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ADDIS ABABA UNIVERSITY SCHOOL OF GRADUATE STUDIES LLM PROGRAM IN BUSINESS LAW

Estimated Business Income Tax Assessment of Companies with Books of Account under the Federal Tax System of Ethiopia, Law and Practice

**A Thesis Submitted to the School of Law of Addis Ababa University in Partial Fulfillment
of the Requirement for the Master of Laws (LLM) Degree in Business Law**

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September, 2024

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(Approval Sheet)

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Declaration

I, the undersigned, declare that this thesis is my original work, and has not been presented for a degree in any other university, and that all sources of materials used for the thesis have been fully acknowledged.

Teka Mehari Hagos

Abstract

The presumptive tax assessment has two major areas of application. These are estimated tax assessment and standard assessment. The former applies for assessment taxpayers whereas the later applies for small and informal businesses. To express it in the other ways, standard assessment applies for category C taxpayers and estimated tax assessment for category A and B business income taxpayers. Estimated business income tax assessment is designed for taxpayers with the duty to maintain books of accounts. The standard assessment model, on the other hand, is intended to the small taxpayers who are relieved from the duty to keep books of account. The estimated business income tax assessment method is commonly applied in the federal tax system of Ethiopia. It however has not received the attention it deserves in Ethiopian legal education and the tax administration. This however needs to change instantly for the better if Ethiopia is ever going to fulfill its growing need to build a modern and efficient tax administration capable of raising the revenues generated by the economy and preventing arbitrary taxation. The existence of some income tax and tax administration laws incorporating relatively extensive provisions on estimated tax assessment under the federal tax system can be seen as one important leap in this regard.

To do its own humble part, this research paper attempts to bring the concept of business income tax assessment to the spotlight by focusing on the issue of estimated business income tax assessment of companies with books of account under the federal tax system of Ethiopia. In so doing, the research shows the important areas where the Ethiopian estimated business income tax assessment rules and the practical estimated tax assessment of companies with books of account in the federal tax system of Ethiopia fall short of. It then concludes that the gaps existing in the rules and the practice are too significant to be ignored and could lead to failure in realizing Ethiopian tax policy objectives. The research finally recommends some key solutions in order to fill the gaps already identified.

Acronyms

Art	Article
Arts	Articles
COM.C	Commercial Code
EC	Ethiopian Calendar
Ed	editor/edition
Ed's	editors/editions
FDRE	Federal Democratic Republic of Ethiopia
FITP	Federal Income Tax Proclamation
FTAP	Federal Tax Administration Proclamation
GC	Gregorian Calendar
LTO	Large Taxpayers Branch Office
L.REV	Law Review
MOF	Ministry of Finance
MOR	Ministry of Revenues
No	Number
P.	page
Plc.	Private Limited Company
STO	Small Taxpayers Branch Office
Pp.	Pages
VAT	Value Added Tax
Vs.	Versus

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CHAPTER ONE

Introduction

1.1 Background of the Study

Taxes are levied in almost every country of the world, primarily to raise revenue for government expenditures, although they serve other purposes as well. The history of taxation is as long as the history of governments. Governments were and are imposing and collecting taxes in different forms and modalities. Taxation in Ethiopia obviously has similar purposes and functions like other countries. Accordingly, Ethiopian governments through different periods were imposing and collecting different types of taxes

Like their varieties in type, the way the tax liability is assessed differs from country to country. Countries also differ in the way they do structure their taxes especially the direct taxes. Hence, the income tax laws of countries may be designed on a scheduler or global basis. The new FITP of Ethiopia shows that it is structured as a scheduler income tax under which five categories of income are specified.¹ Among these, Schedule C stands for business income tax sources and subcategorized in to class A, class B, and class C categories.² Of the three categories of taxpayers under Schedule “C”, the two categories (A and B) are in principle subject to the rule of self-assessment and must maintain books of account. The third category of taxpayers (C) represents the small or informal businesses which are relieved from the regime of self-assessment and subject to the presumptive income tax regime mostly known as standard assessment. In exceptional circumstances, the two categories (A and B) may be subject to the presumptive (estimated) income tax assessment mechanism which is different from self-assessments prepared based on books of account of the taxpayer.

Presumptive taxation methods represent a methodology of assessment of tax liability alternative to the regular method used to compute actual taxable income, based on taxpayers’ books of accounts. The presumptive methods used for small, medium and large taxpayers have to be different taking the nature of the taxpayers in to account. The new FITP provides that a Category

¹ The Federal Income Tax Proclamation, Proclamation NO 979/2016, Federal Negarit Gazeta, 22nd Year No.104, 2016, Art 8

² Ibid, Arts, 18 and 3

'C' taxpayer must pay business income tax for each tax year as determined under the income tax regulations.³ The regulation on its part states, Category "C" tax payers shall pay tax in accordance with turn over based standard presumptive business tax or indicator based presumptive business tax methods.⁴ On the other hand, Article 26 of the new FTAP states that when a taxpayer has failed to file a tax declaration for a tax period as required under a tax law, the tax authority may base on such evidence as may be available and at any time, make an assessment referred to as estimated assessment This Article also states that estimated assessment shall apply only for the purposes of a tax that is collected by assessment.⁵ Under the same proclamation tax assessment is defined to mean a self-assessment, estimated assessment, jeopardy assessment, and amended assessment, or penalty assessment.⁶ Therefore, estimated assessment can be used during jeopardy assessment, amended assessment and penalty assessment. According to the terms used under the new FTAP and FITP, presumptive methods are expressed as estimated tax assessment for taxpayers with the duty to keep books of account and standard assessment for small taxpayers.⁷ Therefore for purpose of conformity with the Federal tax laws currently in use and since the focus of this thesis is on presumptive tax assessment of taxpayers with books of account,, the term estimated tax assessment is used throughout this paper.

Therefore, assessing the gaps in the governing law and existing practice in the presumptive (estimated) tax assessment of companies under the Federal System is the subject of this research.

1.2 Statements of the Problem.

If the estimated tax assessment method is to be applied when a taxpayer fails to declare and pay its tax liabilities or fails to keep books of account or when the tax Authority amends the books of account, it obviously plays a crucial role in the tax administration. It is expressed as more effective and relevant than the standard assessment which may lead in to a closer amount of

³ Ibid, Art, 49

⁴ Council of Ministers Regulation, Regulation No 410/2017, Negarit Gazeta, 23rd Year No.82, 2017,Art 60

⁵ The Federal Tax Administration Proclamation, Proclamation No 983/2016, Federal Negarit Gazeta, 22nd Year No.103, 2016,Art 26(4)

⁶ Ibid, Art 2(32)

⁷ The Federal Tax Administration Proclamation, Proclamation No 983/2016, Federal Negarit Gazeta, 22nd Year No.103, 2016,Art 26, The Federal Income Tax Proclamation, Proclamation NO 979/2016, Federal Negarit Gazeta, 22nd Year No.104, 2016,Art 49, see also Council of Ministers Regulation, Regulation No 410/2017, Negarit Gazeta, 23rd Year No.82, 2017,Art 60

income and due to its room to consider business or occupation based losses.⁸ On the other hand, under estimated assessment, due to the discretion provided to a given tax authority to investigate estimated income of a given taxpayer may create possible loopholes for corruption.⁹ Therefore, if it is used unregulated it poses a serious problem in the general tax policy objectives of Ethiopia. The following are some of the problems with the estimated business income tax assessment of companies under the federal tax system of Ethiopia. Although the Federal Income Tax and Federal Tax Administration Proclamations, Regulations and subsequent directives have remedied some ills of the previous estimated business income tax assessment of companies, there are still gaps in the governing laws and existing practice. The governing laws on the area are still not enough and lack clarity. Beside to this, non-adherence and incapacity of Ethiopia's tax authorities for their proper application are posed as problems on which this research is based.

1.3 Research Questions

Based on the above stated problems the following research questions are provided;

- What is the concept of estimated business income tax assessment in general, its rules in Ethiopian law
- What are the major gaps in the estimated business income tax assessment laws of Ethiopia?
- How is estimated business income tax assessment being carried out in practice regarding companies with books of account under the federal tax system in Ethiopia?
- How far is the practice of estimated business income assessment regarding companies in conformity to the Ethiopian Income Tax and Tax Administration rules and the problems they pose in enforcement of the laws in practice?
- What are the possible solutions towards filling the gaps existing in estimated business income tax assessment rules and the practice in meeting the expected objectives of the rules?

⁸ Helaway Tadesse, & Gunther Taube, Presumptive taxation in Sub-Saharan Africa; Experiences, and Prospects 12 (January 1996) (WP/96/5 IMF African Department). Available at www.imf.org/external/pubs/ft/wp/wp9605.pdf accessed on January 13, 2024

⁹ Muuz Abraha, Evaluation of the efficiency of standard assessment for category C taxpayers in Ethiopia, the case of Tigray Regional State, Haramaya Law Review, vol, 4:1 p,113-114(2015)

1.4 Objectives of the study

The general objective of this research is to bring the issue of estimated business income tax assessment of companies to the spotlight and show the shortcomings of its governing rules and the prevailing practices in Ethiopia. In so doing, it aims at assessing whether the Ethiopian Ministry of Revenues is assessing business income tax of companies using the estimated method properly.

Consequently, the specific objectives of the research are:

- Explaining the concept of estimated tax assessment as it applies in Ethiopian law;
- Showing the accepted standards in determination of taxable business income using the estimated tax assessment method for companies in Ethiopian federal tax system;
- Showing how business income tax is assessed using the estimation method is carried out in practice in the tax administration and weighing it against the law and
- Finally identifying the major gaps in the estimated business income tax assessment laws of Ethiopia and their enforcement in practice, and pointing to possible ways of improvement

1.5 Literature Review

The topic “Business Income Tax Assessment of companies with Books of Account Under the Federal Tax System of Ethiopia” is almost a neglected area in the Ethiopian legal system. To the knowledge of the researcher, there is no single domestically written literature on the subject. However, various books have been written, studies carried out, laws enacted and treaties ratified in the area of estimated business income tax assessment . Yet, it is difficult to secure access to most of these materials apart from reading them in bibliographies attached to books written on the subject. Therefore, the reference made to the international literature on corporate taxation is limited to few books available to online materials on the subject.

1.6 Research Design and Methodology

This research has both doctrinal and non-doctrinal features. Doctrinally, a descriptive inference is made of the Ethiopian legal frame work regarding presumptive taxation with a comparative analysis of the best practices. In the non-doctrinal path, an empirical endeavor is made to see how determination of taxable business income of companies is actually carried out using estimated methods on the ground which is then weighed for conformity against the Ethiopian laws .On the other hand, some tax audits decided using the estimated tax assessment methods

are chosen for analysis of the practice based on a purposive sampling from the Large Taxpayers Branch Office (LTO) and Small Taxpayers Branch Office(STO) of the Ethiopian Ministry of Revenues (MOR) for enabling to see the major problems in the area. In addition to this some cases reviewed by the Tax Review Departments of the MOR, Tax Appeal Commission and Federal High Court and all cases decided by the Cassation Bench of the Federal Supreme Court of Ethiopia on the area are also chosen for analysis. The research has also used interviews on Purposive selecting of interviewees practicing in the area and a company manager. The researcher has employed unstructured interview questions for the interviews. The data collected and the practice reviewed as such is then qualitatively analyzed.

1.7 Scope and Limitations of the Research

Although the concept of presumptive taxation involves a wide array of specific thematic areas, this research is only focused on the concept of estimated business income tax assessment, and at that, only for taxpayers with books of account in the federal tax system of Ethiopia. The scope is thus narrowed for reasons of financial, time and mostly, space limitations. Absence of related domestic research on the subject was also another noteworthy constraint. Besides facing such constraints the researcher used both published and unpublished materials and used different data's other than literatures.

1.8 Significance of the Research

This research is believed to contribute to the effort of reaching at the much aspired knowledge based estimated business income tax assessment in Ethiopia which undoubtedly will contribute to achievement of the tax policy objectives of the country. In addition to it serving as one of very few reading materials written on issues of estimated tax business income tax assessment in Ethiopia for anyone interested in the subject, its contribution to further research in such apparently overlooked area will also be paramount. But none of these are as important as the contribution it will make in informing officials of the tax authority and law makers to enable them ponder about the problems existing in their respective areas of expertise and induce them to come up with relevant solutions.

1.9 Organization of the Research Paper

This research paper is comprised of four Chapters. The first chapter introduces the research while the second chapter lays the conceptual foundation for the understanding of presumptive

business income tax assessment in general and the Ethiopian rules on estimated business income tax assessment of companies with books of account in the federal tax system of Ethiopia followed by the third chapter in which the practice of determination of business income tax of companies using the estimation method is examined. The final chapter is where conclusions are made and relevant recommendations given.

CHAPTER TWO

The Concept of Estimated Business Income Tax Assessment

2.1 General Introduction

Taxes can be classified in different groups using different criteria's. They are most commonly classified as either direct or indirect based on whom the duty to pay the tax lays, Taxes may also be divided into two namely: Central Tax (federal tax) and Local Taxes (regional taxes) based on who collects the tax within a given country. Income taxes are among direct taxes imposed on different types of incomes. The concept of income is wide and difficult to confine it with a single definition. Thus, different scholars have long debated on the definition of the term. This resulted in the absence of a comprehensive and uniform definition of it. However, different legal systems try to define it based on their own contexts. For example under the FITP Income is defined broadly to mean every form of economic benefit, whether in cash or kind, and derived from every source and in every form paid, credited, or received.¹⁰

The way how different incomes should be taxed is also another point of difference among different systems. Accordingly, the income tax of countries may be structured on a scheduler or global basis. A scheduler income tax is one in which separate taxes are imposed on different categories of income. Beginning from coming in to force of the FDRE constitution, Ethiopia formally follows the federal state structure. Accordingly, the Ethiopian federal system divides revenue sources between the federal government and regional governments. The federal constitution has three lists in this regard: federal, concurrent and regional.¹¹ In Ethiopia, the federal constitution declares that the federal government shall levy taxes and collect duties on

¹⁰ The income tax proclamation, cited above at 4. Art. 2(14)

¹¹ The Constitution of the Federal Democratic Republic of Ethiopia, Proclamation No 1/1995, Federal Negarit Gazeta, 1st Year No.1, 1995,Art,96 and 97,and 98, respectively

sources reserved to it, and the states likewise exercise the same power with respect to sources that fall under their jurisdiction.¹² As a result, the revenue generated from respective sources belongs exclusively to each level of government. The federal constitution provides exclusive revenue sources under the title federal power of taxation and state power of taxation. Taxation powers of the federal government include: employment from the employees of the federal government and its public enterprises and international organizations, federal stamp duties, monopoly tax, national lottery, fees from licenses issued and services provided by organs of the federal government.¹³ On the other hand, taxation power of the regional states within their jurisdiction include: taxation of employment income from employees of the state government; agricultural tax from farmers, tax on individual traders, houses and other property owned by private persons or regional government; employment, and sales tax from public enterprises owned by the state government; forest products, royalties and land lease fees from small mining undertakings.¹⁴ In a similar way, the constitution includes concurrent powers of taxation and the federal government will levy and collect taxes on those listed under concurrent powers of taxation and the incomes are shared based on the decisions of the House of Federations, the upper chamber of the federal legislature.¹⁵ Regarding residual taxes the federal houses jointly decide by 2/3rds majority.¹⁶

In general, the division of revenue raising power in Ethiopia is mainly structured according to the categories of taxpayers or source of the revenue. The constitution allocates income tax on business profits on the basis of ownership of the business or the legal form of business organization. The Constitution under its article 99 assigns taxation of corporate income as well as income of shareholders concurrently to the federal government and the regional governments. Therefore, the federal government is empowered to legislate, collect and adjudicate on income taxes which are its exclusive and or concurrent power of taxation. The Federal Income Tax and Tax Administration laws are therefore are designed following this in mind. Like the FDRE constitution, the new federal ITP operates as a schedular system. Accordingly, it provides five schedules of incomes.¹⁷ These are Schedule ‘A’ provides income from employment, Schedule

¹² Ibid, Art, 51(10) and 52(2(e))

¹³ Id, Art,96

¹⁴ Id, Art,97

¹⁵ Id,Art,98

¹⁶ Id,Art,99

¹⁷ See n 1

‘B’ provides income from rental of buildings, Schedule ‘C’ – provides income from business, Schedule ‘D’ provides other income, and Schedule ‘E’ - exempt income.¹⁸ . The same provision provides that a taxpayer that derives income from different sources that is subject to tax under the same Schedule for a tax year shall be taxable under the Schedule on the total income for the year.¹⁹ Therefore, though dominantly schedular, the new ITP provides for the consolidation of income within the same Schedule, but not across Schedules.

Business income tax, which is mostly assessed on self-assessment, is known with different names like profit tax, corporate tax, corporation tax or company tax. The purpose of this tax is to generate revenue for the government by taxing the profits earned by businesses. The rate of this tax varies from country to country and is usually calculated as a percentage of the company's net income. As per the FDRE constitution’s arrangement, unless for the purpose of Addis Ababa and Dire dawa city administrations, the power of the federal government to legislate, enforce and adjudicate on business income taxes is limited on private companies and public enterprises solely or jointly owned by the federal government. According to the new commercial code of Ethiopia, the private companies include Share Company, Private limited company and one person private limited company.²⁰ As it is cited by Tewodros Meheret, in the current context of Ethiopia, public economic enterprises are formed as enterprises, corporations or share companies.²¹ Thus, federal government-owned and/or controlled public enterprises in the economic form of corporation, Share Company, or public enterprise that produces and sell industrial, commercial, or financial goods and services to the public are subject of this tax too. Therefore, business income taxpayers under the federal tax system are dominantly companies’ private or public nature.

For the sake of administrative convenience or principles of economy may require classifying business income taxpayers into different categories. The Ethiopian business income tax system classifies businesses into three categories A, B, or C according to whether or not the business is incorporated, and its turnover. ²²Category “A” taxpayers are composed of two groups. The first group comprises of those taxpayers whose annual turnover for a single tax year is 1000,000 or

¹⁸ The Federal Income Tax Proclamation, Proclamation NO 979/2016, Federal Negarit Gazeta, 22nd Year No.104, 2016,Art 8(1)

¹⁹ Ibid, Art,8(2)

²⁰ The Commercial Code of the Federal Democratic Republic of Ethiopia, proclamation No 1243/2021,Negarit Gazeta, 27th year No 23,Art,172(3) and Art,174

²¹ Tewodros Meheret, The concept and characteristics of public enterprises in Ethiopia, an overview, MIZAN LAW REVIEW, Vol. 8, No.2, p,350 (2014).

²² See note 2

more.²³ In addition, any company incorporated under the laws of Ethiopia is a category “A” taxpayer irrespective of its annual turnover.²⁴ Category B include any person other than a body, having an annual transaction of more than 500,000 but less than 1,000,000 and category C any person other than a body, having an annual transaction of less than 500,000.²⁵ Keeping books and accounts is a mandatory requirement for Category “A” and category “B” taxpayers.²⁶ However, category C businesses income taxpayers are not required to keep books of accounts because they pay their taxes based on an assessment made by the revenue authorities. They are required to pay an income tax from their incomes they generate based on the schedules attached at the back of the income tax regulation.

2.2 Presumptive Taxation in General

Presumptive taxation methods represent a methodology of assessment of tax liability alternative to the regular method used to compute actual taxable income, based on taxpayers’ books of accounts. According to Victor Thuroyni, a renowned scholar on taxation, the term "presumptive" is used to indicate a legal presumption that the taxpayer's income is no less than the amount resulting from application of the indirect method.²⁷ Thuroyni has given the justifications for the introduction of presumptive techniques stating: “First is simplification, particularly in relation to the compliance burden on taxpayers with very low turnover.... Second, is to combat tax avoidance or evasion..... Third, by providing objective indicators for tax assessment, presumptive methods may lead to a more equitable distribution of the tax burden, when normal accounts-based methods are unreliable because of problems of taxpayer compliance or administrative malpractice. Fourth, rebuttable presumptions can encourage taxpayers to keep proper accounts, because they subject taxpayers to a possibly higher tax burden in the absence of such accounts. Fifth, presumptions of the exclusive type can be considered desirable because of their incentive to a taxpayer who earns more income in which he/she will not pay more tax. Finally, presumptions that serve as minimum taxes may be justified by a combination of reasons (revenue need, fairness concerns, and political or technical difficulty in addressing certain

²³ The Federal Income Tax Proclamation, Proclamation No 979/2016, Federal Negarit Gazeta, 22nd Year No.104, 2016, Art 1(a(2)

²⁴ Ibid, Art,3(1(a(2)

²⁵ Ibid, Art, 3(1(b) and (c)

²⁶ የታክስ ሂሳብ መዝገብ አያያዝ መመሪያ ቁጥር 176/2014 (unpublished ,Ministry of Revenues),(in Amharic) (hereinafter The Book of Records Directive, No 176/2022 Art,4,see also

²⁷ Victor Thuroyni, Tax Law Design and Drafting (volume 1; International Monetary Fund: 1996; ed.) Chapter 12, Presumptive Taxation,p,1

problems directly”²⁸. Generally, we can infer that presumptive taxation is one of the techniques that serve to assess taxable income and tax liability of small or large taxpayers. On the other hand, there is no uniformity in applying the presumptive taxation in each tax regime as different types of presumptive methods exist in different countries. The scope of application for presumptive taxation can be for any tax like income tax, turnover tax, and value-added tax (VAT) or sales tax though it is most commonly used for the income tax. The extent to which presumptive taxes are used varies greatly from country to country. Some countries employ almost no presumptive taxation, while others use presumptive taxes extensively.

2.2.1 Classification of Presumptive Methods

Presumptive methods can be classified as rebuttable or irrebuttable. Rebuttable mean that the taxpayers can prove that their actual income was lower than the presumed income. Whereas in irrefutable one taxpayers are not allowed to claim (and prove) that their actual income was lower than the presumptive income.²⁹ In short under the rebuttable one, a taxpayer can reject a presumed tax based on other evidences but under irrebuttable presumption it cannot be challenged using contradictory facts or evidences. On the other hand, Irrebuttable presumptions can be divided into two types: minimum tax, where tax liability is no less than that determined under the presumptive rules, and exclusive, where tax liability is determined under the presumption alone, even if the regular rules might lead to a higher liability.³⁰

Presumptive methods can also be distinguished according to the degree of discretion that they allow tax officials. Some presumptive methods are quite mechanical, allowing no discretion while other methods involve a large degree of discretion for the tax authority applying them. Allowing excessive discretionary power can pave a way for arbitrary taxation and corruption. Conversely, if it is more mechanical, it can lack flexibility during implementation

2.2.2 Types of Presumptive Methods

In a system of tax assessment in which the taxpayer is required to calculate his own total income and tax liability, has to file a return to the tax authorities. If the taxpayer has failed to file or

²⁸ Ibid

²⁹ Vito Tanzi and Milka Casanegra de Jantscher, International Monetary Fund Fiscal Affairs Department, 1987, Presumptive Income Taxation: Administrative, Efficiency, and Equity Aspects, p,09

³⁰ See(n26),p,02

when its declarations are rejected for whatever reasons, is to let the tax administration determine the tax liability of the taxpayer. This could involve use of different methods that has a factual basis for the particular case. In some countries, there are no particular thresholds for use of indirect methods. Thus, in Israel, the assessing officer has the power to "determine to the best of his judgment the amount of the person's chargeable income and assess him accordingly."³¹ In India, the statute requires best judgment assessments when the taxpayer has failed to file a return or to produce information, and authorizes such assessments when the taxpayer's accounts are incorrect or incomplete or when no method of accounting has been regularly employed by the taxpayer.³²

The first common method used to estimate income is the change in the taxpayer's net worth over the year. Several countries use comparisons of beginning-of-year and end-of year net worth as a method for determining a taxpayer's income when books and records are non-existent. Or inadequate to establish actual incomes. The way net worth method is used and the details of its operation vary from system to system. In India, the Income Tax Act specifically states that if, in any financial year, a taxpayer is found to be the owner of money, cash credits, property, or other investments and cannot explain their source, then their value may be assessed as income for that financial year.³³ The bank deposit method is also used to reconstruct income through presumption. According to this method a tax auditor uses records of deposits into the taxpayer's bank accounts and to presume, unless the taxpayer can show the contrary, that the deposits constitute income.³⁴ Depending on the taxpayer's financial and business practices, this can, of course, lead to either a grossly exaggerated or a grossly understated estimate of net income. The effectiveness of this method obviously depends on the state of development of a country's financial institutions. Therefore, in countries where most amounts are transferred in cash, it is not likely to be very helpful.

The Percentage of Gross Receipts is another method of presumptive taxation. This method provides a minimum-tax type and hence the taxable income of a business can be no less than a specified percentage of the gross receipts of the business.³⁵ However, this method is criticized for its involvement of substantial cascading effect like a sales tax and for it lacks close correlation

³¹ See(n27),p,08

³² Ibid,,p,09

³³ See(n25),p,08

³⁴ Ibid,p,09

³⁵ Ibid,p,08

between a particular year's income and turnover.³⁶ Moreover, to be accurate this method requires research into actual profit margins, and if taxpayers fail to declare their gross receipts, they can avoid the presumption and is more likely to impinge on those taxpayers who cannot hide their gross receipts.³⁷ A minimum taxes based on a fixed percentage of the assets of a business is also a similar method used in different countries.

Countries also apply industry specific methods for small businesses which include fixed amounts based on profession or trade, contractual method, methods based on turnover and standard assessment. The contractual method differs from other presumptions in that its application is based on advance agreement between the taxpayer and the tax authority to base tax liability on estimated income instead of on actual income.³⁸ Some countries tax particular types of income or income from specific industries on the basis of turnover, with presumptive deductions based on ratios developed for the industry or type of income in question. This method has some similarity with the percentage of gross receipts. The other prominent type of presumptive taxation is the so called standard assessment method. It was developed in Israel (the tahshiv method) and was established for use in those cases in which the taxpayer was genuinely unable to keep appropriate books and records.³⁹ The fofait system in France used to assess the income tax of farmers, unincorporated business enterprises and professional persons whose gross receipts fall below stipulated levels is labeled as alternative legal bases of-assessment using indicators to determine estimated income rather than assessments that are supposed to be based on conventional records.⁴⁰

³⁶ Ibid,p,10

³⁷ See((n27),p,08

³⁸ See(n25),p,22

³⁹ Victor Thuronyi, Tax Law Design and Drafting (volume 1; International Monetary Fund: 1996; ed.) Chapter 12, Presumptive Taxation,p,24 and Vito Tanzi and Milka Casanegra de Jantscher, International Monetary Fund Fiscal Affairs Department,1987, p.08

⁴⁰ See(n27),p,08

2.3 The Legal Framework of Estimated Business Income Tax Assessment of Companies With Books of Account In The Federal Tax System of Ethiopia

2.3.1 Tax Assessments under the Federal Tax System of Ethiopia

Tax liability of taxpayers may be assessed through assessment based or withholding systems. As mentioned above, the ITP provides for self-assessment for Schedule B, C and D (non-withholding) liabilities. Schedule A and some Schedule D liabilities are collected through final withholding. Most employees whose income consists primarily of income from employment never get to worry about filing income taxes, as these are done for them by their employers. Similarly, most of those chargeable with income taxes under Schedule “D” have their tax obligations met for them by their withholding agents. Only in few instances are employees subject to the regime of self-assessment. In contrast, Schedules “B” and “C” taxpayers are subject to the regime of self-assessment, which requires many of these taxpayers to maintain books and records and file their tax returns at the end of the tax year. The degree of self-assessment, of course, varies according to the categories of taxpayers under those schedules. Some of the taxpayers (Category “A” and “B”) are required to maintain adequate books and records in accordance with the law while Category “C” are subject to a presumptive tax regime, which nonetheless requires them to declare their annual turnover to the tax authorities.

According to the federal tax administration proclamation, tax assessment is defined to mean a self-assessment, estimated assessment, jeopardy assessment, and amended assessment, penalty assessment or any other assessment made under a tax law.⁴¹ Therefore, in the Ethiopian tax system tax assessment is concerned to assessment taxpayers only. The tax assessment types are briefed here in below.

2.3.1.1 Self-assessments

The traditional method of assessing tax liabilities of taxpayers was highly inclined to higher intervention of tax officials. However, the modern or contemporary tax systems are changing this dynamics where taxpayers are playing a vital role in assessing their tax liabilities. Self-assessment is among the prominent type of tax assessments where taxpayers voluntarily comply with their tax obligations without the intervention of tax officials. Taxpayers self-assess: that is,

⁴¹ The Federal Tax Administration Proclamation, Proclamation No 983/2016, Federal Negarit Gazeta, 22nd Year No.101, 2016,Art 2(32)

they calculate and pay their own tax liabilities and the tax authority accepts the taxpayer's tax declaration at its face value. Under the federal tax system of Ethiopia, it is defined to mean an assessment treated as having been made by a self-assessment taxpayer under Article 25 of the same proclamation.⁴² For self-assessed taxes, the taxpayer's filed tax declaration is treated as a tax assessment and the taxpayer is obliged to pay the amount of tax stated in the tax declaration with the filing of their tax declaration.⁴³ If the taxpayer has not filed a tax declaration, the tax authority can raise an original assessment using any evidence available more probably using an estimated assessment. If the tax authority is not satisfied with a Self-assessment declaration, it will proceed to other type of assessment i.e. amended assessment (discussed below).

2.3.1.2 Estimated Assessments

This is another type of tax assessment which comes to the table when the self-assessment taxpayer fails to self-declare its tax liabilities or during other assessment types which demands this mechanism. It is when the taxpayer fails to declare, not when the tax authority is not satisfied with a self-assessment declaration. In a similar fashion, article 26 of the new FTAP states that when a taxpayer has failed to file a tax declaration for a tax period as required under a tax law, the Authority may base on such evidence as may be available and at any time, make an assessment referred to as an "estimated assessment."⁴⁴ It also proclaims that this kind of assessment will apply only for the purposes of a tax that is collected by assessment.⁴⁵ Therefore, estimated assessment can be used during any assessment other than self-assessment. The FTAP has delegated the Ministry of Revenues of to enact an implementation directive for estimated tax assessment.⁴⁶ Accordingly, the ministry has enacted an estimated tax assessment directive number 138/2018. This directive under its preamble states that if a taxpayer fails to declare and pay its tax liabilities or fails to keep books of account or when the tax Authority amends the books of account by either alteration, reduction or addition can assess the tax liability using an estimated tax assessment. In the federal tax system of Ethiopia the expression of the term presumption taxation, is interchangeably used as estimated assessment for self-assessment categories (A and B) and standard assessment for category C Schedule "C" business income tax

⁴² Ibid, Art, 2(28)

⁴³ Ibid, Art, 25(1)

⁴⁴ Ibid, Art, 26(1)

⁴⁵ Ibid, Art, 26(4)

⁴⁶ Ibid, Art, 26(8)

payers. From the wording of article 26 of the of the FTAP and the preamble of the estimated tax assessment directive shows that estimated tax assessment seems to have an alignment with taxpayers required to maintain books of account only.

2.3.1.3 Jeopardy Assessments

The name jeopardy assessment implies a risky situation that could force the tax authority to make the tax assessment. It refers the tax office's urgent action which would be jeopardized by the delay to follow the regular procedure to assess any unpaid tax. In the federal tax system of Ethiopia, Jeopardy assessment is defined to means an assessment made by the tax authority under Article 27 of this Proclamation.⁴⁷ Rather than giving clear cut definition of the term it tries to show its correlation with the type of assessment stated under article 27 of the TAP. Article 27 of the proclamation on its part stipulates the power of the tax authority to make an assessment of the tax payable by a taxpayer for a tax period in the circumstances specified in Article 23 (i.e. advance tax declarations) or Article 42 (an assessment for the preservation of funds). In short jeopardy assessment is intended to cover the instances of advance tax declaration and an assessment for the preservation of funds and assets deposited with financial institutions.

An advance assessment is raised by the tax authority in advance of the normal due date for filing a tax declaration when there is some risk to the revenue if the tax authority were to wait until the normal due date. It is commonly raised when a taxpayer has ceased to carry on business before the end of the tax year, if a taxpayer is about to leave the country permanently; or when the tax authority has reason to believe that a taxpayer will not file a tax declaration for the period by the due date,⁴⁸ It applies when the tax authority has reasonable grounds to believe that the collection of tax owing by a taxpayer is in jeopardy and there is a need to take urgent steps to ensure collection of the tax.⁴⁹ On the other side, the conditions under article 42 of the TAP doesn't show any kind of tax assessment It rather shows the tax authority's power to serve an administrative order to financial institutions block the accounts of the taxpayer, freeze access to any cash, valuables, precious metals, or other assets of the taxpayer in a safe deposit box held by the financial institution; and provide information relating to the accounts or contents of the safe deposit box dealing with funds or assets deposited with the financial institution by a defaulting

⁴⁷ Ibid,Art,2(12)

⁴⁸ Ibid,Art,27(1),and 23(2),(3),(4)

⁴⁹ Ibid,Art,42(1)

taxpayer.⁵⁰ Therefore, it is a means to preserve the funds or assets of a defaulting taxpayer not a tax assessment type,

2.3.1.4 Amended Assessments

. As stated above the system of self-assessment is shifting the burden of the tax authority to taxpayers assess and pay their tax liabilities. However, this assignment is with all its responsibilities. The tax administration will conduct post assessment checks if any failure and forced to take appropriate enforcement actions, including applying penalties and or conducting post declaration tax audits. Amended assessment can be one type of post assessment check for any failure of responsibility during the original assessments. In the federal tax system of Ethiopia, the tax authority can amend an original assessment by making alterations, reductions, or additions, based on such evidence as may be available.⁵¹The original assessment may be a self-assessment, estimated assessment, jeopardy assessment, penalty assessment, or any other assessment made under a tax law so as to ensure that the taxpayer is liable for the correct amount of tax payable in respect of the tax year to which the original assessment relates. An amendment of a self-assessment may be made by the tax authority on its own motion or on application by the taxpayer. If a taxpayer realises that an error has been made in making a self-assessment, the taxpayer can apply to the tax authority for an amendment to the self-assessment within the normal time limit for amending assessments.⁵²

2.3.1.5. Penalty Assessment

A penalty assessment is treated as a tax assessment and, is defined to means an assessment of penalty made by the Authority under Chapter Two of Part Fifteen of the Proclamation.⁵³ This part of the TAP ranges from articles 101 to 115 and deals with administrative penalties. Therefore, these administrative penalties are considered as a tax decision for the purposes of TAP.

2.3.1.6 Standard Assessments

The federal tax administration proclamation doesn't include standard assessment under the category of tax assessments. However, the income tax proclamation has included some provision which gives a hint about the business tax of category C taxpayers based on the mode of

⁵⁰ Ibid,Art,42(2)

⁵¹ Ibid,Art,28(1)

⁵² Ibid,Art,29(1)

⁵³ Ibid,Art,2(32),and Art, 2(25)

assessment to be determined by a regulation to be issued by the council of ministers.⁵⁴ Accordingly, the income tax regulation has incorporated some provision about presumptive business tax of category C taxpayers. The regulation therefore states the presumptive business tax to be paid by category “C” tax payers will be calculated in accordance with the schedule attached to it.⁵⁵ Though the TAP has failed to include presumptive business tax of the small businesses that is the standard assessment under the definition of tax assessment, the income tax proclamation and regulation have clearly included it as a mode of tax assessment. In reality it seems very difficult to identify who category C taxpayers are under the federal tax system of Ethiopia. However, the standard tax assessment is considered as a type of tax assessment.

2.3.2 Estimated Business Income Tax Assessment Under the FDRE Constitution and Tax Proclamations

The FDRE constitution stipulates.....in exercising their taxing powers, States and the Federal Government shall ensure that any tax is determined following proper considerations⁵⁶.

Richard K. Gordon

The Ruler should act like a bee which collects honey without causing pain to the plant. — Mahabharata⁵⁷

Traditionally the Ethiopian income tax system dates back to Axumite kingdom; whereas, the beginning of modern tax system traces back to the 1941.⁵⁸ As it cited by Muuz Abraha the history of beginning period of the income tax assessment was believed that Ethiopia income tax system was inhibited by the presumptive taxation model.⁵⁹ That is to say; the taxable incomes had not been inferred from taxpayers’ accounts. Rather, various proxies were used to establish

⁵⁴ The Federal Income Tax Proclamation, Proclamation NO 979/2016, Federal Negarit Gazeta, 22nd Year No.104, 2016,Art 49

⁵⁵ The Federal Income Tax Regulation, Regulation No 410/2017,Federal Negarit Gazeta, 23rd Year No.82, 2017,Art 60(1)

⁵⁶ The Constitution of the Federal Democratic Republic of Ethiopia, Proclamation No 1/1995, Federal Negarit Gazeta, 1st Year No.1, 1995,Art,100(1)

⁵⁷ Victor Thuronyi, Tax Law Design and Drafting (volume 1; International Monetary Fund: 1996; ed.) Chapter 12, Presumptive Taxation,p,1

⁵⁸ Tadesse Lencho, Towards Legislative History of Modern Taxes in Ethiopia (1941-2008), 25 JOURNAL OF ETHIOPIAN LAW 106, 104-158 (2012).

⁵⁹ Muuz Abraha, Evaluation of the efficiency of standard assessment for category C taxpayers in Ethiopia, the case of Tigray Regional State ,Haramaya Law Review, vol, 4:1 p,115-116(2015)

tax liability of different taxes. He further stated that the estimated income tax assessment approach was introduced the Income Tax Proclamation No. 173/1961 to be applied 'if no records and books of account are maintained by the taxpayer or if for any reason the records and books of accounts are unacceptable to the Income Tax Authority, or if the taxpayer fails to declare his or its income within the time specified in the law.⁶⁰ This proclamation continues to be effective holding the estimated income tax assessment until it was repealed by a subsequent Income Tax Amendment Proclamation No. 227/2001. This amendment proclamation had some controversial provision which might be confusing with estimated tax assessment. According to this amendment proclamation Category "A" and "B" taxpayers were required to pay a minimum income tax equal to 2% (two percent) of turnover. However, if their regular tax liability exceeds the minimum tax amount, the taxpayer should pay the regular tax rather than the minimum tax and vice versa provided, however, that if the taxpayer otherwise liable to pay the minimum tax submits books of account certified by an independent accountant the taxpayer is liable only for the regular tax amount.⁶¹ The Income Tax Proclamation Number 286/2002 on its part included standard assessment and estimated assessments in separate provisions. This proclamation provided standard assessment method to be used to determine the income tax liability of Category C taxpayers and should be a fixed amount of tax determined in accordance with a Council of Ministers Regulations establishing a schedule of standard assessment amounts that reflect variations in the type of business, business size, and business location.⁶² On the other hand, it had incorporated estimated tax assessment which would be applied if no records and books of accounts are maintained by the taxpayer, or if, for any reason, the records and books of accounts are unacceptable to the Tax Authority, or if the taxpayer fails to declare his or its income within the time prescribed by the Proclamation, the Tax Authority may assess the tax by estimation by directives to be issued by the Minister of Revenue.⁶³

Business income tax taxpayers can be classified in to different categories like small, medium, or large taxpayers mainly depending on the amount of income derived by the taxpayers. Tax law frameworks of different countries including Ethiopia provide specific rules governing the

⁶⁰) Ibid

⁶¹ The Income Tax Amendment Proclamation, Proclamation NO 227/2001, Federal Negarit Gazeta, 7th Year No.09, 2001, Art 40(e)

⁶² The Income Tax Proclamation, Proclamation NO 286/2002, Federal Negarit Gazeta, 8th Year No.34, 2002, Art 68

⁶³ Ibid, Art, 69

assessment method, tax rate, accounting period, deduction, exemption, and other related guidelines for each of the above listed group of taxpayers. Although the impacts of application of different types of presumptive business income tax assessment mechanisms would also deserve discussion, the theme of this thesis is on the estimated business income tax assessment of companies with books of account in federal tax system of Ethiopia. Therefore; the focus will be on the tax laws governing this area of taxation.

In Ethiopia, the Constitution is the supreme law of the land. Any law, customary practice or a decision of any organ of state or a public official that contravenes this Constitution shall be of no effect. Therefore, any principle of tax stipulated under the constitution will get supremacy over any other stipulations of other laws in Ethiopia. The constitution can also be described as a guiding law for all tax legislations and the respected practice which follows. Proclamations come below the Constitution in the hierarchy. They are acts of parliament, discussed and voted on in the HPR and signed by the president of Ethiopia. International treaties that have been ratified by Ethiopia have similar status to proclamations because they are also enacted by the HPR. Regulations are the next level. They are issued by the Council of Ministers to supplement a proclamation. Regulations have detailed descriptions of the provisions of the respective proclamation. Directives come next to regulations. Accordingly, the position of the regulations and directives on the ladder of hierarchy is below proclamation. However, in so far as the regulations are passed by the Council of Ministers, they are higher in hierarchy than the directives passed by each ministry. Then the basic substantive and procedural rules and principles pertaining to taxation flows from proclamations and regulations. Directives are the lowest level in the Ethiopian legislation hierarchy. They describe how regulations should be implemented and are usually developed by a ministry or a department within a ministry. According to the hierarchy of laws in the federal laws of Ethiopia, tax directives occupy a rank below tax regulations. Under the federal tax system, tax directives are issued either by the Ministry of Finance or Ministry of Revenues.

The FDRE constitution says nothing and is not expected to say anything about the mode of assessment of business income taxes. However, there is some provision which may be deemed helpful in the quest for any limitation in making estimated tax assessments. The constitution under article 100(1) states ‘‘In exercising their taxing powers, States and the Federal Government shall ensure that any tax is related to the source of revenue taxed and that it is

determined following proper considerations.’’ In nutshell this provision obliges states and the federal government to determine taxes following proper considerations. The Amharic version of this provision is more elaborative and sends the required message in a simple way. According to the Amharic version, states and the federal government are required to determine taxes following due considerations. This implies proper attention be paid during any tax assessment including estimated tax assessment methods. Therefore, the constitution seems to prohibit arbitrary (discretionary) tax assessment of any kind and has to be taken as a guiding principle during tax legislations and the practice thereof. From this principle, one can conclude that there is constitutional guarantee for the avoidance of arbitrary (discretionary) estimated tax assessment under the federal tax system of Ethiopia.

Meanwhile, as stated above the former income tax proclamation number 286/2002 under its article 69(1) proclaims for estimated tax assessment if no records and books of accounts are maintained by the taxpayer, or if for any reason, the records and books of accounts are unacceptable to the Tax Authority, or if the taxpayer fails to declare his or its income within the time prescribed by this Proclamation, the Tax Authority may assess the tax by estimation. The new tax administration proclamation, on its part proclaims the estimated tax assessment will be employed only when a taxpayer has failed to file a tax declaration for a tax period as required under a tax law.⁶⁴ This means there will be no estimated tax assessment if the taxpayer has filed its tax declaration properly. In a related way, this proclamation, oblige the Authority to make estimated assessments based on evidence not arbitrarily. This provision can also be taken as a very basic guiding principle for lower ladder in hierarchy of tax laws in the federal tax system.

2.3.3 A Directive on Retention of Books of Account and Estimated Tax Assessment

Maintaining proper books of account cannot only be assumed by a statutory requirement imposed on taxpayers for the sole interest of the tax office. Rather businesses will want to maintain such records for as long as it is considered essential for their own activities. From the side of a business, keeping records will enable to control its activities, safeguard its assets, and monitor profitability thus informing its strategic direction. It also satisfy external auditors, company directors, shareholders, creditors, investors and other interested stakeholders that the

⁶⁴ The Federal Tax Administration Proclamation, Proclamation No 983/2016, Federal Negarit Gazeta, 22nd Year No.103, 2016,Art 26(1)

records reflect a true and fair value of the business. It enables a business to meet various statutory requirements, including requirements for both Revenue authorities and external auditors. These objectives apply to all types of commercial activity where a business is required by law to keep, maintain and produce its records to a Revenue authority for examination in order to verify a tax declaration, or to fulfill other statutory obligations under company law, such as to publish its annual accounts. Revenue authorities need to examine records in order to collect the right amount of tax at the right time within their jurisdiction. Other stakeholders requiring reliable information include shareholders, banks, creditors, customers and other regulatory authorities. On the basis of the financial documents and statements, potential and existing business shareholders decide whether to invest equity in business; banks decide whether to provide loans or other financial means; and suppliers and customers decide whether to undertake transactions. These other stakeholders may need assurance that the financial documents and statements of the business reflect economic and legal reality. Auditability of the financial statements is a prerequisite for this assurance and the statutory audits performed by private auditors for public and private companies will normally provide needed assurance to stakeholders. Businesses in turn should create reliable and verifiable records that allow it to determine its tax liability, including any claim for a refund of tax, and then maintain these records as required by legislation. These records should possess sufficient levels of authenticity, integrity and usability to form part of a satisfactory audit trail enabling auditors to verify the accuracy or otherwise of the tax return. This remains true for both electronic and paper-based transactions. The underlying principle for record keeping is that all documentation, in whatever format, that forms part of the audit evidence must provide auditors with reasonable assurance those transactions are properly authorized and recorded in the accounting records. This will also enable the business to monitor profitability; safeguard its assets; and inform its strategic direction.

According to the new commercial code of Ethiopia, any person or business organization carrying on trade is duty bound to keep books and accounts as are required in accordance with business practice and law, having regard to the nature and importance of the trade carried on.⁶⁵ However,

62 The Commercial Code of the Federal Democratic Republic of Ethiopia, proclamation No 1243/2021, Negarit Gazetta, 27th year No 23, Art.61

the commercial code exempts Petty traders exempted from keeping accounts like the tax laws.⁶⁶ The same proclamation stipulates that all books of accounts and accounting documents shall be preserved for ten years from the date of the last entry or from the date of preparation of such documents.⁶⁷

On the other hand, article 82 the Federal ITP of specifies the record-keeping obligations of a taxpayer. Sub-articles (1), (2) and (3) of this article set out the record-keeping obligations of taxpayers liable for business income tax (Schedule ‘C’). Sub- article (1) applies to Category ‘A’ taxpayers and states a general obligation that they must keep books of account prepared in accordance with the financial accounting standards (i.e. IFRS). Paragraphs (a)-(e) specify documents that Category ‘A’ taxpayers must keep. A taxpayer required to keep documents under the article must keep the documents in accordance with requirements in Article 17 of TAP. In particular, article 17 of TAP requires that the documents to be kept in such manner so as to enable a person’s tax liability under the ITP to be readily ascertained. It also stipulates that such documents must be kept for the longer of: (i) the record-keeping period specified in the Commercial Code (10 years from the date of entry or date of preparation); or (ii) five years from the date that the tax declaration for the tax period to which the documents relate was filed with the Authority.⁶⁸ A person who fails to keep records as required under this Article 82 and in accordance with the requirements of Article 17 of TAP may be liable for a penalty under Article 102 of TAP. Further, a taxpayer who fails to keep records as required under this Article may not be able to satisfy the burden of proving that a tax assessment is incorrect should they wish to challenge the assessment.

The FDRE Ministry of Revenues has issued directives related to tax books of accounts. These directives are officially available in Amharic only and they are referenced in Ethiopian calendar which is seven to eight years behind the Gregorian calendar. These are directive numbers 152/2011 and 176/2014 respectively which were effective at different times and the later repealed the former one. Directive Number 176/2014, which repealed Directive No 152/2011, applies on the business community who are mandatorily required to keep books of accounts and those who voluntarily request to keep the same.. Keeping books of accounts is a mandatory

⁶⁶ Ibid,Art,62

⁶⁷ Ibid,Art,63

⁶⁸ Ibid,Art,17(2)

requirement for Category “A” and “B” taxpayers and, a voluntary option for Category “C” taxpayers. Category “A” taxpayers for business income tax are required to keep books of account prepared in accordance with the financial accounting reporting standards ⁶⁹The new directive has also made clear the types of documents which taxpayers has to retain. Article 23(1) of the same directive stipulates that the books of account of a taxpayer cannot be rejected, unless there is a fundamental error in such a manner that cannot enable a person’s tax liability to be readily ascertained , According to the directive, the following reasons can cause for the rejection of books of account. ⁷⁰These are,

- 1 If the taxpayer is not able to prove that its books of account is correct, when requested by the tax authority
2. If the taxpayer fails to produce supporting documents necessary for financial accounting or tax assessment when requested in written,
3. If the taxpayer produces books of account prepared using receipts not allowed by the tax authority, or
4. When the taxpayer fails to prepare keep books of account in accordance with the financial accounting reporting standards

The directive has stipulated clear conditions where the books of account of a taxpayer could be rejected. It shows that the books of account of a taxpayer could not be arbitrarily rejected and states for its rejection on a legally pre specified grounds. Therefore, the tax office couldn’t resort to reject the books of account of a taxpayer in the absence of conditions stated under the law to do so. The ultimate consequence of rejection of books of account of a taxpayer on the above stated grounds will cause a change in the tax assessment mechanism. The rejected books of account were, one which would be used by the taxpayer for a self-assessment mechanism and then if rejected the tax authority will be authorized to assess the tax using the estimated tax assessment method. This directive clearly stipulates that once a taxpayer’s books of account are rejected under this article, it will be subjected to the rule of estimated tax assessment mechanism. ⁷¹

⁶⁹ የታክስ ሂሳብ መዝገብ አያያዝ መመሪያ ቁጥር 176/2014 (unpublished ,Ministry of Revenues),(in Amharic) (hereinafter The Book of Records Directive, No 176/2022.Art,8(1)

⁷⁰ Ibid,Art,24(1)

⁷¹ Ibid,Art,24(4)

2.3.4 The Estimated Tax Assessment Directive and Business Income Taxpayers With the Duty to Keep Books of Account

The Ethiopian Revenue and Customs Authority (currently the Ministry of Revenues) has enacted estimated tax assessment directive number 138/2010 as per the power vested to it under article 26(8) of the Tax Administrative Proclamation. This directive is officially available in Amharic only and it is referenced in Ethiopian calendar which is seven to eight years behind the Gregorian calendar. Under the provision which deals about the scope of application of this directive states that it applies on a taxpayer who fails to declare its income or fails to pay its tax liability through declaration as per tax laws or when its tax assessment declaration is rejected and then the tax authority is to modify the financial statement either by change, deduction or increment.⁷² In a related way, the definition part of this directive defines Estimated Tax Assessment to mean an assessment used on a taxpayer who fails to file its tax declaration as required under a tax law or fails to file before the estimated tax or declared its income without books of account or when the tax authority alters or reduces or increases the amount of tax after rejecting the books of account of the taxpayer, based on such evidence as may be available and at any time.⁷³ This directive states the guiding principles of the estimated tax assessment. Among others, for the implementation of this directive, the estimated tax assessment principle shall be guided by⁷⁴

- The authority will determine the amount of tax taking in to account the economic activity and price inflation from time to time
- Whenever a taxpayer gets different incomes within the same schedule, will be consolidated other than business income under schedule C and mining income tax.
- Sales amount will be assessed using the standard assessment schedule attached to it.

Part two of the directive deals with estimated assessment of schedules A, B and D and part three mechanisms that will be followed to assess the business income tax of schedule C through estimation. Article 9 of the directive on the other hand stipulates the patterns of determining income of schedule C by estimation. These are⁷⁵

The sales amount of the tax will be determined through estimation in the following manner:

⁷² የ ግምት ታክስ ስሌት አረጋግጦ ምመድያ ቁጥር 138/2010 (unpublished, Ministry of Revenues) (in Amharic) (hereinafter Estimated Tax Assessment Directive, No 138/2018, Art,3

⁷³ Ibid,Art,2(1)

⁷⁴ Ibid,Art,4

⁷⁵ Ibid,Art,9(1),(2),(3),(40,and(5)

- About the taxpayer's monthly or annually sales amount, using the sells information obtained from the taxpayer or from third party.
- If information is obtained about the monthly or annual purchase amount from the taxpayer or third party, it will be changed in to sells using the gross profit margin schedule attached with this directive.
- The formula for the purpose of sub article B will be

$$\text{Sales} = 100(\text{purchase} \times 100) / \text{gross profit margin}$$
- In conditions where information cannot be obtained from third party, the sales amount for indirect tax will be determined using the sales amount declared under the preceding month and for direct taxes the monthly or annual income amount declared under the preceding year will be used. .

If the taxpayer monthly or annual sales amount cannot be determined in the methods indicated under sub article 1 of this article,

- Income assessment committee that comprises at least three members drawn from tax assessment and cash sales register machine monitoring team of the branch office will study the market condition by appearing in person at the place of the business area.
- The market survey under sub article A of this article, shall submit the daily average income to the branch manager or assigned coordinator using the annual amount of tax declared or assessed by two to three businesses with similar type and level and taking in to account the level of the city and thus will be used to decide the tax after endorsed.

If a taxpayer is caught and warned by the tax authority for carrying out a transaction without a receipt for three times within a year after coming in of effect of this directive, its tax will be assessed using the methods stated under sub article 2

For the purpose of sub article 2 and 3, the market assessment shall take in to consideration

- The business activity as well as suitability of the business location.
- The number of employees in the company and the amount of their salary
- The manner of the business premises and the lease amount if any
- The companies utility payments like electricity, water and telephone consumptions
- Other administrative expenses

The methods indicated under sub articles 1-3 will be applied orderly and the tax will be assessed using the profit margin assigned for schedule C taxpayers.

The other point worth of mention here is, articles 10, 11, part six and seven of the directive Article 10 deals about standard assessment and sectors which are subject of it. Meanwhile, article 11 of the directive stipulates the profit margin assigned for different businesses. Part six of the directive under article 17 deals about estimated tax assessment during jeopardy tax assessment. Accordingly, when the tax Authority has reasonable cause to believe that the collection of tax owing by a taxpayer is in jeopardy and if the tax is not able to be assessed based the books of account, the jeopardy tax will be assessed through estimation.⁷⁶ Meanwhile, part seven of the directive stipulates the scenario for estimated tax assessment if a taxpayer's manual receipt is lost.⁷⁷ The new Tax Administration Proclamation proclaims that the estimated tax assessment will be employed only when a taxpayer has failed to file a tax declaration for a tax period as required under a tax law.⁷⁸ In addition to this the proclamation clearly stipulates that, the estimated assessment will only apply for the purposes of a tax that is collected by assessment.⁷⁹ Thus, at first point taxpayers with the duty to keep books of account are category A and B the latter with a simplified one. These categories of taxpayers are entitled to pay their tax liability based on their own tax declaration. Failure to fulfill this duty will subject them taxpayers to estimated tax assessment other than what they were entitled to. Second, the estimated tax assessment system relates to assessment based taxpayers that includes schedule B, schedule C and some schedule D income taxpayers. The cumulative reading of the two sub provisions under article 26 of the TAP show that purpose of estimated tax assessment is entirely intended to taxpayers with the duty to retain books of account. From these basic points in consideration, the estimated tax assessment directive seems ill drafted. The first point, the directive has intermixed assessment tax and final withholding taxpayers. This seems against the intention of the lawmaker which designed the estimated tax assessment to apply for assessment taxpayers only. The other point worth of mention is, the directive has included estimated assessment and standard assessment in one without making any demarcation in between them. The estimated tax assessment directive has copy pasted the gross profit margins stipulated for standard tax assessment under the income tax regulation. These two methods of tax assessments are however designed for different categories of taxpayers those who do have the duty to keep books of

⁷⁶ Ibid,Art,17(1)

⁷⁷ Ibid,Art,21(3)

⁷⁸ The Federal Tax Administration Proclamation, Proclamation No 983/2016, Federal Negarit Gazeta, 22nd Year No.103, 2016,Art 26(1)

⁷⁹ Ibid,Art,26(4)

account and those relieved from this one since their transactions are below the threshold. Depending on the volume of their transactions and their economies of scale the gross profit margins of small, medium or large taxpayers will obviously be different. Therefore, the estimated tax assessment directive should have come up with its own list of gross profit margins that better fits its target taxpayers.

Chapter Three: **The Practice in Estimated Business Income Tax Assessment of Companies in** **the Federal Tax System of Ethiopia**

3.1 The Practical Aspect At the Tax Tribunals

The FITP and FTAP has entered in to effect beginning from July 2016 replacing the former income tax proclamation number 286/2002 and the administrative and procedural provisions previously incorporated under different domestic tax laws. The new FITP and FTAP have brought significant changes especially in presumptive business income tax assessment. The presumptive tax assessment has two major areas of application. These are estimated tax assessment and standard assessment. The former applies for assessment taxpayers whereas the later applies for small and informal businesses. To express it in the other ways, standard assessment applies for category C taxpayers and estimated tax assessment for category A and B business income taxpayers. The council of ministers has enacted the standard assessment of category “C” business income taxpayers, which is included under the income tax regulation. According to this regulation, the presumptive business tax to be paid by category “C” tax payers will be calculated in accordance to the schedule attached to it.⁸⁰The Minister of Finance is also mandated to revise the schedule in accordance with which the tax to be paid by category “C” tax payers is assessed at least every three years.⁸¹

On other side, the FTAP has authorized the Authority (currently Ministry of Revenues) to issue a directive for the implementation of estimated tax assessment.⁸²Accordingly, the Authority

⁸⁰ Council of Ministers Regulation, Regulation No 410/2017, Negarit Gazeta, 23rd Year No.82, 2017,Art 49(1)

⁸¹ Ibid,Art,49(3)

⁸² The Federal Tax Administration Proclamation, Proclamation No 983/2016, Federal Negarit Gazeta, 22nd Year No.103, 2016,Art 26(8)

(currently Ministry of Revenues) has enacted estimated tax assessment directive number 138/2018 which was effective beginning from 2018 and still effective up to date. The estimated tax assessment directive which was supposed to focus on assessment taxpayers has included all schedules of income and standard assessment together. The estimated tax assessment is mixed with standard assessment and to the worst goes up to copy pasting the schedules attached under the income tax regulations for category ‘‘C’’ taxpayers. It has attached this schedule directly and also proclaims the estimated tax assessment to be calculated using gross margin assigned for category ‘‘C’’ taxpayers. According to Ato Wasihun Abate, the gross profit margin attached at the back side of the estimated tax assessment directive is a direct copy of the gross profit margin used for small taxpayers under the income tax regulation.⁸³ Hence he described it as against the principles of economist of scale.⁸⁴ The two types of assessments (estimated and standard) were incorporated for different categories of taxpayers and thus the estimated tax assessment directive seems inappropriate for the reason it uses a standard assessment margins.⁸⁵ The problem here is not related with standardizing the estimated tax assessments, rather the argument is the estimated tax assessment method shouldn’t copy paste the gross profit margins assigned for standard assessment taxpayers. The large and middle taxpayers (Category A and B) are mostly believed to have low margin and higher volume of sales compared to schedule C taxpayers.⁸⁶ He further briefed that the taxpayers should have been divided into categories based on their level and amount of capital used in the business and important to specify a turnover ceiling above which it no longer applies.⁸⁷ In a similar way, Ato Zeleke Jambo expressed his view that the kind of copy pasting the standard assessment gross profit margin for large taxpayers is inappropriate and causing a serious problem during implementation.⁸⁸ He further briefed that the two types of assessments are aimed for different categories of taxpayers with different economies of scale, the small taxpayers having small transaction with high profit margins and the large and medium taxpayers to the vice versa and recommended the estimated tax assessment assign its own gross profit margins.⁸⁹

⁸³ Interview with Ato Wasihun Abate, External legal advisor to the Ministry of Finance (Addis Ababa, Ethiopia, March 19, 2024)

⁸⁴ Ibid

⁸⁵ Ibid

⁸⁶ Ibid,

⁸⁷ Ibid

⁸⁸ Interview with Ato Zeleke Jambo, Deputy Branch Manager at LTO branch of MoR (LTO, April 07, 2024)

⁸⁹ Ibid

To see the status and what is on the ground, estimated tax assessment of companies with books of account under the federal tax system, the following cases are selected and assessed as follows,

CASE ONE

In the case between, Keangnum Private Limited Company Ethiopian Branch vs. large taxpayers' branch office, the investigation tax audit department of ERCA (currently Ministry of Revenues) has decided a profit tax by an estimation assessment using 2% profit margin. For clear understanding of the issue, the income tax assessment of Keangnum Private Limited Company Ethiopian Branch, which is a South Korean company engaged in construction business was among the taxpayers at LTO – Ministry of Revenues. It was then audited by the tax office for five years (2010- 2014) and communicated by a letter numbered 02/30/16020/2009 on 22/04/2017. When it comes to the income tax assessment, the Ministry of Revenues) has assessed 367,327,447.28 including principal, interest and penalty tax. An anonymous tax auditor, who participated in the tax assessment, elaborated the process of assessment of business income tax in KEANGNUM's case. According to him, the books of account of the company was rejected for the reasons first it had declared a huge amount of loss which they couldn't believe, second the expenses made to the projects were not believable, third its internal audit control system was weak, fourth its books of account was not prepared in accordance to law and hence decided to assess the tax by an estimation using 2% profit margin on the total sales of the company.⁹⁰ Such an approach is however unacceptable for the company. According to the objection statement of the company submitted to the tax review department, it disclosed that it has kept all its books of account properly and if there are any documents and expenses not acceptable, they should have alienated the rejected one to make an amendment other than rejecting the whole books of account and decide by estimation. It argued that it was under loss for a number of years for different reasons and the investigation audit department has failed to verify whether the reason for the loss was right or not and simply focused on the mere reason that the amount of loss was huge only.

The anonymous auditor further stated, the 2% profit margin was selected since they have not found appropriate to apply the directive on standard assessment to construction business which is 16%.⁹¹ He added that the 16% profit margin was unrealistic to use for the company and they

⁹⁰ Interview with an anonymous tax auditor (Addis Ababa, Ethiopia, March 01, 2024)

⁹¹ Ibid

have checked the contract which the company has agreed with the Ethiopian Road Authority and have found the intention of the client (the company) which it has pre stated its intention to secure a profit margin of 0-3% from the total contract price.⁹² Then the tax auditors have used an average margin of 2% which they stated it fair taking the maximum 3% profit margin which the taxpayer has expected during the signing of the construction contract.⁹³

The company further argued that the 2% profit margin was like a lottery lot selection and not supported by any law and thus requested the new tax administration proclamation number 983/2016 was decisive and be applied on its complaints. The anonymous tax auditor finally disclosed that the tax thus assessed was taken by the taxpayer to the tax review committee and beyond to the ERCA's head office, but the assessment was not reversed.⁹⁴ The tax review office has affirmed the tax decision of the tax audit. The details of the arguments of both sides and its stands are briefed in the decisions.⁹⁵

CASE TWO

In a similar case between SBI International Holding AG Ethiopian Branch vs. Ministry of Revenues Large taxpayers Branch Office, the office has decided profit tax on the company based on an estimated tax assessment using 5% profit margin. SBI International Holding AG Ethiopian Branch is a Swiss company engaged in construction business was among the taxpayers at Large Taxpayers Office of the Ministry of Revenues. It was audited for the period 2018-2020 G.C. for business income tax. When it came to the income tax assessment the large taxpayers branch office of the Ministry of Revenues) required 141,621,577.70 including principal, interest and penalty tax. Ato Workneh Meseret, who is tax audit team coordinator at the large taxpayers' branch office, stated the reasons for amendment of the revenue under estimated assessment. He stated that the company has declared continuous losses and the reason for such loss was due to the fact that it adjusted its estimated cost to complete the construction project above the contract price beginning from the commencement of the project and this does mean working for a loss and actually the books of account of the company was loss, the machineries which the company is using were purchased from a parent company abroad, and failed to bring the book value of

⁹² Ibid

⁹³ Ibid

⁹⁴ Ibid

⁹⁵ Keangnum private limited company, Ethiopian branch v. the FDRE MOR Large Taxpayers Brach office),, Tax Review office, decision, file No 1-6/40/10,(2018)

these items, and fourthly the majority of its other purchases were from its parent company.⁹⁶ He added that, they have adjusted amount of the estimated cost and have decided amended tax based on the rules of percentage of completion of long term contracts under article 32 of proclamation number 979/2016 using estimated tax assessment mechanisms.⁹⁷ He further stated that, before they decided they have checked out the contract which the taxpayer has agreed with the Ethiopian Road Administration and have found the intention of the client (the company) which it has pre stated its intention to secure a profit margin of 5% from the total contract price.⁹⁸ Here as per the estimated tax assessment directive number 138/2018, the profit margin for construction sector is 16%, however the tax auditors stated that they have found it not sound to use as stated under the directive taking the economies of scale of the taxpayer and the profit margin registered by similar companies in the business,⁹⁹ Ato Werkinch further disclosed that the tax thus assessed was taken by the taxpayer to the tax review committee but the assessment was not reversed.¹⁰⁰ On a related way, Ato Zeleke Jambo, who is currently the deputy manager of the large taxpayers' branch office, disclosed that there are lots of scenarios where the large taxpayers' branch office of the Ministry of Revenues was forced to use other methods to estimate direct or indirect taxes outside the estimated tax assessment directive number 138/2018.¹⁰¹ He further briefed that the directive was and is full of gaps and not helpful as expected to fill the gaps. Ato Zeleke finally expressed that the profit margin attached under the directive are most of the time unrealistic and not workable especially for large taxpayers.¹⁰² Ato Werkinch has also expressed a similar view about the gross profit margins attached under the directive.¹⁰³ The taxpayer has taken the case to the tax review department of the branch office, but the assessment was not reversed and has

⁹⁶ Interview with Ato Werkneh Meseret, Tax Audit Team Coordinator at LTO branch of MoR (LTO) (Addis Ababa, Ethiopia, April 07, 2024)

⁹⁷ Ibid

⁹⁸ Ibid

⁹⁹ Ibid

¹⁰⁰ Ibid

¹⁰¹ Interview with Ato Zeleke Jambo, Deputy Branch Manager at LTO branch of MoR (LTO) (Addis Ababa, Ethiopia, April 07, 2024)

¹⁰² Ibid

¹⁰³ Interview with Ato Werkneh Meseret, Tax Audit Team Coordinator at LTO branch of MoR (LTO) (Addis Ababa, Ethiopia, April 07, 2024)

affirmed the tax decision of the tax audit for similar reasons.¹⁰⁴ The details of the arguments of both sides and its stands are briefed in the decisions.¹⁰⁵

Scrutiny of the above two decisions with regard to the estimated tax assessment directive

By chance, the above two cases shares similar issue of law and fact in between. There is around four years' time duration between the two cases, but still the same problem for different companies engaged in similar business. The differences are one in the case of keangnum private limited company Ethiopian Branch the auditors used 2% profit margin whereas in SBI International Holding AG Ethiopian Branch case, they have used 5% profit margin. The similarity is in both cases is one the auditors had chosen the profit margins out of nowhere simplify on the justification of fairness, and secondly they have tried to take guess number using what the taxpayers had pre stated their intention to secure some amount of profit margin during the conclusion of a contract. Thirdly, in both cases the auditors were in a fierce dilemma and decided not to use the 16% profit margin stated under the directive on the reason it was not realistic to use for companies like in the cases. On the other hand, the above two cases show that, the tax authority seems not convinced to use the directive on estimated taxation which was issued by itself. The method and profit margin chosen in both cases were inconsistent to what is discussed in chapter 3 above. The directive illustrated some methods which are deemed helpful to estimate the sales amount of the taxpayer under assessment. According to the directive the taxpayers under these two cases were supposed to be assessed using the 16% profit margin assigned for businesses engaged in the construction business. The tax authority had rather relied only on the contractual agreement the two companies had with Ethiopian Roads Authority. The reference on both cases was the profit margin which the companies had expressed their intention to secure during the conclusion of the construction contract which is nothing other than a simple expression of their hope before the performance the construction work. Above all the margins chosen on both cases are not based on the self-assessment of the taxpayers, third party information or any other legally supported grounds to use so. Therefore, using profit margins which were pre stated under contractual agreements before the work was done for tax assessment purposes without basing on any legal authority, domestic or treaty-based, can be seen as one serious gap in the practice as it is against the tax principle of legality and may also open for

¹⁰⁴ SBI International Holding AG Ethiopian Branch v. the FDRE MOR Large Taxpayers Brach office), Tax Review office, decision, file No LTO/MD/1614/14,(2022)

¹⁰⁵ Ibid

arbitrary taxation which can cause easy manipulation of taxpayers and can create a fertile ground for corrupt practices. On the other hand, the tax Auditors have rejected the gross profit margin stated under the directive for construction sector as exaggerated and unrealistic and opted for a lower gross profit margin. This also shows how the estimated tax assessment under the federal tax system is full of lacuna and creating difficulty on the ground during implementation.

CASE THREE

In other recent case, between, Guna Trading private limited company which is engaged in trading business and a public enterprise under the umbrella company called EFFORT vs. the large taxpayers' branch office of the Ministry of Revenues. The taxpayer was audited by the investigation audit directorate of the Ministry of Revenues for four years (2009- 2012 E.C.) and was communicated by a letter numbered 5.4.3/425/15 and dated on 08/11/2022. The investigation audit directorate of the Ministry of Revenues decided a total of birr 500,100,622.26 including principal, interest and penalty tax by an estimated tax assessment method. The taxpayer has filed its notice of objection to the decision to the tax review directorate established under the large taxpayers' branch office. In their written submission to the tax review department, the investigation audit directorate tax auditors has briefed that the taxpayer was engaged in the distribution of products like palm oil, sugar, and cement and had repeatedly requested it to submit all its documents for an audit but failed to do so and responded that it had recently relocated its head office from Addis Ababa to Mekelle and couldn't deliver all its documents due to the war in Tigray and finally the directorate has decided to assess the tax at 13% gross profit margin.¹⁰⁶

On the other side, the taxpayer on its notice of objection stated that since all its documents were at its head office situated at Mekelle and it couldn't submit such documents due to the war there, and expressed the situation as a force majeure to fulfill its obligation for the submission of the documents.¹⁰⁷ It therefore argued that the investigation audit department's tax decision by estimation was not right and demanded for a re-audit after an occurrence of any enabling situation to submit all its documents from Mekelle in the future.¹⁰⁸ Furthermore, it argued that it was engaged in the distribution of basic goods in Tigray and Afar regional states at a profit

¹⁰⁶ Guna Trading private limited company v. the FDRE MOR Large Taxpayers Brach office),, Tax Review office, decision, file No LTO/RD/1768/15/(2023)

¹⁰⁷ Ibid

¹⁰⁸ Ibid

margin fixed by the Ministry of Trade and challenged the 13% profit margin couldn't apply to it stating this was a margin for companies engaged in similar sector however with a free market selling price.¹⁰⁹ At this part it has argued the decision was against the basic essence of the trade practice and consumer protection proclamation number 813/2013.¹¹⁰ In nutshell, it has demanded for the total revocation of the audited decision.

The tax review department has finally rendered its decision which is in favor of the taxpayers arguments. In its decision, the tax review department stated that article 11/1 of the estimated tax assessment directive number 138/2018 obliged to take the profit margin set by the government if it is proofed that the taxpayer has used the selling price and profit margin fixed by the concerned government body.¹¹¹ The tax review department has further clarified that it has proofed these facts from the concerned government bodies and challenged the 13% was against the basic notion of the directive.¹¹² Besides, it has affirmed the situation in Tigray was above the control of the taxpayer due the war occurred there.¹¹³ Therefore, it ordered the investigation tax audit department to re-audit after reviewing the documents of the taxpayer.¹¹⁴

Reflection on the above judgment

This case triggers a serious point to question as to when is a taxpayer labeled as if failed to file its tax declaration and submit supporting documents. Due to the war broke out in Tigray region of Ethiopia three years ago, the region was under a total blockage. This fact was noticed by both sides however it has posed a serious risk factor. From the taxpayer side, it has paid the tax required for the years under the audit period based on its books of account audited by an external auditor and declared it on its self-assessment. Meanwhile, when the tax office requested books of records probably for an amended assessment, it couldn't fulfill this by the fact that the documents were at an area which is under total blockage due to the war in the region. For no doubt this condition fails under force majeure which will relieve the taxpayer from the duty that demands submission of the required documents for an audit. Therefore, the taxpayer couldn't be labeled as if not volunteer to submit the required documents and thus closes the room for estimated taxation. However, the tax auditor needs documents of the company to make the audit

¹⁰⁹ Ibid

¹¹⁰ Ibid

¹¹¹ Ibid

¹¹² Ibid

¹¹³ Ibid

¹¹⁴ Ibid

properly and therefore the company seems blameless to the tax office for resorting to estimated tax assessment. Besides, the audit time does have a period of limitation to make an amended assessment and seems unreasonable to wait for unspecified time. To the worst the tax laws including the estimated tax assessment directive lack clarity to put a way out under such demanding situations both to the tax authority and the taxpayer. If such conditions have to be construed on the side of the tax office, obviously it will enable the tax office use the estimated tax assessment on taxpayers with no fault of them. If on the other way this situation is used in the favor of a taxpayer, it will have a negative impact on the tax office as well. This case can show the legal lacuna which exists in the federal tax system of Ethiopia including the estimated tax assessment directive to fill such gaps.

CASE FOUR

In the case between, CE Textile Manufacturing private limited company and the Ministry of Revenues North West Addis Ababa Small Taxpayers Branch Office Tax Audit process owner, the taxpayer was audited for the year 2020-2021. The company is a Chinese company engaged in textile manufacturing business and was among the taxpayers at Small Taxpayers Branch Office of the Ministry of Revenues. The company was under tax holiday as per the investment incentive regulation and thus the auditors couldn't assess profit tax and therefore, the tax audit process owner of the branch office has made an assessment of excise tax and value added tax only with a total of birr 32,143,735.05 including principal, interest and penalty tax using an estimation tax assessment. The taxpayer has filed its notice of objection on the decision to the tax review office established under the North West Addis Ababa Small Taxpayers' Branch Office. In its objection points the company stated that it has registered a loss of 57 million and 28 million birr for the tax year 2020 and 2021 respectively urging it as proper loss occurred due to different legal reasons.¹¹⁵ In their written submission to the tax review office, the tax auditors have briefed that the taxpayer was engaged in textile manufacturing business and urged that its sales price was below its cost and therefore amended it by changing its cost of goods sold using 24% gross profit margin of the sector.¹¹⁶ Following this they have adjusted the loss amount incurred during tax holiday time which was supposed to be forwarded to a total of half of the tax holiday period.

¹¹⁵CE Textile Manufacturing private limited company vs. the FDRE MOR North West Addis Ababa Small Taxpayers Brach office, Tax Review office, decision, file No ሰ፱/4-0-6/1/148,(2022)

¹¹⁶ Ibid

¹¹⁷ Accordingly, they have amended the loss registered for income tax and assessed the excise and value added tax only.¹¹⁸ The tax review office finally reversed the tax decision and remanded it to the tax audit department to make the audit again. The tax review office stated that the selling price of the company was not checked whether it was made with reference to the market price of similar products at the time and place.¹¹⁹ Therefore, it finally ordered the selling price of the company to be compared using the selling price of similar products under the files of national statistics agency and if not possible through this way, to apply the market price value of similar products of similar companies at that time and place.¹²⁰

Reflection on the above decision

The audit finding on the above case is mainly related with the adjustment of the cost of goods sold. The auditors have rejected the cost of goods sold for the reason it was built using the cost of good below its actual cost. According to the cost adjustment made, the loss maintained by the company at its books of account for income tax purpose was rejected and assessed the above stated indirect tax liabilities. In this case there are two basic adjustments made by the auditors. At the first point, he tax auditors have adjusted the cost of goods sold maintained by the company. After the adjustment, they have calculated the tax using 24% gross profit margin stipulated under the estimated tax directive. Here the tax review office seems not convinced to uphold the tax decision mainly for the reason the adjustment violates free market principle which authorizes the trader to sell at the market price Therefore, it confirmed the estimated tax assessment but reversed the 24% gross profit margin and ordered to use profit margin using market assessment of similar companies selling the same product. However, the estimated assessment directive doesn't refer gross profit margin of this kind, it rather oblige to use the profit margin schedules attached under the directive in this case the 24%. This case also shows how the tax office is not convinced to apply the gross profit margin stated under the estimated tax assessment directive for it is unrealistic or not working on the ground.

CASE FIVE

In one case, BGYG General Trading private limited company vs. Ministry of Revenues, the litigation at first went up to the Federal Supreme Court and returned back to Tax Appeal

¹¹⁷ Ibid

¹¹⁸ Ibid

¹¹⁹ Ibid

¹²⁰ Ibid

Commission and then to Federal High Court and again to Federal Supreme Court. Initially, the Western Addis Ababa Branch Office of the Ministry of Revenues has decided business income tax and value added tax on the taxpayer. The anonymous general manager of the company stated that the company was a vat registered and with a duty to keep books of account.¹²¹ In the course of doing business the taxpayer requested credit for VAT, and the branch office has expressed its interest to check documents and books of account.¹²² In so doing, some employee of the company has brought receipts used by it and among the manual receipts used by the taxpayer, receipt number 005 and 018 was found to be illegal and the tax office communicated with the company about the issue.¹²³ The anonymous manager of the company appeared and after looking at the receipts he responded the receipts are forged and prepared by the finance officer to hide his mistakes.¹²⁴ Then after he has provided the original copy of the two receipts and briefed the tax office the fact that, the finance officer has arranged the fake copy of the original when he was not able to get the original receipts.¹²⁵ In nutshell, the tax office has got the forged copy from the finance officer and the original ones from the manager. Finally the audit department of the tax office has decided valued added tax and profit tax taking the average sales in the whole original receipts assuming as if the company was using original and forged receipts side by side for the same transaction.¹²⁶ After this the company has filed its notice of objection to the decision, in writing after the service of the notice of the decision and objected that there was no any legal and factual background to assess double tax using the genuine submission of legal receipts by the company with a forged receipts submitted by a finance officer who was engaged in an illegal activities and finally fired from his position.¹²⁷ Moreover, it objected the tax assessment was decided by an estimated mechanism and against the modalities stated under the estimated tax assessment directive number 138/2018.¹²⁸ After the audit, criminal investigation was opened on the company and the manager of it. The civil litigation has passed through all the tax litigation proceedings and still pending at the Federal Supreme Court on the appeal of the tax office. However, the criminal part was closed by the Economic Crimes prosecution Directorate of the

¹²¹ Interview with anonymous general manager of BGYG General Trading plc.(Addis Ababa, March 15,2021)

¹²² Ibid

¹²³ Ibid

¹²⁴ Ibid

¹²⁵ Ibid

¹²⁶ Ibid

¹²⁷ Ibid

¹²⁸ Ibid

Ministry of Justice. The Prosecutor has stated that evidences of the audit failed to proof the fact that the company and the manager were aware of the forged receipts and if they used any of the illegal ones.¹²⁹ Furthermore, the prosecutor stated that the audit findings are arbitrarily decided and lacked legality.¹³⁰ The tax appeal commission has affirmed the decision of the tax audit.¹³¹ However, the Federal High Court reversed it¹³² and the Federal Supreme Court remanded it to the tax appeal commission again.¹³³ After the remand the federal taxes appeal commission decided like before¹³⁴ and the federal high court reversed it again.¹³⁵ Now the case is under appeal at the federal Supreme Court again.¹³⁶

Reflection on the above decision

This case was selected for this research mainly to review how the case was decided through estimated tax assessment mechanism. Looking at the two forged receipts, the tax auditors had estimated the sales amount using their estimation method. The audit department of the tax office has decided VAT and profit tax taking the average sales in the whole original receipts assuming as if the taxpayer was using original and forged receipts side by side for the same transaction using the profit margin of the taxpayer. This tax decision was made on November 2018 which is after the coming in effect of the estimated tax assessment directive number 138/2018. In the amended assessment, the tax office has estimated the sales amount of the taxpayer using the above techniques. Therefore, the tax assessment made has to be checked with the guiding provisions stipulated under article 9 of the estimated tax assessment directive. Since the case is under active litigation at the federal Supreme Court, the author has chosen to say one thing only that is the sales estimation method employed seems arbitrary as the directive says nothing in similar scenarios.

¹²⁹ The FDRE Ministry of Justice, Economic Crimes directorate Prosecutor, file no.....(2018)

¹³⁰ Ibid

¹³¹ BGYG Trading plc. v, the FDRE MOR, Federal Tax Appeal Commission decision file no ታይኮ ከቢ-2138/11 , (2019),

¹³² BGYG Trading plc. v, the FDRE MOR., federal high court decisions file no ,243196,(2021)

¹³³ FDRE MOR y.BGYG Trading plc. Federal supreme court decision decisions file no 207643 (2022)

¹³⁴ BGYG Trading plc. v, the FDRE MOR, Federal Tax Appeal Commission decision file no ታይኮ /ከቢ-2138/11 (2023)

¹³⁵ BGYG Trading plc. v, the FDRE MOR., federal high court decisions file no 305512 (2023)

¹³⁶ FDRE MOR. v, BGYG Trading plc, Federal supreme court decision decisions file no 255064 (2023)

3.2 The Estimated Business Income Tax Assessments and Their Interpretation at the Cassation Bench of the Federal Supreme Court

Tax and appealable decisions are final and can be challenged only under the objection and appeal procedures dealt in Part Nine of the tax administration proclamation.¹³⁷ The procedures for disputing tax decisions are the filing of a notice of objection to a tax decision to a tax review office, Tax Appeal Commission on issues of fact and at High Court and Supreme Court on questions of law. Those aggrieved with the decision of the Supreme Court if the decision contains fundamental error of law can still seek for cassation under this court. The Cassation power of the federal Supreme Court is recognized under the FDRE Constitution.¹³⁸ Following the constitution, proclamation number 454/1665 clearly introduced cassation power of the federal supreme court. The recent Federal Courts Proclamation has also provided that the Federal Supreme court has a power of Cassation over any final decisions (from court or other adjudicative organs) so far as it exhibited a fundamental error of law.¹³⁹ The Supreme Court has rendered binding decisions on some tax dispute so far. To the best knowledge of the author, the cassation bench has rendered binding decision on the following three cases related with estimated tax assessment. All those cases were entertained at the cassation division of the federal supreme court at tax periods covered within the repealed income proclamation number 286/2002. There is no any cassation bench decision on estimated tax assessment of companies with books of account rendered so far based on the new income tax laws. As briefed above, there are similarities between the repealed income tax proclamation and the new income tax laws contemporary in effect on estimated business income tax assessment of companies with books of account. Therefore, in order to check the understanding of the cassation bench of the Supreme Court on the area, the author found it appropriate to review these decisions.

The first case entertained at the Cassation bench was between Ato Abebe Gebr'egziabher (applicant) and Arada sub city tax office (respondent).¹⁴⁰ and finally published on volume 13 of the cassation bench decisions. The case began when the respondent assessed an amended tax on

¹³⁷ The Federal Tax Administration Proclamation, Proclamation No 983/2016, Federal Negarit Gazeta, 22nd Year No.103, 2016,Art 53(1)

¹³⁸ The Constitution of the Federal Democratic Republic of Ethiopia, Proclamation No 1/1995, Federal Negarit Gazeta, 1st Year No.1, 1995,Art,80(3(a)

¹³⁹ The Federal Courts Proclamation, Proclamation No 1234/2021, Federal Negarit Gazeta, 27thYear No.26, 2021,Art,10(2)

¹⁴⁰ Abebe gebre'egziabher v. Arada sub city tax office., federal supreme court cassation decisions file no 69921,(2012) vol 13,p,521-523

the applicant using an estimated tax assessment mechanism. The applicant is engaged on the import of stationery materials and maintained its books of account but the profit margin it registered was found to be below the margin surveyed on businesses engaged in similar sector i.e. the standard assessment.¹⁴¹ The argument of the applicant was it has maintained proper books of account and the respondent should not have assessed the tax by estimation without nullifying the books of account and argued the tax as against article 69(1) Of proclamation number 286/2002.¹⁴² The cassation bench finally affirmed the respondent's tax decision.¹⁴³

The second case entertained at the Cassation bench was between Mulu Amin Trading private limited company (applicant) and the Ethiopian Revenue and Customs Authority (respondent).¹⁴⁴ and finally published on volume 16 of the cassation bench decisions. The applicant is a self-assessment taxpayer and after paying its tax liability on some tax year in accordance with books of account, a fire caught on its business premises destroyed all its books of account and supporting documents.¹⁴⁵ After some lapse of time, the respondent requested the applicant to submit its books of records for audit and the applicant responded it couldn't fulfill this as the documents are destroyed by fire.¹⁴⁶ Then after, the respondent has decided the tax using estimation. The basic essence of the litigation was surrounded on this and finally the cassation bench reversed decisions of lower courts.¹⁴⁷ Then it remanded the case to be assessed again after weighing the evidence which shows about the loss of the documents which the court construed as an act which contravenes the hearing right of the applicant.¹⁴⁸

The other case was between Ato Tekle Fereja (applicant) and the Ethiopian Revenue and Customs Authority (respondent)¹⁴⁹ and finally published on volume 21 of the cassation bench decisions. The applicant has maintained its books of account but the profit margin it registered was found to be below the margin surveyed on businesses engaged in similar sector i.e. the

¹⁴¹ Ibid

¹⁴² Ibid

¹⁴³ Ibid

¹⁴⁴ Mulu Amin Trading plc. v. the Ethiopian Customs and Revenue Authority, federal supreme court cassation decisions file no 88446,(2014) vol 16,p,302-396

¹⁴⁵ Ibid

¹⁴⁶ Ibid

¹⁴⁷ Ibid

¹⁴⁸ Ibid

¹⁴⁹ Ato Tekle Fereja. v. the Ethiopian Customs and Revenue Authority, federal supreme court cassation decisions file no 133773 (2017) vol 21,p,209-212

standard assessment.¹⁵⁰ The argument of the applicant was it has maintained proper books of account and the respondent should not have assessed the tax by estimation without nullifying the books of account and argued the tax as against article 69(1) Of proclamation number 286/2002.¹⁵¹ The cassation bench however finally affirmed the respondent's tax decision.¹⁵²

Reflection on the cassation decisions

The first and third cases had similar issue of fact and law. The taxpayers under the two cases(cassation file numbers 69921and 133773 are self-assessment taxpayers and had maintained proper books of account. The tax office had not rejected the books of account as well. However, the tax office has amended the profit margin on the mere reason it found the profit margin of the taxpayers to be below the profit margin stated under the standard assessment for similar businesses. These all cases were entertained at the cassation bench before the coming in to effect of the current ITP and FTAP. The estimated tax assessment mechanism was included under the former income tax proclamation but now it is under the Federal tax administration proclamation. However, the two laws shares similar scenarios for estimated tax assessment. Under the above two cases at hand, the cassation bench stated the reason to reject the books of account and opt for estimated tax assessment was for the taxpayer has registered a profit margin below the surveyed margin for standard assessment. Surprisingly at both cases the taxpayers has maintained proper books of account and was not rejected at all. The grounds for estimated tax assessment under the former income tax proclamation were if no records and books of accounts are maintained by the taxpayer, or if, for any reason, the records and books of accounts are unacceptable to the Tax Authority, or if the taxpayer fails to declare his or its income within the time prescribed by this Proclamation. The two taxpayers have declared their taxes using the self-assessment mechanism and thus the option to make any kind of amendment for self-assessment tax was and is amended assessment. Under self-assessment, the tax authority accepts the taxpayer's tax declaration at face value and is not legal to reject the gross profit margin stated under self-assessment unless it is disproved during amended assessment. If the tax authority accepts the self-assessment, it is duty bound to accept the profit margin declared by the taxpayer. Accepting the self-assessment tax declaration as it is and making a cross reference to profit margins surveyed for standard assessment seems self-contradictory and using both self-assessment and estimated assessment at

¹⁵⁰ Ibid

¹⁵¹ Ibid

¹⁵² Ibid

the same time. In short it can be described as a double standard at one time. If the tax office accepts the self-assessment tax declaration, it has to accept the profit margin declared by the taxpayer as well. Above all the reason stated for the revision of the gross profit margin was not one stated as a reason to opt estimated tax assessment over self-assessment. Therefore, the gross profit margin shouldn't have been changed while the self-assessment tax declaration was not rejected. Hence, the tax authority's tax decision and the decision of the cassation bench on these cases didn't look proper and not supported by the then income tax proclamation.

Whereas in the case entertained with cassation file number 88446, the order of the cassation bench to remand to federal tax appeal council would seem proper. However, if the books of account and documents were destroyed by fire, what could be the viable solution other than tax through estimation is not clear. The taxpayer stated that it was not able to produce the books of account and documents since they were destroyed by fire, and accordingly the tax office decided the tax through estimation. The cassation bench remanded the case, in order the lower ladder of litigation check whether this allegation was right or not and decide the tax accordingly. Therefore, if the allegation was proved to the positive there seems no other means other than estimated tax assessment and the reason for the remand would mean nothing.

The above cases in general show the level of understanding of the cassation bench with regard to the purpose of estimated tax assessment. First of all there seems confusion on the ground for rejection of the books of account. From the cases entertained at the bench, the court seems understood as if the tax office could reject the books of account of a taxpayer with its discretionary power. Second, the interpretation of the cassation bench construing the existence of a difference among a gross profit margin stated under the self-declared tax and profit margin surveyed for standard assessment, as a sufficient ground to make an amendment on the profit margin seems mistaken. Last but not least, the cassation bench seems not clear on the difference between estimated assessment and standard assessments. Had it been clear on this point, it wouldn't have affirmed the tax office's decision that had used reference of the gross profit margin of standard tax assessment taxpayers to reject the profit margin used under unchallenged self-assessed tax declaration.

Chapter – Four

Conclusion and Recommendations

4.1 Conclusion

This research studied the estimated business income tax assessment of companies with books of account under the federal tax system of Ethiopia and explored the current Ethiopian rules applicable in this system and their enforcement in practice. In so doing, it showed the gaps existing in the Ethiopian rules and the practice as seen from the legal and practical points of view. From laws perspective, some major gaps were identified. While there are laws enacted on the area, taking the complex nature of the area, there are still gaps in the laws. The Tax Administration Proclamation has empowered the Ministry of Revenues to enact estimated tax assessment directive. Therefore, an estimated tax assessment directive was enacted accordingly. However, this directive has intermixed estimated tax assessment and standard assessment mechanisms under the same directive. The estimated tax directive has also copy pasted the gross profit margins of the standard tax assessment taxpayers which is against the intention of the legislature to differentiate estimated tax assessment and standard tax assessment. Drafting presumptive taxation of large and small taxpayers to share the same techniques and sharing the same gross profit margin seems against the nature of the economies of scale and the responsibilities that could be assumed by each category of taxpayers. Taking this in to account the estimated tax assessment directives seems ill drafted. On the other hand, the estimated tax assessment directive looks insufficient to cover all instances of estimated tax assessment. In addition, the estimated tax assessment mechanisms for business income taxpayers are very limited. The estimated tax assessment rules stipulated under the directive can easily expose taxpayers for arbitrary taxation and prone to corrupt practice to tax officers easily. Last but not least, the estimated tax assessment lacks check and balance mechanisms, lack of efficiency, creating disputes/conflict, vulnerability to corrupt practices caused by the estimated assessment. And also lack timely revision taking in to account the inflation rates and economic situations. From a practical point of view, on the other hand, some problems were identified in the drafting and application of some provisions in the tax laws that may have an effect of reversing the basic principle the law itself had set out to uphold and causing a diversified understanding of the same concept among different parts of the tax administration. The major gaps identified in this regard

are: Tax auditors opt to reject the books of account of taxpayers on conditions that doesn't satisfy the legal requirements in order to use estimated tax assessment mechanism. The tax offices use this assessment mostly to assess higher taxes amount. At some instances tax auditors were reluctant to use the estimated tax assessment directive considering it as having exaggerated profit margin for large and medium taxpayers. There were also scenarios where tax auditors use estimated techniques and profit margins arbitrarily. There is lack of knowledge on the understanding and even existence of estimated mechanisms by auditors of the tax authority, and the directive not being given a single place in tax assessments, and the outright denial of the estimated tax assessment mechanisms with no sound justifications. Widespread subjectivism also being witnessed in estimated business income tax assessment by tax auditors for not completely relying on legal authority in their decisions. The net effect of these problems will cast its own dark cloud on the federal tax system of Ethiopia. This will lead to arbitrary taxation, spread of corrupt practice, loss of revenues and creating hindrance for foreign trade and investment. Besides, efforts at bringing equity and modernizing the tax system would be unlikely to be successful with such problems existing. The following recommendations are forwarded in view of contributing towards such goals.

4.2 Recommendations

The findings of this research didn't base on a very detailed empirical data. However, taking in to consideration the various limitations, it has tried to use some doctrinal and empirical data in order to uncover the legal and practical gaps in the estimated tax assessment of companies under the federal tax system of Ethiopia. The revenue gain and loss aspects of estimated tax assessment of companies aren't done by this research. Though this research is pioneer on the area under study, the federal tax system should commission a higher scholarship research than the current author on estimated tax assessment and the mechanisms viable from the context of Ethiopia and other countries

The findings of this research clearly indicate that there are legal gaps and the current practice on estimated tax assessment is broken. Thus, the federal government should opt for adoption of an efficient, fair, predictable and legal administration of estimated tax assessment under the federal tax system of Ethiopia and fulfill the policy objectives of taxation in general, the most important recommendations that the researcher forwards after conducting this study are:

- For the Ministry of Revenues to redraft the estimated tax assessment directive separate from standard assessment.
- The estimated tax assessment directive to be drafted again has to use a different type of gross profit margins different from the schedules stated for small taxpayers.
- The estimated tax directive has to employ different estimation mechanism that could catch each and every group of taxpayers
- The estimated tax assessment directive has to be designed in a way that could avoid or minimize arbitrary taxation and corrupt practices
- The estimated tax assessment directive has to include check and balance mechanisms.
- It has to include a mechanism for timely revision
- For the issuance of clear rules in subsequent legislations by the government clarifying the problems identified in this research;
- The estimated tax assessment directive was enacted before the coming into effect of the Administrative Procedure Proclamation Number 1183/2020. So I recommend any interested person to file a petition requesting a judicial review of this directive at the Federal High Court of Ethiopia based on the current Administrative Procedure law.

The other issues worth recommending is ,tax-auditors and legal personnel of Ministry of Revenues, Tax appeal commission judges and Federal Court judges to be given continuous trainings on the concept of presumptive taxation in general and of estimated tax assessments in particular. For every estimated tax assessment notification by tax auditors of the Ministry of Revenues to be justified by a legal authority such as clearly justifying the reasons for the rejection of books of account, the estimation methods employed and the profit margin used for the assessment of business income tax of companies

This research studied the issue of estimated business income tax assessment of companies with books of account and explored the current Ethiopian rules applicable in estimated business income tax assessment of companies in practice. In so doing, it showed the gaps existing in the federal tax system of Ethiopian laws and the practice.

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APPENDIXES

Appendix 1

Abebe Gebr'egziabher vs. Arada sub city tax office (Federal Supreme Court Cassation Bench, File No. 69921) pages 524-526 published under volume 13 in Amharic 03 pages

Appendix 2

Mulu Amin Trading private limited company Vs. the Ethiopian Revenue and Customs Authority (Federal Supreme Court Cassation Bench, File No. 88446) pages 302-306, published under volume 16 in Amharic 05 pages

Appendix 3

Tekle Fereja vs. the Ethiopian Revenue and Customs Authority (Federal Supreme Court Cassation Bench, File No. 133773) pages 209-212, published under volume 21 in Amharic