No 410/2017, Art 35

⁷²Reg.No 78/2002, Art. 8/6/ A &B

The Recent Income Tax Regulation comes up with easy requirement when compared with the repealed one because in order to allow deduction for payments made to the nonresident parent company, the branch company which have permanent establishment in Ethiopia is expected only to prove that the expense was incurred in deriving, securing or maintaining the business income.⁷³ On the other hand if the taxpayer incur loss due to the sale of business asset, such loss is not deductible if the taxpayer sold the business asset to related person.⁷⁴

13. Deducting payment made to managers and children of partners

Exaggerated salary and other payments made to managers of PLCs or a partnership is under the supervision of the Tax Authority and if the authority thinks that the payment made to the managers is exaggerated it may refuse some portion of these expenses from being deductible from the gross income of the PLC or the partnership because.⁷⁵ Similarly Salary payments made to the children of the business person or the member of the partnership will be considered as deductible expense only if the children full fills the criteria needed for the position of the work.⁷⁶

14. Entertainment expenditures

Unless the taxpayer is engaged in the provision of entertainment, the expenditure which is incurred for such entertainment is not deductible. But if the tax payer is engaged in mining, manufacturing, or agricultural business he will be allowed to deduct the expenditure which is incurred for providing food for the employee for free. The law defines entertainment to mean the provision of food, beverages, tobacco, accommodation, amusement, recreation, or hospitality of any kind to any person.⁷⁷

On the other hand the income tax regulation limits the deductibility of expenditure incurred for serving food and beverage for employees only for taxpayers who engaged in the provision of food and beverage service.⁷⁸

⁷³Reg. No 410/2017, Art. 35

⁷⁴Proc. No. 979/2016,Art. 27/1/m

⁷⁵ Reg. No 78/2002, Art 8/7/

⁷⁶, Reg. No 78/2002, Art 8/7/

⁷⁷ Proc. No. 979/2016,Article 27/2/

⁷⁸ Reg. No 410/2017, Art 30

Even though the law says the amount of expenditure which is allowed to be deducted is going to be determined by the directive which is going to be issued by the ministry of finance, Until this paper is prepared the Ministry of Finance doesn't come up with such directive.⁷⁹

15 Foreign currency exchange loss

If the business income taxpayer is engaged in international business transaction like export import trade and if he incurred foreign currency exchange loss in the tax year, he is allowed to deduct such loss only from his income which is derived from currency exchange gain. But if he failed to gain income from currency exchange in the tax year in which the currency exchange loss was incurred, then he is not allowed to deduct this loss from other income of the business which's source is different from currency exchange gain. This will apply for all business income taxpayers who are engaged in international business transaction except financial institutions.⁸⁰

Non recoverable expenditure or loss incurred by the business income taxpayer in relation to insurance policy or a contract of indemnity, guarantee or surety is allowed to be deductible as long as the business income taxpayer can prove that the expenditure was necessary to derive the business income. Furthermore the taxpayer needs to show that the expenditure or loss is not recoverable.⁸¹

16. Deducting expense & loss in relation to foreign business

An Ethiopian resident business income taxpayer may engaged in foreign business and derives income from such business. In this case the resident taxpayer is allowed to deduct expense incurred in relation to the foreign business which is the source of the taxable income only from that particular business's foreign income. Similarly if this resident taxpayer incurs foreign loss for the tax year, he is allowed to forward the loss and deduct it from the following year's foreign income of that business. He can carry the loss forward to the other following year until the loss is totally deducted. But it is not possible to carry forward such loss for more than five tax years.⁸²

Sometimes it will be obligatory to cease a given business activity in the middle of a tax year. But some payments may be made to the taxpayer after the business ceased its operation. In this case if the income derived is considered as taxable business income, then the business income

⁷⁹Proc 979/2016 Art. 27/1/j

⁸⁰Reg. No 410/2017 Art.44

⁸¹Proc. No. 979/2016, Art 27/1/e

⁸²Proc. No. 979/2016, Art 46/1/-/3/

taxpayer will be allowed to deduct expenses which are incurred to derive the income to the extent permitted by the income tax proclamation.⁸³

17. Employee expenses

If the taxpayer has employees who are working in the business, he is allowed to deduct the contribution which he made for pension or provident fund based on the relevant laws the country. But if the taxpayer voluntarily contributes more than what is stated in the relevant laws and contribute for employees' pension or provident fund more than 15% of the monthly employment income of the employee, then such excess expenditure is not deductible.⁸⁴

Medical expenses or premium paid for medical insurance policy by the employer for the benefit of the employee is considered as necessary expense of the business so the businesses income taxpayer is allowed to deduct such expenses.⁸⁵

Sometimes an employees of a taxpayer may receive guests outside the business premise and incur expense for that guest for the purpose of promoting and enhancing the business of the taxpayer. For this purpose the taxpayer may allocate representative expenditure and such expenditure of the taxpayer is allowed to be deducted only if it is not more than 10% of the employment income of the employee.⁸⁶

18. Insurance premium payments

If the business income taxpayer bought insurance policy for the business activity, the premium he paid to the insurer is considered as necessary expense so allowed to be deductible from the gross income of the business.⁸⁷

One precondition which can be set against such expense may be the nature of the business activity insured. Here what if the premium is paid for insurance against damage to the business asset like to the car, computer or photo copier? Since such equipment's are business assets, there is other rule to deduct expenses in relation to such business asset. i.e. depreciation rule. In other jurisdiction such premium is treated differently and those premiums which are paid to insurance for business activity other than business asset is deductible expense. So the business person may

⁸³ Proc. No. 979/2016, Art 74

⁸⁴ Proc No. 979/2016 Art. 27/1/c

⁸⁵ Reg. No 410/2017, Art 29

⁸⁶ Proc 979/2016 Art. 27/1/i

⁸⁷ Reg. No 78/2002, Art. 8/3/

buy insurance policy for the inventory it has. Such expense can be considered as deductible expense. But our income tax law doesn't differentiate the premium paid for the business asset from premium paid for other goods since it says all premiums paid in relation to the taxable business income will be allowed to be deducted from the business gross income.⁸⁸

To conclude, the income tax proclamation with its regulation is very detail in defining those conditions which needs to be meet for a given business expense to be benefited from deduction. So while assessing the taxable income of a given business income taxpayer, the Tax Authority is expected only to be governed by those preconditions set by the country's income tax legal regime.

⁸⁸ Ibid

CHAPTER FOUR

DEDUCTION RELATED CASES

In the previous chapter, I have tried to discuss the international as well as the local principles and conventions which need to be followed while allowing or denying deduction for business expenses. In this chapter I will try to analyze various cases which are decided by the Tax Review Committee of Addis Ababa City Administration Addis Ketema Branch Small Level Taxpayer's Revenue Offices, Addis Ababa City Administration Revenue Office Tax Review Committee. I will also try to analyze some cases decided by Addis Ababa City Administration Tax Appeal Commission, Addis Ababa City Administration Supreme Court Cassation Bench, and Federal Supreme Court Cassation Bench decisions concerning deductible business expenses. I tried to get some cases from Addis Ababa City Administration Large Level Taxpayers Revenue Branch Office and from Federal Revenue and Custom Authority Tax Review Committees but they refused to give cases by saying it is confidential (it is taxpayer's secret).

Before directly pass to assessing deduction related cases, I interviewed some officials from ERCA about the possible reason which is used by the Tax Authority to accept or deny deductibility of business expense. The first person with whom I have discussed on the issue is Ato Debelle Kabeta who is Branch Office Support and Supervision Directorate Director at ERCA. While discussing with Ato Debele, he said that among other pre conditions set by the tax laws of the country, failure of the business income taxpayer to collect VAT or failure to bring evidence which show the collection of VAT is one ground to deny deduction for those expense. According to him, while purchasing the materials which are necessary for deriving the taxable income if the taxpayer failed to collect or report the tax which they collect in the form of withholding, VAT and so on, then those expense will not be deducted from the business income.

The other person with whom I conducted interview on the issue of deductible expense is Ato Semma Tizazu who is the chairperson of Addis Ababa City Administration Tax Review Committee. According to Ato Semma, most of the time the claim brought to the tax review committees relates with business expense. He added that in the current world the business transaction is more dynamic and it is not possible to set the tax rules to be compatible with such

dynamic nature. By using this dynamic nature of business, some business income taxpayers try to use the loop whole in the tax law and reduce their tax obligation. So the tax law of the country should have some room for such dynamic nature of business.

Ato Semma added that the expense which is incurred for the purchase of goods which are necessary for deriving the taxable income may not be deducted when there is problem on the side of the seller. These problems may include the illegality of the receipt which is issued by the seller and the seller's failure to report his taxable income to the Tax Authority. The other instance is when the business income taxpayer purchase goods from business persons who are not obliged to use VAT receipt(category C taxpayers). In such a case those expense may not be allowed to be deducted since the receipt brought by the taxpayer is not acceptable by the Tax Authority.

Ato Habte Endayelalu is another person with whom I discussed on deductible expense issue. Ato Habte is Senior Tax Auditor at ERCA Large Level Taxpayer's Branch Office. According to him most of the time the self-assessment of business income taxpayer have problem with respect to deductible expense. Because the business income taxpayer try to reduce its tax obligation by using various means. Among those means increasing the expense of the business and reducing the profit margin are some of them. For this effect the taxpayer brings receipt which may not be accepted by the Tax Authority. Sometimes the taxpayer may bring exaggerated expense in relation to a purchase which have estimated market value. So to reduce such negative conduct of the taxpayers, the Tax Authority use various directives, circulars and authorized letters to decide on the deductibility of those expenses.

Having the discussions in mind lets assess various deduction related cases:-

1. VAT as Precondition on Deductibility of Business Expenses

In a case between W/ro Amsalework Abebe and Addis Ababa City Administration Revenue Office Addis Ketema Branch Small Level Taxpayers Office W/ro Amsalework brought her claim to the Tax Review Committee because the Tax Authority denied deductibility of expenses which are incurred for conducting the business activity in the year 2003 on the ground that she failed to report VAT.

The Tax Review Committee after hearing the case and assessing the evidence brought to it by both parties sustained the decision of the Tax Authority. In its ruling the committee argued that

since the taxpayer failed to report the VAT which she collected on behalf of the Tax Authority, she can't require deduction for the business expenses.⁸⁹

But as long as the taxpayer proved that the expense is incurred for deriving the business income, and fulfills the requirements of the tax laws, those expense should be deducted. Because failure to report VAT which she collected has its own consequences. So penalizing the taxpayer by denying deduction for her expense is not supported by the tax regime of the country.

In the case between Ato Elias Dinku Mohamod and Addis Ababa City Administration Revenue Office Addis Ketema Branch Small Level Taxpayers Office, the claim which was raised by Ato Elias relates with VAT issue. The Tax Authority denied the deductibility of expense which amounts Birr 115,273.56 for the year 2005E.C. The reason which was raised by the Tax Authority for denying deduction was because the taxpayer failed to report his VAT obligation. The Tax Review Committee after hearing the case sustained the decision of the Tax Authority in this regard by giving similar reasoning with the Tax Authority.

Such ruling of the Tax Review Committee is not supported by the tax rules of the country. As long as there is a valid receipt which show the expense, it should be deducted from the business income and the VAT issue should be treated separately.⁹⁰

On the case between Ato Shiferaw Zeleke and Addis Ababa City Administration Revenue Office Addis Ketema Branch Small Level Taxpayers Office, the Tax Authority denied the deductibility of expenses incurred by Ato Shiferaw in 2007 tax year because he failed to report his VAT obligation. According to the case, Ato Shiferaw was registered for VAT on April 5/2007E.C. So he was expected to collect VAT and made report to the Tax Authority starting from that date. The Tax Review Committee sustained the decision of the Tax Authority by saying as long as the

⁸⁹*W/ro Amsalework Abebe G/meskel Vs Addis Ababa City Administration Revenue Office Addis Ketema Branch Small Level Taxpayers Office*, Addis Ketema Branch Small Level Taxpayers Office Tax Review Committee, 19/7/2010E.C, File No 18634/2010, [unpublished]

⁹⁰*Ato Elias Dinku Mohamod Vs Addis Ababa City Administration Revenue Office Addis Ketema Branch Small Level Taxpayers Office*, Addis Ketema Branch Small Level Taxpayers Office Tax review committee, 17/06/2010E.C, File No 17259/2010, [unpublished]

taxpayer failed to report his VAT obligation after he is registered for VAT, the expense which are incurred in relation to those purchase shouldn't be deducted.⁹¹

But such ruling of the Tax Review Committee is not supported by the tax laws of the country. Furthermore the deduction issue shouldn't be linked with reporting VAT. If the taxpayer failed to report the VAT which he collected, he should be penalized by VAT rules and denying deduction by such reason and requiring the taxpayer to pay income tax, interest and penalty is not acceptable.

On the case between Ato Aliyu Armango and Addis Ababa City Administration Revenue Office Addis Ketema Branch Small Level Taxpayers Office, Ato Aliyu brought his claim to the Tax Review Committee because the Tax Authority deny the deductibility of business expense for the year 2006 not because it is not related with the business activity; rather because the taxpayer failed to discharge his obligation in relation to VAT. Because of the above reason the Tax Authority totally rejected the self-assessment report of the taxpayer and decided his tax obligation by estimation based on Article 48/2/ and Article 69 of Income Tax Proclamation No 286/2002 and Article 22/2/ of VAT Proclamation No 285/2002.

The Tax Review Committee after hearing the case sustained the decision on the Tax Authority.⁹² On its ruling the Tax Review Committee argues that the laws permit the Tax Authority to reject the self-assessment report of the business income taxpayer if it believes that the self-assessment report is not acceptable for any reason.

⁹¹*Ato Shiferaw Zeleke Vs Addis Ababa City Administration Revenue Office Addis Ketema Branch Small Level Taxpayers Office*, Addis Ketema Branch Small Level Taxpayers Office Tax review committee, 11/8/2010 E.C, File No 16492/2010, [unpublished]

⁹²*Ato Aliyu Armango Vs Addis Ababa City Administration Revenue Office Addis Ketema Branch Small Level Taxpayers Office*, Addis Ketema Branch Small Level Taxpayers Office Tax review committee, 8/8/2010 E.C, File No: 15247/2010, [unpublished]

As long as the expense which is incurred by Ato Aliyu is proved to be business expense, such expense should be deducted from the business income by accepting the self-assessment report. The conduct of the Tax Authority instead of accepting the self-assessment of the taxpayer, to decide the tax obligation by estimation when it believes that the self-assessment report of the taxpayer is not acceptable makes the taxpayers to lose their trust on the tax policy of the country. Because deciding the tax obligation of the taxpayer by estimation should be taken as the last resort.

2. The Legality of the Supplier as Precondition to Allow Deduction

In the case between W/ro Weynishet Bekele and Addis Ababa Medium Level Taxpayers Branch Office, the appeal was brought to Addis Ababa City Administration Tax Appeal commission against the decision of Kirkos Sub City Income and Custom Office Tax Review Committee by W/ro Weynishet Bekele who is engaged in Stationary business. . According to the appeal, the Tax Authority refused to accept some business expenses which were incurred in 2002 and 2003e.c tax year and decided to pay Birr 502,917.87/ five hundred two thousand nine hundred seventeen 87/100 Birr/ as business income tax and VAT Birr 340,635.00/ three hundred forty thousand six hundred thirty five Birr/. Furthermore the Tax Review Committee decided that W/ro Weynishet should pay penalty and interest.

According to the case W/ro Weynishet purchased various materials which were necessary for the business from a number of traders which are engaged in the business. The reason for denying deduction for the expense was not the nature of the expense rather it was due to the legality of the suppliers from whom the purchase was made. W/ro Weynishet argued that the failure of the suppliers to report their tax obligation shouldn't be ground to deny deduction for lawful expense.

The Tax Authority on its part argued that:-

- The transaction between W/ro Weynishet and Ato Biniam is invalid because Ato Biniam Bekele is accused of tax relation crime and the authority is not able to find him in his address. Furthermore the seller is the brother of the buyer and because of the family relation, there is risk of tax evasion in the transaction.
- The transaction between W/ro Weynishet and Ato Samuel is not accepted because the seller was accused of tax evasion and he becomes guilty.

- The transaction between w/ro Weynshet and Ato Tewdros is not accepted because even though the seller is allowed to print VAT sales receipt from No 001 up to 1000, and he collect income using 900 receipts, he failed to assess and pay his tax obligation and he is accused of tax evasion.

After hearing the case, the Tax Appeal Commission decides against W/ro Weynshet by arguing that the receipts which are brought by the taxpayer are not acceptable as legal since the sellers fail to assess and report their taxable income. Furthermore the sellers are accused of tax evasion. The other reason raised by the Tax Appeal Commission for its decision against W/ro Weynshet is three of the sellers from whom she purchased the goods doesn't have the evidence which proves they actually engaged in importing stationary materials.

But how can the failure of the seller to report and to pay his tax obligation be the ground for denying deduction for the buyer who in good faith incurred expense by purchasing goods from such supplier?

Whose responsibility is to check the legality of the seller? As business person it may be expected to check the legality of a given receipt. But once if the seller show the buyer the permission it gets to print the sales receipt from the Tax Authority, then the buyer shouldn't be responsible for the failure of the seller to assess and report its taxable business income or for the sellers engagement in illegal conduct. Such act of the Tax Authority is not supported by the tax laws of the country as it is transferring the responsibility of the Tax Authority on the shoulder of the buyer.⁹³

In the case between Ato Sinimegn Mihirete and Addis Ababa No 2 Medium Level Taxpayers Branch Office, the case was brought to the Tax Appeal Commission by Ato Sinimegn Mihirete because he was not satisfied by the decision of the Tax Authority on his self assessment report for the year 2002 up to 2006. According to the case Ato Sinimegn is engaged in auto spare part business in Nifas Silk Lafto Sub City and he brought the following claims:-

1. The Tax Authority denied the deductibility of expense incurred for the purchase of business goods for the year 2006 by arguing the receipts brought by the taxpayer which amounts to

⁹³*W.ro Weynshet BekeleVsA.A. Medium Taxpayers Branch Office* , Addis Ababa City Administration Tax Appeal commission, 2005E.C, File No- 0095/95/07 [unpublished]

Birr 347,000.00 are invalid because the seller failed to report the purchase value to the Tax Authority.

2. The Tax Authority denied expense incurred for business input for the year 2005 and 2006 which amounts to 855,901.08. Furthermore the Tax Authority refused to return the VAT paid by the business income taxpayer in relation to those purchase by arguing that the seller failed to report its Tax obligation.

The Tax Authority on its part argued that in relation to the deductibility of expense incurred for the purchase of business goods, since the seller of the goods never reported their tax obligation, the Tax Authority suspects such receipt is not valid. So the expense which is incurred for the purchase of those goods can't be deducted. In relation to the VAT return request by the taxpayer, the Tax Authority argued that since the sellers failed to report the VAT which they collect with respect to those purchases, the Tax Authority can't return the VAT to the taxpayer.

The Tax Appeal Commission after hearing the case sustained the decision of the Tax Review Committee on both cases by giving similar reasoning with the Tax Authority.⁹⁴

Such decision of the Tax Appeal Commission is not supported by the tax law of the country because the seller's failure to report the purchase value of the goods to the Tax Authority is not the responsibility of the buyer. In addition to this the seller's obligation to report the VAT which he collected shouldn't affect the deductibility of the expense incurred by the buyer since they are separate business income taxpayers.

3 Withholding as Precondition to Allow Deduction

The next case is brought from Addis Ababa City Administration Revenue Office Tax Review Committee. Since the committee require me not to mention the name of the business income taxpayer for the purpose of privacy and protecting the business secrete of the taxpayer, I will try to discuss the case without mentioning the name of the taxpayer. The case was brought by one taxpayer against the decision of Addis Ababa City Administration Revenue Office Medium Level Taxpayers Branch Office

⁹⁴*Ato Sinimegn MihreteVs Addis Ababa No 2 Medium Level Taxpayers Branch Office, Addis Ababa City Administration Tax Appeal Commission, 2008E.C, File No- 031/08 [unpublished],*

In this case the taxpayer brought about four claims against the decision of the Tax Authority one of which relates with the issue of this paper. According to the applicant, the Tax Authority denied the deductibility of business expense which was incurred for the repair work of its business asset which amounts to Birr 86,520.00 on 2006E.C tax year.

The Tax Authority in their part argued that the expense which the taxpayer incurred for the repair work is not deductible because while paying for the repair work, the taxpayer failed to withhold 2% from the total amount of payment made to the service provider.

The Tax Review Committee after hearing the case sustained the decision of the Tax Authority. On its ruling the committee gives the following reason:-

While conducting business, the business income taxpayer is presumed to know its obligation to withhold the 2% when it made payment to the service provider who has TIN Number. Even though the taxpayer argued that its failure to withhold the 2% is by mistake of the accountant, the committee doesn't accept such reason of the taxpayer. So the expense in relation to the repair work is not allowed to be deducted from the business income.

Such ruling of the Tax Authority is not supported by the tax laws of the country because it is not legal to deny deduction for the expense of the business income taxpayer in relation to repair work for the business asset for the ground of failure to withheld 2%. Failure to withheld 2% has its own legal consequence under the Income Tax Proclamation Article 97 sub article 3 and 4. So it was sound to accept the deductibility of the expense in relation to the repair work to the business asset and to penalize the business income taxpayer for its failure to withhold the 2% based on the current Income Tax Proclamation.⁹⁵

In another case between one business income taxpayer and Addis Ababa City Administration Revenue Office Addis Ketema Branch Small Level Taxpayers Branch Office, the taxpayer brought his claim to the Tax Review Committee because the Tax Authority denied the deductibility of expense amounts to Birr 17,200.00 which is incurred for the repair of photo

⁹⁵ *One TaxpayerVs Addis Ababa City Administration Revenue Office Medium Level Taxpayers Branch Office, Addis Ababa City Administration Revenue Office Tax Review Committee, 2007E.C, File No A.A,C.R.O.T.R.C 1658/2007. [unpublished].*

copier and printers which are parts of business asset in the year 2006 because the taxpayer failed to withhold the 2% tax from the payment for the service provider.

The Tax Authority on its part argued that as per the Income Tax Proclamation of the country, the taxpayer is expected to withhold 2% while he made payment to the service provider who has TIN number. Since the taxpayer doesn't fulfill the requirement of Income Tax Proclamation No 286/2002 Article 53 and Article 24/2/ j/ of Income Tax Regulation No78/2002, the expense which is incurred in relation to repair work is not acceptable.

The Tax Review Committee after hearing the case sustained the decision of the Tax Authority by giving similar reasoning.⁹⁶

The decision of the Tax Review Committee is not supported by the tax law of the country. And the tax authorities should treat deduction issues and other taxpayers obligation separately. Because failure to withhold has its own consequences as per the Income Tax Proclamation. So the business income taxpayer should be allowed to deduct those business expenses and the Tax Authority can penalize the taxpayer for his failure to withhold the necessary amount from the payment he made.

In addition to this while I am discussing with Ato Habte Endalemaw, who is tax auditor at ERCA about withholding issues he said that for a taxpayer who bring evidence which show payment of employee salary, the taxpayer should show the evidence which proves he withhold the necessary employment tax and made payment to the Tax Authority. According to the tax auditor, this precondition is also be applicable on branch - parent company expenses. In the globalization era the advancement of technology makes life easy in various aspect. One of the area which benefited from such advancement of technology is international business transaction especially companies which are engaged in trans boundary business. Such international companies may have their main office abroad and open branch office which has permanent

⁹⁶*DMC Plc Vs ,Addis Ababa City Administration Revenue Office Addis Ketema Branch Small Level Taxpayers Branch Office, Addis Ababa City Administration Revenue Office, Addis Ketema Branch Small Level Taxpayers Branch Office Tax Review Committee, 19/7/2008E.C, Case file No:- A/K/S/C/S/T/P/B/O/16378/2008. [unpublished]*

establishment in Ethiopia. In order to facilitate the branch office business the employees of the head quarter conduct various works while they are situated in the head quarter office. The branch office is expected to contribute some portion of its income for the salary of head quarter employees because without the support of the head quarter, the branch's business may not be effective.

According to Ato Endalamaw, as long as it is proved that the Branch company incurred expense for salary payment for the employees of the parent company, the branch is expected to withhold employment tax and if this is not fulfilled the expense incurred by the branch company for the parent company employees is not deductible

Such kind of pre-condition which is required by ERCA contradicts with the Income Tax Proclamation. Because according to the proclamation, employment tax will be imposed on employees who derived their employment income from Ethiopian source. For an employment income in order to be considered as Ethiopian source income, there are two options. The first one is when the employment service is exercised in Ethiopia, in this case the income of the employee is considered as Ethiopian Source income. The other option to consider a given employment income as Ethiopian Source is when the employer is the FDRE government. In this case even though the employee exercise his employment service in any country in the world, the employment income will be considered as Ethiopian Source income.⁹⁷ In these two cases the employer is obliged to withhold the employment tax by deducting it from the gross employment income based on the rate set by the income tax law.⁹⁸ Failure to withhold the employment tax has its own consequences. The law penalizes the employer who fails to withhold the employment income tax by requiring the employer to pay interest in addition to the expected employment income tax.⁹⁹

But if the employees of the head quarter are located in another country and they are serving the branch company with out coming to Ethiopia, then there is no legal ground to consider such income of the head quarter employees as Ethiopian source income

⁹⁷Proc.No. 979/2016, Art. 6/1/ A &B

⁹⁸Proc.No. 979/2016, Art. 10, Art. 11 and Art. 58

⁹⁹Proc.No. 979/2016, Art. 97

4 Receipt Legality as Precondition to Allow Deduction

In one case between one business income taxpayer and Addis Ababa Medium Level Taxpayers Branch Office, the taxpayer was engaged in construction business and he brought about 6 claims against the decision of the Tax Authority. Since the Tax Review Committee required me not to mention the name of the applicant, I will proceed to the case with out mentioning the name. One of the claims was in relation to deductibility of expenses which is incurred for the purchase of cement for Dilla project. According to the case the taxpayer was engaged in construction work and it signed a construction contract with the government. For the purpose of facilitating the project the government bought cement on behalf of the contractor and give it to the contractor for the construction work. The government deducted the expense which it incurred for the purchase of cement from the payment due to the taxpayer and write a letter for that effect. But the Tax Authority deny the deductibility of this expense because there is no receipt presented by the Taxpayer. The letter which was written by the government which proves the taxpayer incurred expense for the purchase of cement was not enough for the Tax Authority to accept such expense.

After hearing the case, the Tax Review Committee proposed a decision in the favor of the taxpayer since the letter which is written by the government that proves the purchase of cement is a valid evidence to consider the expense.¹⁰⁰

The ruling of the Tax Review Committee is supported by the Income Tax Proclamation of the country because as long as the taxpayer is able to prove the expense is incurred and such expense is verified by a valid evidence, the Tax Authority should accept such expense and deduct it from the business income of the taxpayer.

In the case between W/ro Weynishet Bekele and Addis Ababa No. 2 Medium Level Taxpayers Branch Office the appeal was brought by W/ro Weynishet Bekele The appeal was brought against the decision of Kirkos Sub City Income and Custom Office Tax Review Committee.

¹⁰⁰ *One Taxpayer Vs Addis Ababa City Administration Revenue Office Medium Level Taxpayers Branch Office, Addis Ababa City Administration Revenue Office Tax Review Committee, 2010E.C, File No A.A.C.R.O.T.R.C 1398/2009. [unpublished].*

According to the appeal, The Tax Authority refused to accept some business expenses which were incurred in 2002 and 2003e.c tax year and decided against the taxpayer to pay Birr 502,917.87/ five hundred two thousand nine hundred seventeen 87/100 Birr/ as business income tax and VAT Birr 340,635.00 /three hundred forty thousand six hundred thirty five Birr/. Furthermore the Tax Review Committee decided that W/ro Weynished should pay penalty and interest.

The case shows that W/ro Weynished purchased various materials which were necessary for the business from a number of suppliers who are engaged in the business. The reason for denying deduction for the expense was not the nature of the expense rather it was due to the legality of the receipts given by the sellers. According to the law, category A and B business income taxpayers and category C taxpayers who registered for VAT by their willing are obliged to use cash register machine for their sale and in case where the machine become defective, the seller is allowed to use sales receipt which is printed under the authorization of the Tax Authority. W/ro Weynished argues that she purchased the materials from lawful suppliers who are permitted to import the materials and for each purchase she received a cash receipt which is printed under the authorization of the Tax Authority.

The Tax Authority on its part argues that:-

1. Most of the receipt which is submitted by w/roWeynished is cash receipt
2. The transaction between W/ro Weynished and Ato Samuel is not accepted because the receipt given by Ato Samuel is preprinted/ which is not authorized by the Tax Authority/.
3. The transaction between W/roWeynished and Ato Suleyman Musa is not accepted because the receipt given by the seller is not acceptable since the Tax Authority doesn't authorize Ato Suleyman to print the receipts which he gave to W/ro Weynished.

After hearing the case, the Tax Appeal Commission decides against W/ro Weynished by arguing that some of the receipts brought by W/ro Weynished is illegal since the Tax Authority didn't give any permission to print those receipts. The other reason raised by the Tax Appeal Commission for its decision against W/ro Weynished is most of the receipts which are submitted by W/ro Weynished is cash receipt which should only be used when the cash register machine is in fault,

or electric power failure. In addition to this the Tax authority argued that in order to use the cash receipt, the taxpayer should inform and get the consent of the Authority.¹⁰¹

The later decision of the Tax Appeal Commission is not supported by the laws of the country because as long as the receipt which is submitted by the taxpayer is printed under the authorization of the Tax Authority, Such receipt should be taken as a valid evidence for the expense which is incurred by the taxpayer since the Receipt Directive permits to do so. The only thing which needs to be proved is whether there was a valid reason to use the cash receipt instead of cash register machine.¹⁰² With respect to the receipt submitted by the taxpayer which is not printed under the authorization of the Tax Authority, the decision of the Tax Appeal Commission is supported by the tax rules of the country.

In the case between Engineer Werku Mekonin's heirs guardian W/ro Genet Ersido and Bole Sub City Revenue Office, the case was initially brought to Addis Ababa City Administration Tax Appeal Commission by W/ro Genet against the decision of Bole Sub City Revenue Office Tax Review Committee. The Tax Authority as well as the Tax Review Committee denied the deductibility of some expenses because of the following reasons:-

1. Legality issue on the receipt which is submitted by the taxpayer for the purchase of cement, sand and other construction materials.

According to the case the taxpayer was engaged in construction work at rural area of the country during 1990s according to Ethiopian calendar. While working his construction work, the taxpayer needs to purchase cements, sand, and other construction materials which were necessary for the construction project. But around the construction site it was not possible to find suppliers which sell those construction materials by giving printed receipt. The custom in that area and other similar area of the country was to give a paper receipt which is prepared by the seller without any stamp on it (sometimes the seller may use a stamp which simply say "paid"). At the end of the tax year, while the taxpayer is assessing its tax obligation, the taxpayer deducted these expenses which were incurred to generate taxable income and reported its taxable

¹⁰¹ *W.ro Weynished Bekele Vs Addis Ababa City Administration Revenue Office No. 2 Medium Taxpayers Branch Office*, Addis Ababa City Administration Tax Appeal Commission, 2005E.C, File No- 0095/95/07 [unpublished]

¹⁰² *Final Receipt Directive No 110/2016*, Ethiopian Revenue and Customs Authority, article 8 [unpublished]

in come to the Tax Authority. Even though those expenses were necessary to derive the taxable income of the business, the Tax Authority deny the deductibility of these expenses due to the legality of those receipts and considers those expense as taxable income of the taxpayer and require the taxpayer to pay income tax, interest and penalty .

2. The expense which is incurred by the taxpayer for the repair work of construction trucks were not acceptable by the Tax Authority because the receipt doesn't show the Plate No of the truck. Even though the receipt brought by the applicant shows the Chassis No of the truck which can prove the owner of the car in a better way, it was not enough for the Tax Authority to accept it and allow deduction for such expense.
3. The expense which was incurred by the taxpayer for the purchase of fuel for the construction trucks were note acceptable by the Tax Authority because the name of the owner of the truck was not mentioned in the receipt. Showing the Plate No of the truck was not enough for them to allow deduction for such expense.

The Tax Appeal Commission after hearing the case, and investigating various evidences, reversed the decision of the Tax Review Committee and decided in favor of the taxpayer on all of the three issues on February 13/1999E.C with file No W-17. Even though the Tax Authority brought its appeal by file No7813 to the Federal High Court by being dissatisfied by the decision of the Tax Appeal Commission, the Federal High Court sustains the decision of the Tax Appeal Commission on July 25/2003E.C. Again the Tax Authority brought the case to the Federal Supreme Court by appeal by file No13085. The Federal Supreme Court after hearing the case reversed the decision of the lower courts and decides in favor of the Tax Authority on February 3/2004 E.C-. The reason for its ruling was the legality of those receipts.

The taxpayer was dissatisfied with the decision of the Federal Supreme Court and brought the case to the Federal Supreme Court Cassation Bench by file No14699 by arguing that the decision of the Federal Supreme Court has basic error of law. After hearing the case, the Federal Supreme Court Cassation Bench reversed the decision of the Federal Supreme Court and sustains the decision of the Federal High Court and the Tax Appeal Commission. While deciding the case the cassation bench gives the following reasons for its ruling:-

1. With respect to the first case, the paper receipt which is brought by the taxpayer should be acceptable by taking in to consideration the construction work was done at rural area and at the time of the construction project, the business practice and the custom shows that such paper receipts were serving as a valid receipt. According to the Income Tax Regulation No 258/55 Article 29, which was the governing law at the time, it requires the taxpayer to bring real financial documents and vouchers. According to the cassation bench, the main purpose of this article is to prove the expense are incurred to derive the taxable income and control the taxpayer from bringing forged documents for the purpose of tax evasion. But extending its purpose to include controlling document preparation procedure will affect the very purpose of the tax law.

So as long as the receipt brought by the taxpayer proves that the expense is incurred for the purpose of deriving the taxable income, there is no legal ground to deny deduction for such expenses by setting procedural preconditions.

2. With respect to the expenses in relation to construction truck repair work, it is not sound to deny deduction for such expenses only because the Plate No of the truck is not mentioned in the receipt. The existence of the Chassis No is more acceptable to show the owner of the truck. So this expense should be deductible.
3. With respect to the third case the fuel expense which is incurred by the applicant for the construction truck should be deductible as long as the receipt shows the Plate No of the truck. Setting additional precondition to write the owner of the truck on the fuel receipt is not acceptable.

Because of the above reasons, the Federal Supreme Court Cassation Bench on its session on the date 7/3/1998E.C reversed the decision of the Federal Supreme Court and sustains the decision of the Federal High Court and the decision of the Tax Appeal Commission.¹⁰³

¹⁰³Engineer WerkuMekonin's heirs guardian W/ro Genet ErsidoVs Bole sub city revenue office, Federal Supreme Court Cassation Bench, 1998E.C File No – 14699, in የፌዴራል ጠቅላይ ፍርድ ቤት ሰበር ሰሚኒሎች ሰው ጥያቄዎች፣ ቅፅ 3፣ የኢ.ፌ.ዴ.ሪ ጠቅላይ ፍርድ ቤት፣ አዲስ አበባ፣ 1998 ዓ.ም፣ ገፅ 110-113.

The decisions of the Federal Supreme Court cassation bench on each issue is acceptable as it is supported by the tax laws of the country. What is more with respect to fuel cost incurred for the construction truck, there was no standard fuel station receipt and any fuel stations were using their own format to prepare the receipt. So the Tax Authority shouldn't expect the taxpayers to fulfill criteria which it doesn't set in the first place.¹⁰⁴

In the case between Ato Sinimegn Mihrete and ERCA Addis Ababa Medium Level Taxpayers Branch Office the case was brought to the Federal Supreme Court Cassation Bench by Ato Sinimegn Mihrete by arguing that the Addis Ababa City Administration Tax Appeal Commission, the Addis Ababa City Administration Supreme Court and Addis Ababa City Administration Supreme Court Cassation Bench made basic error of law while deciding against his appeal on the decision of the Tax Review Committee on the deductibility of certain expenses for the period from 2002 up to 2006 tax year by raising receipt legality issues.

The taxpayer argued that it is not logical to accept the self-assessment report in relation the collected VAT but denied the deductibility of expenses which are the reason to collect the VAT. The Tax Authority on its part argued that since the receipt brought by the taxpayer is not supported by cash register receipt, it is not possible to allow deduction for such expense. Because the supplier doesn't report to the Tax Authority about the problem of the cash register machine at the time of the sell which was made to the taxpayer.

The Federal Supreme Court Cassation Bench division after hearing the case sustains the decision of the lower court by saying since the case of the receipt is issue of fact, there is no basic error of law on the decision of the lower courts.

But accepting the self-assessment report of the taxpayer with respect to the VAT he collected on the one hand and denying deduction for the purchase which is the main cause for the collected VAT on the other hand shows failure of the tax administration system of the country.¹⁰⁵

¹⁰⁴*Final Receipt Directive No 110/2016*, Ethiopian Revenue and Customs Authority, article 32 [unpublished]

¹⁰⁵*Ato Sinimegn MihreteVs ERCA A.A. medium level Taxpayers branch office*, Federal supreme court cassation bench division ,2010E.C, File No 138671 [unpublished]

5. Purchase from Category C Taxpayer as a Restriction to Deny Deduction

In the case between Ato Alemu Jebo and Addis Ababa City Administration Revenue Office Addis Ketema Branch Small Level Taxpayers Office, the applicant brought his case against the decision of the Tax Authority because it denied the deductibility of transport expense, depreciation cost and other expense amounts to 157,239.40 for the year 2007

The Tax Authority on its part argued that with respect to the expense incurred in the year 2007 especially the receipt brought by the taxpayer for the purchase of the depreciable asset, it is not acceptable not because it is not proved properly instead it is because the purchase was made from category C taxpayer, which doesn't have obligation to use receipt. So the expense in relation to such purchase is not deductible. The Tax Review Committee after hearing the case sustains the decision of the Tax Authority by giving similar reasoning.

But as long as the taxpayer is able to prove the expense incurred, he should be allowed to deduct those expense. Since the Receipt Directive of the country sets conditions on how to purchase goods from category C taxpayer, as long as the preconditions are fulfilled, the expense should be deducted from the gross income of the taxpayer.¹⁰⁶

The case between Ato Sinimegn Mihirete and Addis Ababa No 2 Medium Level Taxpayers Branch office was brought to the Federal Supreme Court Cassation Bench division by the Ato Sinimegn by arguing that the Addis Ababa City Administration Tax Appeal Commission, the Addis Ababa City Administration supreme Court and Addis Ababa City Administration Supreme Court Cassation Bench made basic error of law while deciding against his appeal on the decision of the Tax Review Committee on the deductibility of certain expenses by the ground of the status of the supplier, VAT related issues and personal expenses for the period from 2002 up to 2006 tax year.

The taxpayer on his cassation bench application argued on two grounds. The first argument is as per article 2/11/ of the former Income Tax proclamation and Article 8/11/ of the former Income

¹⁰⁶ *Ato Alemu Jebo Vs Addis Ababa City Administration Revenue Office Addis Ketema Branch Small Level Taxpayers Office*, Addis Ababa City Administration revenue Office Addis Ketema Branch Small Level Taxpayers Office Tax Review Committee, 3/52008E.C, Case file No:- A/K/S/C/S/T/P/B/O/14572/2008 [unpublished]

Tax regulation, in order to get the taxable income of the business, it is a must to deduct all business expense and other deductible expenses which are incurred for deriving the taxable income. Furthermore as per article 20, as long as the taxpayer is able to prove his business expense, such expenses should be deducted. Based on these articles the taxpayer argued that he purchased the spare parts from a category C supplier who sell various spare parts for the public and he brought a valid receipt for his purchase. Not accepting the receipts which proves the expense is illegal.

The Tax Authority on its part argued that as the taxpayer is engaged in auto spare part sell business, he is expected to purchase the spare parts either from manufacturers or importers. So instead of purchasing from category C suppliers, the taxpayer is expected to bring receipts from category A or category B suppliers. The Federal Supreme Court Cassation Bench on its ruling on 25/5/2010E.C, ruled by sustaining the decision of the lower courts. On its ruling the Cassation Bench argued that the issue of receipt legality is a matter of fact and the cassation bench is mandated only to look the issue of error of law. So on the case at hand the issue is not the acceptability of the expense incurred by the applicant. The expense is not denied by the Tax Authority; what is denied is the status of the supplier. So it is issue of fact which is not the mandate of the cassation bench since on issue of fact the decision of the Tax Appeal Commission is final, there is no legal ground for the cassation bench to look on such issue of fact.¹⁰⁷

The decision of the Federal Supreme Court Cassation Court is correct because the status of the supplier is not issue of law. But especially the Tax Appeal Commission and the Addis Ababa City Administration Supreme Court should accept the receipt which is brought by the taxpayer. There is no legal limitation which obliged business income taxpayers who engaged in auto spare parts business to purchase the spare parts only from manufacturers or whole sellers. By doing so the Tax Authority brings additional precondition on the deductibility of business expense. Such additional criteria adversely affect the taxpayer since the intention of article 2/11/ and article 20 of the former Income Tax Proclamation No 286/2002 and article 8/1/ of the former Income Tax Regulation No 78/2002/ is not denying deduction for such reasons. So the receipt which is given by category C taxpayer should be acceptable evidence to deduct those expenses.

¹⁰⁷*Ato Sinimegn MihreteVs ERCA A.A. medium level Taxpayers branch office, Federal supreme court cassation bench division ,2010E.C, File No 138671 [unpublished]*

6. Other Reasons to Deny Deduction

On the case between Ato Elias Dinku Mohamod and Addis Ababa City Administration Revenue Office Addis Ketema Branch Small Level Taxpayers Office, the taxpayer brought various claims among which some relates to the deductibility of expenses which is incurred for repairing the business house which is about Birr 262,780 on the year 2006E.C. The Tax Authority deny this expense not because it is not evidenced by proper document nor it is because above the percentage limit permitted by the tax law, rather it is because the business house is government house. The Tax Review Committee after hearing the case decided in the favor of the Tax Authority by giving similar argument with the Tax Authority.

Such decision of the Tax Review Committee is not supported by the tax rules of the country because as long as the house is used for conducting the business activity and it was essential to repair the house for the purpose of increasing the income of the business activity, the expense which is incurred for repairing the business house should be considered as an expense incurred for deriving the taxable income so it should be deductible. The only precondition which can be set against deductibility of such expense should be checking whether the business income taxpayer has a valid house rent contract with the concerned government authority. So the expense incurred for such repair work should be allowed to be deducted from the business income of the taxpayer as long as it doesn't exceed the legal limit.¹⁰⁸

In the case between one business income taxpayer and Addis Ababa No 2 Medium Level Taxpayers Branch Office, the business income taxpayer is engaged in export business. He brought his claim against the decision of the Tax Authority which is made on his self assessment report for the year 2004E.C. On his application the taxpayer require the Tax Review Committee to review 8 decisions of the Tax Authority among which one of them relates with deductible expense which is the concern of this paper.

According to the case the Tax Authority deny the deductibility of expense incurred for the purchase of 1900 Quintal Sesame. The reason to deny deduction for such expense is the taxpayer's failure to post the sell of the Sesame on ledger. After hearing the case the Tax Review

¹⁰⁸ *Elias Dinku MohamodVsAddis Ababa City Administration Revenue Office Addis Ketema Branch Small Level Taxpayers Office, Addis Ababa City Administration Revenue Office Addis Ketema Branch Small Level Taxpayers Office Tax Review Committee,17/06/2010E.C, File No 17259/2010, [unpublished]*

Committee proposed the following decision:- As long as the Tax Authority considered the sell of 1900 Quintal Sesame, it should also consider the expense which is incurred for the purchase of 1900 Quintal Sesame since there is no sale without purchase.¹⁰⁹

The decision of the Tax Review Committee is supported by the tax laws of the country. The Tax Authority should accept the document which evidenced the purchase of the Sesame and the taxpayer's failure to post the sell of the Sesame should be treated separately.

In another case between one taxpayer and Addis Ababa No 2 Medium Level Taxpayers Branch Office, the taxpayer brought about 6 claims to Addis Ababa City Administration Revenue Office Tax Review Committee against the decision of the Tax Authority. But I will focus on the claims which are the concern of the paper which was about expenses which are considered as account receivable. The Tax Authority deny the deductibility of these expenses by saying it is exaggerated without any legal ground. But the financial statement of the taxpayer clearly show such expense as accrued income of the taxpayer.

The Tax Review Committee after hearing the case propose the reversal of the decision of the Tax Authority since such expenses should be accepted as long as it is proved by valid evidence.¹¹⁰ The decision of the Tax Review Committee is acceptable since it is supported by the tax laws of the country.

In the case between Ato Anbese Tadesse and Merkato No 1 Small Level Taxpayers Branch Office, the case was initially brought to Addis Ababa City Administration Tax Appeal Commission by Ato Anbese Tadesse. The case was brought on the deductibility of administrative expenses which amounts Birr 96, 1961.88 which are incurred in relation to the business activity. According to him the Tax Authority as well as the Tax review committee denied the deductibility of these administrative expenses by arguing it is already considered while considering the overall expense of the business activity. The taxpayer on his part argued that since he brought a valid evidence which proves the administrative expense incurred in

¹⁰⁹ *One Taxpayer Vs Addis Ababa City Administration Revenue Office Medium Level Taxpayers Branch Office*, Addis Ababa City Administration Revenue Office Tax Review Committee, 2007E.C, File No A.A,C.R.O.T.R.C 2257/2007. [unpublished].

¹¹⁰ *One Taxpayer Vs Addis Ababa City Administration Revenue Office Medium Level Taxpayers Branch Office*, Addis Ababa City Administration Revenue Office Tax Review Committee, 2010E.C File No A.A,C.R.O.T.R.C 1560/2010. [unpublished].

relation to the business activity, the Tax Authority should accept those expense and deduct it from the business income. Because deciding the business expense by estimation should not be the first priority for the Tax Authority. The Tax Authority on its part argued that since the self-assessment report of Ato Anbese is not acceptable by the Tax Authority, the tax obligation of Ato Anbese is decided by estimation based on the Income Tax Proclamation rules. In addition to this while deciding the Tax obligation of the taxpayer, the Tax Authority has already considered the overall expense in relation to the business activity in the tax year. So it is not legal to require additional deduction for those administrative expenses.

The Tax Appeal Commission after hearing the case reversed the decision of the Tax Review Committee and decided in the favor of Ato Anbese by arguing that as long as the taxpayer is able to prove his administrative expense, it should be allowed to be deducted from the business income. The Tax Authority brought its appeal to Addis Ababa City Administration Appellate court against the decision of Addis Ababa City Administration Tax Appeal Commission but the appellate court sustained the decision of the Tax Appeal Commission by giving similar reasoning with the commission. The Tax Authority once again brought the case to Addis Ababa City Administration Appellate Court Cassation Bench by claiming the administrative expense shouldn't allowed to be deducted again as it is already considered with other expense by estimation.

The Addis Ababa City Administration Appellate Court Cassation Bench after hearing the case reversed the decision of the lower courts and decided in favor of the Tax Authority by giving similar argument with the Tax Authority.¹¹¹

The surprising thing is while applying to the Addis Ababa City Administration Appellate Court Cassation Bench; the Tax Authority doesn't show the existence of basic error of law on the decision of the lower courts. But as the jurisdiction of the cassation bench is limited to question of law, such fact based application shouldn't be accepted by the cassation bench. Furthermore as the taxpayer provided a valid evidence which show the expense which he incurred for the administrative cost, such expense should be deducted from the estimated business income so the

¹¹¹*Merkato No 1 Small Level Taxpayers Branch Office Vs Ato Anbese Tadesse*, Addis Ababa City Administration , Addis Ababa City Appellate Court Cassation Bench, 2010E.C, file No 27913, [unpublished]

decision of the Addis Ababa City Administration Appellate Court Cassation Bench is not supported by the tax laws as well as the procedural laws of the country.

From the above cases we can understand that the Tax Authority denied the deductibility of business expenses by setting criteria which doesn't have legal support. Even though the taxpayers properly proved the expense is incurred for the purpose of conducting the business, the Tax Authority required the taxpayer to full fill additional criteria. It is obvious that failure to report VAT or failure to withhold the necessary tax has its own consequences under VAT proclamation and the income tax law. But raising such failure as ground to deny deduction for business expense adversely affects the taxpayer. What is more while the current income tax proclamation is in the draft stage, the drafter included such failure of the taxpayer to withhold from the payment he made as one ground to deny deduction for that expense.¹¹²

According to the cases the other grounds which are used by the Tax Authority to deny deduction is the failure of the supplier from whom the taxpayer purchased the business goods. Such failure of the supplier is may be failure to discharge its tax obligation. In such a case instead of denying deduction the taxpayer which purchased goods from such supplier, the Tax Authority should stick on the supplier of the goods and obliged to discharge its tax obligation. Since the supplier is selling the good for the public by fulfilling the legal requirements, the Tax Authority shouldn't pressurize the business income taxpayer because the Tax Authority is in a better position to control such failure of the supplier.

If the tax administration system of the country was strong, it was easy for the Tax Authority to control and supervise the conduct of business income taxpayers. But the above case shows that the Tax Authority imposes its own obligation on the shoulder of the business income taxpayer. Because any illegal act of the supplier including tax evasion should be controlled by the Tax Authority. As long as the business income taxpayer in good faith purchased the business goods by fulfilling the legal requirements, they shouldn't be denied the deductibility of their expense and the Tax Authority should accept those expenses in one hand and search and penalize the supplier of the goods for its illegal conduct.

¹¹² The Draft Income tax proclamation, 2016Art 27/2/ [unpublished]

The other thing which needs to be stressed is the issue of receipt. The tax laws of the country including the receipt directive sets detailed rules about when and where we can use various kinds of receipts. The receipt directive clearly stated that taxpayers can use cash receipt which is printed under the authorization of the Tax Authority when the cash register machine is not working due to power failure, the failure of the cash register machine or when the cash register machine is under maintenance. If one of the above requirements is fulfilled, the law permits to use cash receipt which is printed under the authorization of the Tax Authority. But practically as we can infer from the cases, the Tax Authority deny deduction for business expenses which are proved by cash receipt. What is more the Tax Authority sets additional criteria by requiring the supplier in order to use the cash receipt, they should inform and get the consent of the Tax Authority. But given the electric power situation of the country, as it is usual to experience power failure now and then requiring the taxpayers to get the consent of the Tax Authority at each power failure to use cash receipt is not only illegal but also not feasible to be applicable.

We have seen also the Tax Authority denied the deductibility of business expense for the expense which was incurred by the taxpayer to purchase business goods from category C Taxpayers. But as long as such category C taxpayers are conducting their business by fulfilling the legal requirements, the expense which is incurred by business income taxpayer by purchasing business goods from such category C taxpayer should be deductible since the tax law permits to do so.

The other thing which I want to address is with respect to the decision of the Tax Authority to reject the self-assessment of the taxpayer and opt to decided the tax obligation of the taxpayer by estimation. In this regard the Tax Authority adversely used article 48 and article 69 of the former Income Tax Proclamation which permit the Tax Authority to decide the tax obligation of the taxpayer by estimation when it believes for any reason that the self-assessment of the taxpayer is not acceptable. If such option of the Tax Authority is used without any restriction it adversely affects business income taxpayer and it can be taken as one ground for the failure of the tax policy of the country.

CHAPTER FOUR

CONCLUSION AND RECOMMENDATION

1. Conclusion

Setting detailed and clear deduction rule and committed to be governed by those rules is the main thing to have proper tax administration system. From the discussions in chapter two and three, we can infer that the tax rules and other legislations of the country have detail rules on deducting business expenses. the income tax proclamation categorized business expenses in to three.

The first category dealt with business expenses which can be deducted without requiring additional precondition other than documentary evidence. In principle the law permit any expenditure which was necessary to derive, secure and maintain the business income to be deducted from the business income of the taxpayer in the tax year. The other business expense for which deduction is allowed without any precondition is the cost incurred by the taxpayer for the disposal of trading stock. The cost which is incurred for the purchase of depreciable assets and business intangibles is another business expense which is allowed to be deducted from the business income based on the depreciation rules. If the taxpayer incur loss on the disposal of business asset other than trading stock, then such expense can be deducted without additional precondition

The government for various policy reasons may deny the deductibility of certain kinds of business expenditures. Business expenditures that has capital nature /except depreciable assets and business intangibles/, an expense which is incurred for increasing the share capital of the company or for increasing the basic capital of a registered partnership are denied the benefit of deduction. In addition to this dividend payment made to share holders or paid out profit share by the taxpayer and personal consumption expenditures are also in the category of non deductible expenses. Expense incurred for fine, penalty of punitive damage are not deductible since the taxpayer is expected to obey the rules and regulations of the country and other contractual obligation for which the taxpayer is a party. Income tax paid by the taxpayer and expense in

relation to recoverable value added tax are some of the non deductible expenses listed in the income tax of the country.

The third category of business expenses which are described in the tax laws of the country are business expenditures for which the taxpayer required to fulfill certain precondition in order to deduct such expenses. Interest payments, charitable donations, expense in relation to loss carry forward, expenses in long term contracts, expense incurred in relation to bad debts and expenses incurred by taxpayers which are engaged in mining or petroleum operation business are some kinds of business expenses which needs the fulfillment of certain preconditions. In addition to this we have discussed the issue of documentation and receipt which may serve as a tool to prove the existence of the expenditure

So we can conclude that the national tax rules described the issue of deduction in detail and it clearly described expenses which needs to be supported by preconditions. Such rules should be enough for the business income taxpayer to be allowed or not to deduct its business expense.

But from most of the cases discussed under chapter four, we have seen the Tax Authority deny deduction for the expense incurred by the taxpayer not because the expense was not necessary to conduct the business; but it is due to the seller's failure to discharge his tax obligation. Denying deduction for expense incurred by the business income taxpayer due to the taxpayer's failure to report VAT is another fact which we have experienced from the analyzed cases. From the analyzed cases, we have seen also the Tax Authority deny deduction for business expense on the ground of failure of the taxpayer to withheld 2% from the payment it made.

The other reason set by the Tax Authority to deny deduction which is practiced in the analyzed cases is the issue of receipt legality. We have practiced that the taxpayer is denied deduction for their purchase which is made by using cash receipt which is printed under the authorization of the Tax Authority. The other additional precondition which is raised by the Tax Authority in relation to receipt issue is denying the acceptability of receipts which are given to the taxpayer by category C taxpayer who doesn't have legal obligation to use VAT receipt. We have practiced also restricting the sellers from whom the business income taxpayer should purchase his business goods.

In most of the cases which are discussed under chapter four, we have seen that the tax review committees decided in favor of the Tax Authority. One possible reason for such result is because the accountability of the tax review committee is to the Tax Authority. In addition to this the composition of the tax review committee members plays a huge role for this result. Because treating tax related issues need multi discipline knowledge including, accounting and legal knowledge.

To conclude even though it is believed that the only source of rules for the Tax Authority to accept or deny should be the tax laws of the country, according to the analyzed cases in chapter four, we can conclude that the Tax Authority sets additional precondition on the deductibility of expense for business income taxpayers. Such unlawful conduct of the Tax Authority discourages business income taxpayers and affect their role in participating in the country's economic development. But as the country is struggling to attract foreign investors by enacting various laws with incentives and tax holiday provisions. Similarly in order to attract foreign direct investment, the country's tax administration system should be clear as much as possible. The Tax Authority itself should be governed by the tax laws of the country. While doing business, the business income taxpayer should be informed what kind of expenses are allowed to be deducted. While allowing or denying deduction for a given business expense the only tool should be the law.

2. Recommendations

Based on the findings of this research I would like to recommend the following recommendations for the tax administration system of the country:-

1. Since the tax administration system of the country is not well organized, it is practiced that similar expense may be allowed to be deducted in one branch of the Tax Authority and denied by the other. Such kind of tax treatment may adversely affect one of the tax policy of the country which is nondiscrimination. So while implementing the tax administration law of the country, the tax administration system should be organized to avoid such discriminatory treatment of the Tax Authority.

2. The Tax Authority must create its own efficient system to supervise and regulate suppliers who failed to discharge their obligation instead of imposing its own obligation on the shoulder of the taxpayers.
3. The composition of the Tax Review committee members should be revised so as to include the representatives of the business community. In addition to this the composition of tax review committee members should consider diversified knowledge.
4. In order to reduce direct or indirect influence of the executive organ on the Tax Appeal Commission, it is better to make the accountability of the Tax Appeal Commission to the House of peoples representatives instead of the prime minister.
5. As the country is struggling to achieve its goal to be middle income country by the year 2017E.C, the country's tax administration system should be well organized so as to attract more foreign direct investment. The preconditions which can be set against the deductibility of business expense incurred by the business income taxpayer shall emanates only from the tax laws of the country.
6. The Tax Authority should empower its personnel with tax principles and tax rules in order to avoid or reduce the subjectivity of those personnel while treating taxpayers with respect to the deductibility of business expense.
7. The attitude of the Tax Authority should needs to be changed. Because from most of the cases which I have seen especially when we look the arguments of the Tax Authority, it seems usual in the Tax Authority to consider most of the business income taxpayer as persons who engaged in tax evasion. This attitude is the main reason to deny deduction for business expense. But the dream of the country will not be come true without the participation of the business income taxpayers. So it is better to change such attitude of the Tax Authority and the authority should consider the business income taxpayers as economic development partner.

INTERVIEW QUESTIONS

Interview questions to Ato debelle Qabetta who is Branch Office support and Supervision directorate director

1. What are the preconditions required by ERCA to allow the deductibility of business expenses?
2. Is there any other criteria other than the tax rules and other relevant legislations which may be used while checking the deductibility of certain business expenses?

Interview questions to Ato Semma Tizazu who is the chairperson of Addis Ababa City Administration tax review committee

1. As you are the chairperson of the tax review committee, what kinds of claim raised by the taxpayers most frequently?
2. Most of the time the business income taxpayers brings their claim to the tax review committee with respect to deduction issues. What is the main reason for this?
3. What are the frequent reasons raised by the Tax Authority to deny the deductibility of certain business expenses?

Interview questions to Ato Habte Endalamaw who is Senior tax auditor at ERCA large level taxpayers branch office.

1. While auditing the self assessment report of business income taxpayers, what kinds of problems you face frequently?
2. What are your legal source which are used in auditing the self assessment report of taxpayers?
3. In case when a branch office which has permanent establishment in Ethiopia incur expense for the salary of the head quarter employees who are located abroad. The expense was incurred because the head quarter employees even though they were located in another country, they were serving the branch office to generate the taxable business income. How do the Tax Authority treat such expense?

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V. Interviewees

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2. Interview with Ato Semma Tizazu
3. Interview with Ato Habte Endalamaw