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Standard Assessment of Small Businesses in Bahir Dar City Administration: Legal and Practical Analysis

Endegen, Amare

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STANDARD ASSESSMENT OF SMALL BUSINESSES
IN BAHIR DAR CITY ADMINISTRATION: LEGAL AND
PRACTICAL ANALYSIS

ENDEGENA AMARE GEBEYE

School of Law

Bahir Dar University

June, 2017

STANDARD ASSESSMENT OF SMALL BUSINESSES IN
BAHIR DAR CITY ADMINISTRATION: LEGAL AND
PRACTICAL ANALYSIS

Thesis

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By

Endegen Amare Gebeye

Advisor

Aschalew Ashagre (Assistant Prof. of Law)

School of Law,
Bahir Dar University

June, 2017



Thesis approval page

The thesis titled “Standard Assessment of Small Businesses in Bahir Dar City Administration: Legal and Practical Analysis” by Mr. Endegen Amare is approved for the degree of Master of Laws (LL.M)

Board of Examiners

	Name	Signature
Advisor:	_____	_____
Internal Examiner	_____	_____
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Dedicated to my Brother

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Acronyms

ANRS	Amhara National Regional State
BDCA	Bahir Dar City Administration
BFED	Bureau of Finance and Economic Development
BPR	Business Process Re-engineering
E.C	Ethiopian Calendar
FDRE	Federal Democratic Republic of Ethiopia
GDP	Growth Domestic Product
MoFED	Ministry of Finance and Economic Development
SIGTAS	Standard Integrated Government Tax Administration System
TOT	Turn over Tax
VAT	Value Added Tax

Abstract

Standard assessment of business taxation is one of the areas in tax law where one can find the substantial departure from tax accounting rules and principles. Due to the unique features of the small businesses, it has been found necessary to levy business income tax in accordance with the proxies and indicators, other than books of account and record keeping system, especially by developing countries, including Ethiopia. The difficulty to comply with the strict record keeping requirement under the standard assessment tax system is the main reason for having presumptive taxation.

In Ethiopia, before the introduction of standard assessment in the tax system in 2001, small businesses were taxed on the basis of estimated assessment. This type of presumptive taxation totally relied on estimation of daily sale of the business by the tax officers. Even if a number of procedures were used to reach the final tax liability of the taxpayers, estimation of daily sale was the main cause of disagreement between the tax authority and small business taxpayers due to the subjectivity of the tax assessors and under-reporting of the taxpayers. In addition, administrative resources were not sufficient to deal with estimated assessment.

The ANRS Tax Authority in general and BDCA Revenue Office in particular have begun to enforce standard assessment on small business taxation. Standard assessment has been introduced by the ANRS Income Tax Regulation No. 4/2003. Then, this method was continued and assessed in 2008 and 2012. However, due to absence of indicators for most of the businesses, the ANRS Tax Authority has relied on estimation of daily sale to apply standard assessment. In such a case, it is admitted that there are problems of legal and practical application of standard assessment of small business taxation in BDCA. This research particularly found that there is a contradiction between the rules of standard assessment and their practical application, since the actual tax liability of small businesses is being assessed according to estimated taxation. This practice has caused controversy between small businesses and the tax authority/revenue office. In addition to this, because of the subjective nature of estimations and under-reporting of daily sale, small businesses have been exposed to the problems of inequity and uncertainty of tax liability. The study was conducted based on a qualitative research approach by analyzing relevant laws, documents and data collected through interviews. Accordingly, the research discloses that there is no effective implementation of standard tax assessment for the actual collection of tax revenues from small businesses in BDCA. The problems affect both the revenue of the government and small business taxpayers. Essentially, they arise from the usual usage of estimation of daily sale to collect taxes and lack of awareness about the application of standard assessment method by the revenue office.

Based on these findings, the research recommends that estimated assessment method shall not be used in order to bring stability and predictability of small businesses taxation. It also recommends that standard assessment needs to be more consistent and can also be adjusted so as to provide an incentive to small businesses to develop the habit of record keeping. In addition, it recommends that income tax laws should incorporate mechanisms to identify the annual turnover of most of the businesses. Last but not least, awareness creation activities to the tax authority/revenue office and business taxpayers on how standard assessment method should operate are recommended.

CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

In this world, no government can be thought of without taxation. It is a sovereign right of the state used to transfer resources from private to public use in order to achieve the economic and political goals of society. In fact, the most flexible ways to rise per capital incomes and to support increases in real domestic product growth rates is through taxation.¹ Taxes are important sources of public revenue and public goods and services are normally subjected to collective consumption, which requires that we should put some of what we earn into the hands of the government.² The rationale for paying taxes in general is to fund the ever-increasing government public expenditure provisions.

In different tax regimes of many countries, taxes are levied on different sources of income classified into some number of segments.³ Largely, countries set their source of income tax taxpayers into small, medium, and large taxpayers mainly depending on the amount of income derived by the taxpayers.⁴ Tax law frameworks of different countries including Ethiopia provide specific rules governing the assessment method, tax rate, accounting period, deduction, exemption, and other related guidelines for each of the above listed group of taxpayers.⁵

Presumptive taxes are taken as one of the oldest types of taxes dating back to the 18th century where tax liability has been assessed based on the whole asset of taxpayers and other related parameters than the actual income or revenue of the taxpayer.⁶ Thus, several governments

¹Lisa Kayaga; *Tax Policy Challenges Facing Developing Countries: A Case Study of Uganda*, Master Thesis, Queen's University Kingston, Ontario, Canada 2007, p. 2 [Here in after, Kayaga; *Tax Policy Challenges Facing Developing Countries*].

² Abreha Mesele and Kahase G/Hiwot; *Income Tax Assessment Procedures and Their Practical Implementations under Amhara National Regional State: Problems and Possible Solutions*, Debre Markos University School of Law, 2013, p. 8. [Here in after, Abreha & Kahase, *Income Tax Assessment Procedures and Their Practical Implementations under ANRS*].

³Muuz 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, No.1, 2015. Pp. 107-127, p. 107. [Herein after, Muuz; *Evaluation of the Efficiency of Standard Assessment for Category C Taxpayers in Ethiopia*]

⁴*Ibid.*

⁵*Ibid.*

⁶Konstantin Pashev, *Presumptive Taxation and Gray Economy: Lessons for Bulgaria*, 4 (Dec. 2015) (WP 0512/1, Center for the study of Democracy) [Herein after, Pashev, *Presumptive Taxation and Gray Economy: Lessons for Bulgaria*].

across the world have relied on various forms of presumptive taxation, in which indirect methods are used for evaluating the effective tax base and computing the corresponding tax liability.⁷ Basically, the effective tax base is estimated using asset of variables that are strongly correlated with it, and are easily observable, but at the same time cannot be tampered by the taxpayers.⁸

Estimation approaches, where presumptive norms are used to generate income actually, amount to a standardization of the provision for ‘best judgment’, which exists in most conventional tax systems as an assessment prerogative over self-declaration.⁹ Thus, estimation might not seem prima facie to require special legislation for its introduction. However, it has to be remembered that the threshold for the application of best judgment is a filed tax return, so that some additional legal provisions may be needed for the application even of estimated taxation to those not voluntarily recording and filing business transactions.

Although, the beginning of modern tax system in Ethiopia traces back to the 1941¹⁰, it is believed that the income tax assessment system of the country was inhibited by presumptive taxation model.¹¹ It is to say, the taxable incomes had not been inferred from taxpayers’ accounts rather various proxies or parameters were used to establish tax liability of different taxes.¹² In such a case, the term ‘Category “C” Taxpayer’ was introduced in Ethiopia for the first time to refer to “small business” by Income Tax Regulation issued pursuant to the Legal Notice 258/1962.¹³ Onwards this time, a universal country level tax reform on all types of tax as part of the general tax reforms was made and the one reform was the introduction of standard assessment in lieu of the estimated assessment.¹⁴

⁷ Aloysius Bongwa; *Managing Ethiopian Cities II, Informality in Ethiopia: Taxing the Hard to Tax*, (Institute for Housing and Urban Development Studies,) Rotterdam, Netherland, 2009, p. 3.

⁸ Alessandro Balestrino, *On the Redistributive Properties of Presumptive Taxation*, CESIFO WORKING PAPER NO.1381, Category 1: Public Finance, 2005, p. 1.

⁹ Indira Rajaram and Kanwarjit Singh, *Report on Presumptive Direct Taxation*: National Institute of Public Finance and Policy, New Delhi, 1995, p. 13. [Here in after, Rajaram and Singh, ‘*Report on Presumptive Direct Taxation*’].

¹⁰ Tadesse Lencho, ‘*Towards Legislative History of Modern Taxes in Ethiopia (1941-2008)*’, *Journal of Ethiopian Law*, 2012, Vol. 25, No 2, pp. 104-158. p.104. [Here in after, Tadesse, *Towards Legislative History of Modern Taxes in Ethiopia*].

¹¹ Muuz, *Evaluation of the Efficiency of Standard Assessment for Category C Taxpayers in Ethiopia*, 2 p. 115

¹² Gunther Taube and Helaway Tadesse; *Presumptive Taxation in Sub-Saharan Africa: Experiences and Prospects*, Washington, D.C., IMF, 1996, African Department Working Paper WP/96/5), p. at 9. [Here in after, Gunther and Helaway, *Presumptive Taxation in Sub-Saharan Africa: Experiences and Prospects*].

¹³ *The Income Tax Regulation*, Legal Notice No. 258/1962, Art. 25 (now repealed).

¹⁴ Muuz, ‘*Evaluation of the Efficiency of Standard Assessment for Category C Taxpayers in Ethiopia*’ at 116.

With regard to the current Ethiopian income tax law, category “C” taxpayers shall pay business income tax for each tax year in accordance with the mode of payment of tax to be determined by Regulations to be issued by the Council of Ministers.¹⁵ These small business taxpayers are indebted with an express obligation of declaring their turnover, but not keeping records and accounts.¹⁶

Small businesses are subject to the presumptive income tax regime of standard assessment, which is based on type, size and location of the small businesses.¹⁷ Hence, they are relieved from the basic income tax law obligation of maintaining books of account and records due to the smallness of their size. Since these businesses do not maintain books and records or are not required to anyway, their income tax liability is assessed through indirect methods enunciated in the standard assessment rules and tables of the Ethiopian income tax laws.¹⁸

In practice, the small businesses annual tax liability is determined primarily by estimation of daily sales, which are used to estimate their taxable income and determine their tax liability in accordance with the standard tables of assessment.¹⁹ Because the rules of assessment with respect to small businesses are different from the regular rules of assessment, the tax authorities have argued that the income of these businesses should not be aggregated with income of medium and/or large businesses even though all these businesses are owned by one sole proprietor.²⁰

Most importantly, to levy and charge a tax revenue is a herculean task to both the tax authorities and taxpayers, especially, the small businesses.²¹ The government needs to administer and

¹⁵ Federal Income Tax Proclamation, 2016, *Federal Negarit Gazette*, Extra- Ordinary Issue, Proc. No. 979, 22nd Year, No. 104, art. 49, [Here in after, Income Tax Proc. No. 979/2016] and Art. 3(4) of the New Amhara National Regional State Income Tax proclamation, 2016, *Zikir Hig*, Proc. No. 240, [Here in after, Amhara Income Tax Proc. No. 240/2016].

¹⁶ Federal Income Tax Regulation, 2002, *Federal Negarit Gazette*, Reg. No. 78, 8nd Year, No. 37 art. 21[Here in after, Income Tax Reg. No. 78/2002]; Council of the Amhara National Regional State Income Tax Regulation, 2003, *Zikre-Hig*, Reg. No. 4, 8th Year, No. 2, article. 23. [Here in after, Amhara Income Tax Reg. No. 4/2003]. But here, Category “C” taxpayers are based on the terminology given to them under art. 3(1) (c) of the Federal Income Tax Proc. No. 979/2016 and the same article in the Amhara Income Tax proc. No. 240/2016 are considered as the taxpayers whose annual income turnover is less than or equal to 500,000 Birr. But these regulations do not work to this amount of annual turnover income of category “C” taxpayers.

¹⁷ Income Tax Proc. No. 979/2016, art. 83 (3) and Income Tax Reg. No. 78/2002, art. 22 (1).

¹⁸Taddese Lencho, *The Ethiopian Income Tax System: policy, Design and Practice*, PhD Dissertation, University of Alabama, Department of Interdisciplinary Studies, 2014, p. 415. [Herein after, Taddese, *The Ethiopian Income Tax System*].

¹⁹*Ibid.*

²⁰*Ibid.*

²¹Abreha and Kahase, ‘*Income Tax Assessment Procedures and Their Practical Implementations under ANRS*, p. 8.

enforce tax revenue very cautiously in order not to incur costs of tax assessment, collection, payment and compliance. Furthermore, it is not advantageous for the tax authorities to impose tax revenue without a due consideration for the administration costs. Because it would be meaningless to impose tax revenue which its administration costs exceeds the paid tax liabilities.²²

In real terms, it would be hardly possible for an administration of a tax system in general and small business taxation in particular to be free from problems. Due to the problems, the system could suffer from tax evasion and avoidance. In addition, the administrative and assessment problems create undue burden on the small business taxpayers. So that objectives of taxation such as encouragement of investment may be affected. It is obvious that developing countries have many constraints in their way to establish effective business tax system.

Ethiopia in general and BDCA in particular are not exception to the above problems. There are problems arising from the laws and practices in the administration and estimated assessment of small business taxation in BDCA. Despite this, there is no research on the problems faced in the standard assessment of small business taxation and its administration in BDCA.

1.2. Statement of the Problem

Tax systems of different countries include taxes accrued on the basis of simplified accounting, or using indirect methods of tax liability assessment of small businesses, which is known as presumptive taxation.²³ The totality of the said taxation, ways and methods for their accrual comprises the special tax treatment within the national taxation system labeled with the term presumptive taxation. The ability of the tax system to adequately perform its functions is to a large extent determined by its correspondence to the economic environment along with certain principles and requirements.²⁴ Specifically, tax burden should be fairly distributed among all the economic entities depending on their taxable capacity. The implementation of this principle is,

²² *Ibid.*

²³ Victor Thuronyi, *Presumptive Taxation of the Hard-To-Tax*, International Studies Program, Working Paper 03-25, Andrew Young School of Policy Studies, Georgia State University, 2003, p.1.

²⁴ S.N. Makedonskiy; *Taxation Mechanism based on Simplified and Indirect Evaluation of tax Liabilities*: Russian-European Center for Economic Policy, Moscow, 2005. <www.recep.ru/files/documents/Taxation_Makedonskiy_eng.pdf> accessed on March 12, 2017.

however, hampered by the small business (sometimes called the hard to tax) economic activity and active tax evasion by a significant part of the taxpayers.²⁵

Meanwhile, tax systems of the majority of countries were meant from the beginning for targeting large businesses with the highest level of budget efficiency from the point of view of tax administration. In addition, small business as a rule finds unacceptable the costs and difficulties associated with the accountancy and submission of statements in accordance with the general tax treatment.²⁶ To alleviate such problems of taxation system, special treatment schemes and methods for the assessment of tax liabilities are to a larger extent taking into account the particular features of specific groups of economic entities compared to the general tax treatment.²⁷

Hence, ineffective implementation of assessment method and administration of small businesses income tax is not a question of Bahir Dar City Administration [*Herein after*, BDCA] only but also a problem for the Amhara region and for the country at large. The city has also been experiencing various business income tax evasions by the small businesses that have the obligation to pay tax to the government.²⁸ As we can see from our daily life experiences, the revenue and income of the government for the development of the town is characterized as insufficient implementation and administration of small business taxation.

Because of the assessment method as well as its result has become source of debate and bitterness among taxpayers and other concerned bodies and individuals.²⁹ Taxpayers have complained that the assessment method has brought up sharp increase more percentage from the previous tax liabilities, which are incomparable to their annual turnover income.³⁰ In addition to this, the assessment of income includes discretion for the tax administration and which may ultimately provide an opportunity to harass taxpayers and task of the determination of income for a large number of small businesses is beyond the capacity of the tax administration in the city. The researcher has also observed frequent conflicts between small business taxpayers and

²⁵ *Ibid.*

²⁶ *Id.*, p. 4.

²⁷ *Ibid.*

²⁸ በአማራ ብሔራዊ ክልላዊ መንግስት ገቢዎች ባለስልጣን፤ በባህርዳር ከተማ አስተዳደር/ቤት የግብር አወጣጥን አሰባሰብና ክትትል የሥራ ሂደት፡ የግማሽ ዓመት አፈፃፀም ሪፖርት፡ 2007 ዓ. ም ገፅ 55. (ያልታተመ፤ ባህርዳር ከተማ አስተዳደር ገቢዎች/ቤት ዋና የሥራ ሂደት)

[Translation mine] (available at BDCA Revenue Office).

²⁹ *Id.*, p. 58.

³⁰ *Ibid.*

tax assessors over the amount of estimated income in BDCA. Generally, the assessment method has become the source of dissatisfaction among many small business taxpayers in the city.

It is worth mentioning that income tax assessment meant an impartial determination of the amount of tax for a given item that is subject to taxation.³¹ However, the subsequent enactment of income tax regulation in Ethiopia for the better regulatory purpose has come with a little room for reducing the inherent problems of the small business categories or groups.³² The main problems of tax assessment of these groups include the investment of extra administration cost, escaping from the tax network, under-taxation, low tax compliance behavior, and/or uncertainty on the part of the tax authority.³³ Taxpayers may be attributable to the difficulty of locating the actual amount of tax liability to be paid. Hence, this provides that estimation of daily sale has remained the main source of conflicts between these small taxpayers and the tax authority. Not only the cause it inflicts on taxpayers within the same category to pay the same tax under standard assessment, the practice has brought varied tax liabilities for taxpayers in similar occupation because the estimates were subjective as a result of which they are frequently exposed to over-taxation.³⁴ Based on the personal observation of the tax officers in determining the amount of tax, the estimates have made taxpayers not to be certain about their tax liability.³⁵ The other shortcoming is low level of assessment of consecutive, represent seasonal or/and fair market value of goods and services in order to make an estimation of daily sale of small business income.³⁶

Indeed, good tax administration may not be rocket science, but it is also by no means easy.³⁷ It takes time, skill, and resources, all of which is in short supply in the Amhara Region in general and BDCA in particular. One common way that tax administrations often attempt to make their job a bit easier is by imposing taxes on bases which they, rather than the taxpayers, determine.³⁸ However, administrative assessments or presumptions are imposed. It employs relatively simple

³¹Muuz, 'Evaluation of the Efficiency of Standard Assessment for Category C Taxpayers in Ethiopia', p.116.

³²*Ibid.*

³³*Ibid.*

³⁴Partnership Project Rhein-Main Chamber, Germany and Ethiopian Chamber of Commerce(ECC); *Taxation in Ethiopia: Direct and Indirect Taxes –Categories of Taxpayers, Declaration of income and Assessment of Taxes, Tax Incentives*, Published by ECC, Addis Ababa, Ethiopia, 2005, p. 42.

³⁵See *Supra note*, 25, p. 55.

³⁶*Ibid.*

³⁷Bird M. Richard and Wallace Sally; *Is It Really So Hard to Tax the Hard to Tax?* The Context and Role of Presumptive Taxes. International Tax Program Institute for International Business Joseph L. Rotman School of Management, University of Toronto, 2003, [Herein after, Bird & Sally, *Is It Really So Hard to Tax the Hard to Tax?*], p. 2.

³⁸*Ibid.*

rules for the accrual and payment of taxes for those economic operators, which often avoid regular taxation. The reasons for the gaps in the practice and the laws with regard to standard assessment method of small business taxation need to be investigated.

1.3. Objectives of the Study

The general objective of the study is to analyze the legal and practical application of standard assessment of small business taxation in BDCA and to recommend appropriate measures to tackle the problems. With this general objective, the study aims at

- Studying the methods for the implementation of standard assessment of small businesses.
- Analyzing the application of standard assessment of small business taxation with respect to the relevant income tax laws.
- Showing the problems that arise in the practical implementation of standard assessment of small business taxation in BDCA.

1.4. Research Questions

The main question this study aims to explore is as to what the legal and practical problems exist in the application of standard assessment of small business taxation in BDCA. To amply answer this main question, the study dwells on addressing the following sub-questions.

1. What are the strengths and shortfalls of presumptive taxation of small businesses on the basis of standard assessment?
2. How do the income tax laws regulate the standard assessment of small businesses in BDCA?
3. What problems do that the tax authority and small businesses face in case of standard assessment in BDCA?
4. How is standard assessment implemented in practice in BDCA?

1.5. Significance of the Study

It is hoped that the study will provide the tax authorities with important guidance in their endeavor towards effective administration of presumptive taxation of small business based on the current tax laws. Besides, it will also benefit the small business taxpayers in the city administration by indicating the improper practices of the tax authorities and it would inform business taxpayers with the significance of standard assessment of small businesses in their

dealing with the tax laws and consider the demand of it. This research will show a path to other researches regarding the implication of standard assessment of small business taxation in other areas of the Amhara Region.

1.6. Literature Review

Owing to the long existing experience of some countries about presumptive taxation,³⁹ as to the knowledge of the researcher, there is no enough literature in Ethiopia on the taxation of small business groups/categories. However, literatures are written with regard to the methods, types, rationales and administrative significance with its legal and practical implementation of standard assessment of small businesses. Among them, Victor Thuronyi and others writers in their books and articles about presumptive taxation defined as it involves the use of indirect means to ascertain tax liability, which differ from the usual rules based on the taxpayer's accounts, which is generally a proxy for the standard tax and, that it is applied when the tax base is too small or hard to verify, due to limited administrative resources, or improper accounting practices.⁴⁰ On the one hand, it involves simple and cost-effective techniques to capture domestic transactions and sources of income that frequently escape taxation under conventional norms. These techniques include lump-sum levies on small scale business activities (standard assessments); the assessment of taxes through indicators or proxies that help estimate a taxpayer's income (estimated assessments); and the collection of minimum taxes irrespective of a taxpayer's actual level of business activity (presumptive minimum taxes).⁴¹ The other issue is that, though there are variations on the initiation and justifications of presumptive taxes across countries, it is believed that the objectives behind the introduction of presumptive taxes are improving the efficiency of collection by reducing taxpayers' administrative and compliance costs.⁴² In addition, it is reducing the administrative costs of compliance and enforcement

³⁹For example, the contractual method of 'Forfait' used in France, comprises small businesses including farmers, whose income is below the established level and those are normally expected to earn a system of assessment of 'normal profits' and also the system *Tachshivim* as used in Israel as Standard assessment guides. See Gunther and Helaway, *Presumptive Taxation in Sub-Saharan Africa: Experiences and Prospects*. This research has further disclosed the adoption of the system in most federal states like Nigeria, Mozambique, Lesotho, and Sierra Leone was made in the 1960's and 1970's.

⁴⁰ Victor Thuronyi, 'Presumptive Taxation in Tax Law Design and Drafting', 1 Chapter 12 (Victor Thuronyi ed., Vol.1; IMF: 1996), [Herein after, Thuronyi, *Presumptive Taxation in Tax Law Design and Drafting*]. For further discussion and analysis of presumptive taxation, see also Pashev; *Presumptive Taxation and Gray Economy: Lessons for Bulgaria*, Indira Rajamaran; *Presumptive Direct Taxation: Lessons from Experience in Developing Countries*, Economic and Political Weekly (forthcoming).

⁴¹Gunther and Helaway; *Presumptive Taxation in Sub-Saharan Africa: Experiences and Prospects*, p. iii.

⁴² Pashev, *Presumptive Taxation and Gray Economy*, p.4.

management; and bridging the way from informal to formal activities and from assessment based on indicators to self-assessment based on actual income.⁴³

Another researcher⁴⁴ has investigated that the current experience with presumptive methods of taxation shows that they require a considerable amount of administrative input if they are to be based on realistic and objective criteria. Thus a combination of administrative, equity, and efficiency arguments for presumptive taxation makes the case for more research in this important but forgotten area.⁴⁵

Presumption of tax is used to indicate that there is a legal presumption that the taxpayer's income is no less than the amount resulting from application of the indirect method. Income tax assessments made on the basis of this technique involve employment of surrounding indirect factors to determine the actual taxable income and tax liability.⁴⁶ On the other hand, there are various researches on several aspects of tax laws of Ethiopia. However, it has not been access a research which deals with all the possible aspects of standard assessment and/or presumption of small business taxation in the way this research intends to takeover. There are some related writings or articles which make simple explanation about the standard assessment of small businesses, contextualized as category “C” taxpayers’ taxation presumptively in Ethiopian tax laws.⁴⁷ However, there are still important issues which prior researches did not closely dwell on the taxing of small business on the basis of standard assessment in the Amhara National Regional State [*Herein after*, ANRS] in general and in BDCA in particular. In the first place, the practice of effective and efficient implementation of presumptive taxation of small businesses on the basis of standard assessment has not been studied in the city. Apart from this, the administration and efficient collection of government revenue from small businesses on the basis of Income Tax Regulation and updated and reorganized directives of income tax

⁴³ *Ibid.*

⁴⁴ Vito Tanzi & Milka Casanegra de Jantscher; *Presumptive Income Taxation: Administrative, Efficiency, and Equity Aspects*, International Monetary Fund Working Paper (Fiscal Affairs Department), 1987, p. 15.

⁴⁵ *Ibid.*

⁴⁶ The term presumptive taxation covers a number of procedures under which the desired base for taxation (direct or indirect) is not itself measured but is inferred from some simple indicators which are more easily measured than the base itself.

⁴⁷ Muuz, *Evaluation of the Efficiency of Standard Assessment for Category “C” Taxpayers in Ethiopia*, p. 107; See also Aloysius Bongwa; *Managing Ethiopian Cities II, Informality in Ethiopia: Taxing the Hard to Tax*, (Institute for Housing and Urban Development Studies,) Rotterdam, Netherland, 2009, Samuel Alemnew and P. Viswanadham, *An Assessment of Business Income Taxpayers Tax Knowledge, Tax Complexity, and Tax Compliance: A Case of Amhara Regional State of Ethiopia*, International Journal of Science and Research (IJSR), Volume 5 Issue 5, May 2016, Merima Nasser, *et al*, *Determining the Challenges of Tax Liability for Categories “C” Taxpayer in the Case of Kirkos Sub-City*, Business Faculty Department of Accounting (Degree Thesis), St. Mary’s University, 2014.

assessment through which the tax authorities are expected to administer in BDCA. However, the appropriateness and adequacy of all this is still liable to be asked. What is more, there is no research on the legal and practical problems of standard assessment of small businesses in the ANRS in general and in BDCA in particular. Problems in relation to estimation of annual turnover income of small businesses, keeping and recording experiences, compliance costs of the aggrieved taxpayers, awareness and cooperation of the concerned bodies in BDCA are open for further study. This study attempts to cover these issues in Bhair Dar City Administration.

1.7. Methodology of the Study

To conduct this research, qualitative research approach is employed. The researcher chosen this method as he believes it is the way for addressing the research questions of the study. Hence, relevant tax laws (proclamations, regulations and directives) of the FDRE Government and the Amhara Region are analyzed. Books, journal articles and other secondary sources such as documents, workshop papers and manuals are consulted. Moreover, to substantiate the data obtained using the above sources, the researcher also conducted interviews with stakeholders.

The researcher largely employed semi-structured interviews to get the necessary data from the respondents. Such formally predetermined flexible questions were used as if some of the respondents are not fully acquainted with the subject matter. In addition, there was no need to employ informal questions and seek informal answers in order to avoid unstructured interviews. In order to know what the practice seems, the data are collected through interviewing from the key selected persons from the ANRS Tax Authorities, BDCA Revenue Office, and Tax Assessment Officers from some of the sub-cities. In addition, interview was conducted with certain relevant taxpayers of small businesses from selective sub-city in order to get the necessary information to answer the research questions on its practice. Finally, the data gathered through the interviews and the relevant documents were analyzed and interpreted qualitatively in line with the tax laws, proclamations, regulations and relevant directives.

1.8. Scope of the Study

The research is limited to investigating the legal and practical aspects of standard assessment of small business taxation in BDCA. In this research, however, standard assessment taxation is confined to the simplified tax system that is applied on small businesses with no requirement of recording and keeping account. Besides, the research explores the problems that encountered by

the implementation of the standard assessment of small businesses and the tax authority in BDCA.

1.9. Limitation of the Study

While conducting this research, the researcher was confronted with shortage of time. Due to this, he does not pretend to say every aspect of the research is thoroughly examined to its little detail. In addition, searching of the piecemeal directives and other documents issued by the ANRS Revenue Authority and Bureau of Finance and Economic Development [*Herein after*, BFED] regarding standard assessment of small business was laborious. It was very difficult to find materials, (such as income assessment training manuals and directives for the revision of the 2003 standard assessments) in the documentation centers of the ANRS Revenue Authority as well as BDCA Revenue Office. Because of the poor document handling systems of these institutions posed its own challenges to easily access them. In addition, some of the interviewees were not willing due lack of awareness among tax officers on standard assessment of small business taxation.

1.10. Organization of the paper

The research is organized in the following chapters: Chapter one consists of the introductory part of the research including background of the study, research objectives, and statement of the problem, research questions and others. The second chapter deals with presumptive taxation of small businesses in general. This chapter discusses the nature of presumptive taxation, small business, and standard assessment. In addition, the general objectives of small business taxation and its presumptive method are presented. As well, it deals with the merits, demerits, types, and forms of presumptive taxation system. More importantly, the chapter discusses the theoretical aspects, implementation, advantage, and disadvantage of standard assessment method. The third chapter is designed to address the legal regime of standard assessment of small businesses in the Ethiopian context. It briefly addresses the historical background and development of standard assessment before and after the 2002 tax laws reforms, and standard assessment under the current income tax regime of the Federal Government of Ethiopia. The fourth chapter, the main thesis of the research, investigates the legal and practical analysis of standard assessment of small business taxation in BDCA. The final chapter concludes the whole research findings and forwards recommendations.

CHAPTER TWO

PRESUMPTIVE TAXATION OF SMALL BUSINESSES IN GENERAL

2.1. Introduction

This chapter discusses presumptive taxation of small businesses in general. The chapter starts with defining some essential concepts such as presumptive tax, small businesses, and standard assessment. It then explains objectives of taxing small businesses, presumptive method as a tool for the taxation of small businesses, merits and demerits of presumptive taxation, forms/types of presumptive taxes. In this regard, theoretical frameworks, implementation methods, merits, and demerits of standard assessment system are discussed.

2.2. Definitions of Basic Concepts: presumptive Tax, Small Business, and Standard Assessment

Though it is widespread in developing countries, presumptive taxation has received little attention in the public finance literature. With few exceptions, the available analyses are based on collections of case studies focusing mainly on the administrative rationale for such taxes. But they lack an explicit formal model of the tax structure or the taxpayer's problem.⁴⁸ However, it is necessary to define the term presumptive taxation as it is applied to small business taxation.

To begin with, Black's Law Dictionary defines presumption as a legal inference or assumption that a fact exists based on the known or proven existence of some other facts or group of facts.⁴⁹ Coming to presumptive taxation, it refers to the use of simplified and cost-effective techniques to tax businesses and individuals frequently escaping taxation, either by non-reporting or underreporting of actual incomes.⁵⁰ Traditionally, the most common presumptive taxation

⁴⁸ Christian R. Jaramillo H, '*Presumptive Income Taxation and Costly Tax Compliance*', Department of Economics, University of Michigan, 2004, P. 1.

⁴⁹ Black's Law Dictionary, 8th, ed, s.v "presumptive".

⁵⁰ Gunther and Helaway, '*Presumptive Taxation in Sub-Saharan Africa: Experiences and Prospects*', p.1.

methods have been standard assessments, estimated assessments, and presumptive minimum taxes.⁵¹

Though a number of countries have been using the presumptive taxation, especially developing ones, to tax small businesses, different definitions are given to explain it. For instance, according to Victor Thuronyi, presumptive tax involves the use of indirect means to ascertain tax base, which differ from the usual rules based on the taxpayer's accounts.⁵² It is an administrative approach of constructing tax bases from those indirect proxies due to absence of books and accounts of taxpayers. Presumptive is a proxy for the standard tax and also applied when the tax base is too small or hard to verify due to limited administrative resources or improper accounting practices.⁵³ For instance, in its commonest application as a proxy for income tax, the tax liability is based on the presumed capacity to earn income, measured through indirect indicators, rather than on actual income of the taxpayers.⁵⁴ Presumptive taxation is also best used to reach the hard to tax sectors of the economy, especially, the small business taxpayers, where the compliance gaps are above the average.⁵⁵

Other researcher, Shlomo Yitzhaki, defined that a tax as presumptive if there is a gap between the tax base as stated in the intention of the tax law and the base used in the implementation of the presumptive base law.⁵⁶ In other words, presumptive taxation exists whenever the legislator is using one tax base in order to approximate another. The tendency of using one tax base to imitate another makes sense only in the presence of complications like asymmetric information, transaction, compliance and administrative costs that make the direct way of applying the tax law too costly to implement. In practice, the legislator may be well aware that the ideal base is hard to measure or to verify, or that it can be easily hidden from the tax inspector or that it is too costly to identify or to measure.⁵⁷ Presumptive taxation is, as a result, widely used around the developing world, with taxable income estimated on the basis of different factors applied to

⁵¹ *Ibid.*

⁵² Thuronyi, *Presumptive Taxation, in Tax Law Design and Drafting*, p. 1.

⁵³ Pashev, *Presumptive Taxation and Gray Economy: Lessons for Bulgaria*, p.3.

⁵⁴ *Ibid.* In this context, a presumptive tax is largely a tool that addresses administrative inefficiency.

⁵⁵ *Ibid.*

⁵⁶ Shlomo Yitzhaki, *Cost-Benefit Analysis of Presumptive Taxation*, Hebrew University and Central Bureau of Statistics, Jerusalem (2007), at p. 2[Herein after, Yitzhaki; *Cost-Benefit Analysis of Presumptive Taxation*]

⁵⁷ *Ibid.*

specific types of taxpayers on aggregate indicators such as industry and region or external indicators of income.⁵⁸

Under presumptive tax regime, as discussed above, the tax base is measured indirectly based on some readily observable characteristics of the taxpayer or the taxpayer's business.⁵⁹ The indirectly measured tax is presumed to be the taxpayer's legal tax liability regardless of whether liability would have been under the normal tax system.⁶⁰ Presumptive taxes are common, where the tax base is difficult for tax authorities to monitor through techniques like information reporting.⁶¹ In addition to this, the authorities may face serious difficulties in their efforts to identify more potential taxpayers and assess their taxable incomes. Administrative measures to assess and collect taxes have been found to be of limited use because of the existence of a large hard-to-tax sector, limited record-keeping by businesses, considerable tax evasion, limited tax compliance, and weak tax administration capacity.⁶²

For the purpose of this research, defining presumptive taxation cannot be enough without identifying what small businesses are. To best comprehend small businesses, it is quite essential to identify the meaning of the term. In taxation of small businesses, determination the segments of businesses is very crucial though it is not an easy task to put its range of application.⁶³ Small businesses are a unique phenomenon for the tax system and form the bulk of taxpayers in the tax net. At the same time, however, they are the major contributors to the informal economy operating outside the tax net in a given country due to complicated tax laws and administrative practices as well as the lack of a culture of voluntary tax compliance.⁶⁴

Small businesses have many different meanings in different contexts. Confusingly, they sometimes used as a proxy for other characteristics which governments may wish to target

⁵⁸ The World Bank Group, *A Hand Book for Tax Simplification*, International Finance Corporation, Pennsylvania Avenue, N.W., Washington D.C., USA, 2009, p.27.

⁵⁹ Kathleen Delaney Thomas, *Presumptive Collection: A Prospect Theory Approach to Increasing Small Business Tax Compliance*, *Tax Law Review*, Vol. 67,2013, pp. 111-168, p. 119. [Herein after, Thomas; *Presumptive Collection: A Prospect Theory Approach to Increasing Small Business Tax Compliance*],

⁶⁰ *Ibid.*

⁶¹ Bird R. and Sally, *Is It Really So Hard to Tax the Hard-to-Tax?* p.1.

⁶² Thomas, *Presumptive Collection: A Prospect Theory Approach to Increasing Small Business Tax Compliance*, p. 167-168

⁶³ Emmanuel G. Ofori, *Taxation of the Informal Sector in Ghana: A Critical examination*, (Master Thesis), Kwame Nkrumah University, Kumasi, Department of Business Administration, 2009, [Herein after, Ofori; *Taxation of the Informal Sector in Ghana: A Critical examination*], p. 34.

⁶⁴ Jan Loeprick, 'Small Business Taxation; Reform to Encourage Formality and Firm Growth, Investment Climate in Practice', p. 1, available at <<http://www.sopenknowledge.worldbank.org...483130BRI0SMEt10Box338894B01PUBLI>> last accessed on March 30, 2017.

through the tax system, such as new firms, entrepreneurship, economic growth and job creation.⁶⁵ Using size as a means of targeting these groups is inaccurate because size does not relate directly to these characteristics. On average, small firms tend to provide lower productivity, lower wages and less secure jobs than large companies.⁶⁶ However, any tax system aim at facilitating tax compliance for small businesses or provide special incentives for its development needs to define the segment of the business community that is considered a small taxpayer.⁶⁷

A definition of what is understood by the term small business generally is also required for a number of other purposes, in particular for statistical purposes and to define access to its development programs outside the tax area.⁶⁸ As such, the definition of small businesses is relative and depends on the purpose for which, and it is not necessarily uniform for all areas. Hence, there is no universal applicable definition of small businesses. While some countries use a standard definition for tax as well as statistical and other purposes, other countries prefer a specific definition of who is to be treated as a small and medium taxpayer in the tax laws.⁶⁹

More frequently, however, tax laws determine specific criteria to determine the eligibility for special small business tax regimes. These criteria have to measure the business taxpayers size, may be the ‘business turnover’,⁷⁰ the tax liability, the number of employees and capital base, type of activity and nature of transactions. In case, a standard definition may not serve the special interest of tax systems designed for small businesses. For example, a definition, which does not distinguish between corporate and unincorporated firms, may be against those tax systems that aim to extend simplified tax systems for unincorporated small businesses.⁷¹ As a result, tax systems incorporate specific definition/criteria to identify small businesses for tax purpose only. Therefore, it must be noted that there is some degree of relativism in the determination of small businesses. The upper band of categorizing and separating small

⁶⁵ Judith. Freedman, ‘*Small Business Taxation: Policy Issues and the UK*’, available at <<http://www3.law.ox.ac.uk/themestaxdocumentsSmallBusinessTaxation.pdf>> (accessed on February 25, 2017), p. 13.

⁶⁶ *Ibid.*

⁶⁷ The World Bank Group, *Designing a Tax System for Micro and Small Businesses: Guide for Practitioners*, (International Finance Corporation, in collaboration with DFID), 2007, p. 39. [Herein after, *Designing a Tax System for Micro and Small Businesses*].

⁶⁸ *Ibid.*

⁶⁹ *Ibid.*

⁷⁰ The problem of turnover is high volume of cash transactions and low recordkeeping standards, determining the correct amount of turnover are difficult. Turnover under declaration is the most widespread used criteria to define a small business.

⁷¹ *Designing a Tax System for Micro and Small Businesses*, p. 41.

businesses is basically dependent upon the legal and economic level of countries.⁷² Hence, a small business in one country may be large in another and the vice versa.

In Ethiopia, giving the definition of small businesses varies according to the institutional structure or the purpose that defines them and hence small businesses are meant different entities for different sectors or purposes. For example, according to the Federal Urban Job Creation and Food Security Agency Establishment Regulation, ‘micro enterprises’ are enterprises having a total capital, excluding building, not exceeding Birr 50,000 in the service sector or not exceeding Birr 100,000 in the industrial sector engaging 5 workers, including the owner, his family member and other employees.⁷³ According to the same legislation, ‘small enterprises’ are enterprises having a total capital, excluding building, from Birr 50,001 to Birr 500,000 in the case of service sector or Birr 100,001 to Birr 1,500,000 in the case of urban agriculture, artisanal mining and construction sector engaging from 6 to 30 workers including the owner, his family members and other employees.⁷⁴ The definitions stated above apply both the fixed capital assets and number of employees’ criteria. Large and medium enterprises, by default, are those enterprises having a total capital with more than 1,500,000 Birr in paid-up capital and engaging above 30 workers including the owner, his family members and other employees.

On the other side, the Ethiopian tax law classifies taxpayers into category “A”, category “B” and category “C” depending on their annual turnover and form of entity.⁷⁵ With the exception of companies and partnerships, all businesses are category “C” taxpayers as far as their annual turnover doesn’t exceed 500,000 Birr.⁷⁶ Hence, category “C” may include businesses ranging from retailers to wholesalers and from those engaging in professional consultancy to other areas of service sector.⁷⁷ Important to note is that the tax law uses a combination of turnover and entity or business type to classify taxpayers. In fact, the turnover-based classification of small taxpayers does not follow the value added tax threshold. Because tax regimes designed for

⁷² *Ibid.*

⁷³ The Federal Urban Job Creation and Food Security Agency Establishment Regulation, 2016, *Federal Negarit Gazette*, Reg. No. 374, 22nd Year, No. 41, art. 2(3).

⁷⁴ *Ibid.*, art. 2(4).

⁷⁵ Federal Income Tax Proc. No. 979/2016, art. 3(1); Amhara Income Tax Proc. No. 240/2016, art. 3(1)

⁷⁶ *Ibid.*, art.3(1)(c).

⁷⁷ List of small businesses are found in the Standard Assessment schedules attached in the appendix part in both of the Federal and the ANRS, Income Tax Regulation No. 78/2002, and Reg. No. 4/2003, respectively.

small businesses are simpler in terms of tax accounting rules than the standard tax regime.⁷⁸ However, the taxation of small business under the VAT is avoided by setting a registration threshold thereby limiting those that are required to register to those who should be able to keep proper records.

Indeed, as far as there are various requirements to classify small businesses into a segment different from other businesses and also in the absence of universal definition, they are identified for tax purpose and share common characteristics in most countries.⁷⁹ One of the common features is that they are not compelled by business tax reasons to keep adequate books of account. Because their incomes are small, the application of standard tax regime brings high compliance costs for them. Application of withholding to collect their income is not practicable, due to their engagement mainly in cash transaction and sells largely to the population. In addition to this as the numbers of small businesses are great, tax administrations face difficulties to effectively scrutinize their activities. To sum up, due to the common features expressed above that small businesses can easily conceal their incomes from the reach of the tax system and hence they are called hard-to-tax groups.⁸⁰

Regarding the concept of standard assessment, it pertains to the determination of tax liability at occupational level without regard to the other many factors save as its main advantages are simplicity, certainty, comprehensiveness, and efficiency. The standard assessment is introduced for category “C” taxpayers to provide fixed taxes for small businesses in consideration of size, type and location of businesses.⁸¹ Because of the presence of fixed taxes, it was an expectation that role of tax officers could be limited to categorizing businesses in the appropriate category on the basis of indicators like size and location of businesses, to minimize tax authority intervention, bring about simplicity and efficiency, and other basic principles of taxation.⁸²

Standard assessment is one of the best methods of presumptive tax that prescribe a fixed, lump-sum tax payment to be paid by persons or enterprises engaged in specific trades and professions.⁸³ As a result of this, the standard presumptive tax assessment assesses income tax

⁷⁸ Lee Burns, *Taxation of the Small Business Sector*, paper presented at the Third Annual Meeting of the Pacific Islands Tax Administrators' Association, Raratonga, Cook Islands, 2006, p. 2.

⁷⁹ Victor Thuronyi, *Presumptive Taxation of the Hard-To-Tax*, International Studies Program, Working Paper 03-25, Andrew Young School of Policy Studies, Georgia State University, 2003, p. 1.

⁸⁰ *Ibid.*

⁸¹ Muuz, 'Evaluation of the Efficiency of Standard Assessment for Category C Taxpayers in Ethiopia', p. 126.

⁸² *Ibid.*

⁸³ Günther and Helaway, *Presumptive taxation in Sub Saharan Africa: Experiences, and Prospects*, p.12.

burden of a given taxpayer based on a given set of criteria. While standard assessments usually prescribe the lump sum payment by reference only to the taxpayer's occupation, trade, or vocation, levies are sometimes differentiated even for taxpayers within a given occupation.⁸⁴

2.3. Objectives of Taxing Small Businesses

The main objectives of a tax system are to guarantee the long-run fiscal policies and programs of government. In fact, the purpose of tax administration is to fully implement the tax system. Tax administration is meant to ensure that tax payers comply with the provisions of tax laws and that the funds derived from tax sources are paid into the government purse.⁸⁵ Thus, taxation is one of the mechanisms used by governments to achieve some economic and social objectives. By the same token, small businesses are taxed with some main objectives. Conventional objectives for taxation of small businesses include effectiveness in raising revenue for the government budget, to increase the size of the formal sectors, to promote economic growth and tax equity.⁸⁶

2.3.1. Generation of Income/ Revenues

Small businesses are one segments of tax group to increase the revenue of the government to finance ever-increasing public sector expenditure and economic growth at large. As a result, the purposes for collecting revenue, particularly, from the small businesses are to give government power to allocate resources, to enable government to provide/support social development, to stabilize the economy, and to encourage optimal economic growth.⁸⁷

Significantly, there are reasons why small taxpayers must be appropriately taxed.⁸⁸ On the one hand, the potential tax contribution of small businesses in combination with that of medium and large sized taxpayers possibly accounts over a quarter of total revenue. On the other side, the effect of ignoring a large amount of potential tax revenue from these sectors is likely to be strong for the dynamics of economic growth.⁸⁹ Since 1980s, the role of small businesses in the

⁸⁴ *Id.*, p. 13.

⁸⁵ Dennis, *et al*, 'The Impact of Taxation on Revenue Generation in Nigeria: A Study of Federal Capital Territory and Selected States', International Journal of Public Administration and Management Research (IJPAMR), Vol. 2, No 2, 2014, p. 26.

⁸⁶ *Id.*, p. 28-30.

⁸⁷ Kayaga, 'Tax Policy Challenges Facing Developing Countries', p. 6.

⁸⁸ Parthasarathi Shome, 'Tax Administration and the Small Taxpayer', Policy Discussion Paper 04/02, International Monetary Fund, 2004, p. 4. [Here in after, Shome, *Tax Administration and the Small Taxpayer*].

⁸⁹ *Ibid.*

global economy has increased where such businesses in the service sector accounted much of the growth of Gross Domestic Product (GDP) in different Countries.⁹⁰ While they are increasingly seen as source of economic growth, compliance costs for tax payment by small taxpayers are quite high.⁹¹

2.3.2. Obtaining Efficient Economic Growth/Development

In relation with the costs of informality, the presence of the hard-to-tax sector is likely to distort the allocation of economic resources in the economy by moving factors of production from the taxed to the untaxed activities. It is also quite likely that a wider presence of this sector represent an impediment to economic development.⁹² In the types of inefficiency associated with the informal sectors, resources may move in order to evade taxation. It meant that tax revenues drive a wedge between the returns to factors of production in different sectors.⁹³ However, the gross-of-tax return to a factor measures the social productivity of the factor, and the gross-of-tax return will be higher in the taxed sector by the amount of the tax.⁹⁴ Consequently, a tax on a factor in only some of its uses encourages over allocation of factors to untaxed activities and so generates an excess burden.⁹⁵ An excess burden arises when efficient firms are crowded out by inefficient firms with greater ability to evade taxes.⁹⁶ In addition to this, the presence of untaxed sector provides opportunities for markets to select producers for their ability to have low costs of production.⁹⁷ Due to these reasons, it is important to bring small businesses to the tax net and to make economic efficiency.

2.3.3. Tax Equity

Tax equity is one of the essential criteria used to evaluate the extent to which substantive governmental goals are being pursued in a fair and just manner. This type of tax system is critical to the effectiveness of tax systems and the attainment of socio-economic objectives in

⁹⁰ *Id.*, p. 6.

⁹¹ *Ibid.*

⁹² J. Alm, J. M.Vazquez, and F. Schneider; "*Sizing*" the Problem of the Hard-To-Tax, Andrew Young School of Policy Studies, Georgia State University, p. 11. available at <<https://www.researchgate.net/profile/...55bb856108ae9289a0956dda.pdf...2004,>> Last accessed March 22, 2017.

⁹³ For example, if factors of production are mobile between taxed and untaxed activities, then they will move between these sectors until the net-of-tax return in the taxed sector equals the return in the untaxed sector.

⁹⁴ *Ibid.*

⁹⁵ *Id.*, p. 12.

⁹⁶ *Ibid.*

⁹⁷ *Id.*, p. 13-14.

general. Based on the ability-to-pay principle, equity can be seen from the perspectives of horizontal or vertical.⁹⁸

Horizontal equity implies that people in equal positions should be made to pay the same amount of taxes because they have the same ability to pay.⁹⁹ It exists when taxpayers similarly situated bear the same tax burden after shifting is taken into consideration. On the other hand, the vertical equity expresses that a tax system should distribute the burden of paying taxes fairly across people with different abilities to pay. It requires the rich to pay more because the “degree of utility of income decreases when income increases,” so a “*just*” tax system that treats citizens “*equally*” would be progressive.¹⁰⁰ Thus, those who are “*better off*” should bear a larger proportion of the tax burden while those who are “*worse off*” should bear less.¹⁰¹ So it is to mean that any difference in tax burden borne by taxpayers who are not similarly situated and suggests that tax payers who are in unequal economic positions should be treated differently. As a result of this, vertical equity aims to achieve distributive justice in case of unequal treatment of unequal while horizontal equity is generally seen as ensuring the fairness of a tax system by equal treatment of equals.¹⁰²

On the basis of the above assumption, small businesses, as one segment of taxpayers, shall carry the tax-burden in reference to their capacity to pay taxes. Hence, if the informal sectors are left to be untaxed, the tax system becomes unfair as the tax burden falls only on some taxpayers. The taxation of small businesses can enhance horizontal equity by facilitating the taxation of the self-employed and informal small-scale business operators, both of whom often escape paying taxes entirely or partially.¹⁰³ Therefore, presumptive methods to tax professionals and the self-employed may then be adopted as a device to ensure that a measure of horizontal equity prevails.¹⁰⁴

⁹⁸ Sisay Bogale and Yohannes Mesfin, *Tax Law: Teaching Material*, Prepared under the Sponsorship of the Justice and Legal Research Institute, Addis Ababa, Ethiopia, 2009, p. 12.

⁹⁹ *Ibid.*

¹⁰⁰ The World Bank Group, *A Hand Book for Tax Simplification*, International Finance Corporation, Pennsylvania Avenue, N.W., Washington D.C., USA, 2009, p.16.

¹⁰¹ Kayaga, *Tax Policy Challenges Facing Developing Countries*, p. 9.

¹⁰² Amin Abdella and John Clifford; *The Impact of Tax Reform on Private Sector Development*, PSD Hub Publication No. 13, Addis Ababa Chamber of Commerce and Sectoral Associations, 2010, p.35. [Here in after, Amin and John, *The Impact of Tax Reform on Private Sector Development*].

¹⁰³ *Ibid.*, see also, *Designing a Tax System for Micro and Small Businesses*, at p. 22.

¹⁰⁴ Vito Tanzi & Milka Casanegra de Jantscher, *Presumptive Income Taxation: Administrative, Efficiency, and Equity Aspects*, International Monetary Fund Working Paper (Fiscal Affairs Department), 1987, p. 7.

2.3.4. Encouragement and Road to Formalization

The issue of formalization is quite complex and we cannot generally state that the formal economy is good and the informal is bad for society. The experiences indicate that no simple rule exists that increasing or decreasing ‘formalization’ necessarily improves or worsens the well-being of the poor or welfare of society at large.¹⁰⁵

The creation of large taxpayer units within a revenue authority is common and has been quite effective. However, there should also an attention by creating a small business tax unit to focus on their compliance issues. The goal of small business taxation system should be broadened beyond simple cost recovery to include the benefits of having more formalized firms in the economy.¹⁰⁶ A good tax regime for small firms is a key policy tool to pave their way out of the “informality trap” of low growth, limited access to markets, and exclusion from formal financial services.¹⁰⁷ Therefore, small business taxation should be seen as an entry point to formality; however, their participation in the tax net is the most critical step in the formalization process.¹⁰⁸ But formalization by itself is deterred by expensive and administratively burdensome procedures. This formalization targets small businesses that are likely to benefit significantly from obtaining formal status, through accessing new markets and financial services as well as security of tenure and investments.¹⁰⁹

However, formalization has its own costs and benefits that are credible determinants of the formality status of the businesses. Among the typical costs are the time and money spent to comply with regulations concerning the start-up and the operation of the business. The benefits are more certainty regarding the prospects of the business, no restrictions on growth, less harassment by inspectors and acquiring visibility for the public and the authorities.¹¹⁰

¹⁰⁵ Akolgo, Paulina Akelentera; *Encouraging Growth and Formalization of small Businesses through Tax Reforms; A study of the Tamale Metropolis in the Northern Region, Kwame Nkrumah University Of Science And Technology, Ghana* (Master Thesis), 2011, p. 31.[Herein after, Akolgo, *Encouraging Growth and Formalization of small Businesses through Tax Reforms*].

¹⁰⁶ Richard Stern and Jan Loeprick, *Small Business Taxation: Is this the Key to Formalization?* Evidence from Africa and Possible Solutions, (World Bank Group), 2007. P. 10.

¹⁰⁷ Jan Loeprick; *Small Business Taxation; Reform to Encourage Formality and Firm Growth, Investment Climate in Practice*, available at <<http://www.sopenknowledge.worldbank.org...483130BRI0SMET10Box338894B01PUBLI>> last accessed March 30, 2017.

¹⁰⁸ *Ibid.*

¹⁰⁹ Richard Stern and Jan Loeprick, *Small Business Taxation: Is this the Key to Formalization?* Evidence from Africa and Possible Solutions, (World Bank Group), 2007. P. 10.

¹¹⁰ Akolgo, *Encouraging Growth and Formalization of small Businesses through Tax Reforms*, p. 35.

2.4. Presumptive Taxation of Small Businesses

Presumptive taxes are potentially valuable whenever direct measurement of the tax base is difficult for the government, a problem common in, but by no means exclusive of, developing economies.¹¹¹ Consequently, the exact shape of a given presumptive tax construct depends on the features of the tax base it applies to.¹¹²

Presumptive taxes are among the oldest tax forms dating back to the 18th century when assets were the major source of income. Thus, tax revenues were based on measures of wealth rather than income, size or value of land and other assets, including number of doors and windows as an indicator of the value of residence and the living standards.¹¹³ The policy objectives of such taxes are; improving the efficiency of collection by reducing taxpayers administrative and compliance costs, reducing the administrative costs of compliance and enforcement management and its techniques. These are taken as a device to minimize the share of shadow economies/businesses, increase efficiency, and fighting corruption by shielding the interactive contact between taxpayers and tax assessing employees.¹¹⁴

In this regard, Thuroyni states that:

“The first one is simplification, particularly in relation to the compliance burden on tax payers with very low turnover. Secondly, 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. Lastly, 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 problems directly.)”¹¹⁵

¹¹¹ Christian R. Jaramillo H; *Presumptive Income Taxation and Costly Tax Compliance*, Department of Economics, University of Michigan, 2004, P. 2.

¹¹² *Ibid.*

¹¹³ Pashev, *Presumptive Taxation and Gray Economy: Lessons for Bulgaria*, P. 3.

¹¹⁴ *Id.*, P. 4.

¹¹⁵ Thuroyni, *Presumptive Taxation in Tax Law Design and Drafting*, at p. 4; See also Kyle D. Logue & Gustavo G. Vettori, *Narrowing the Tax Gap through Presumptive Taxation*, Michigan Law, University of Michigan Law

Hence, presumptive taxation is one of the techniques that serve to assess taxable income and tax liability of taxpayers without obliging to keep record of income and expenditure. However, there is no uniformity in applying the presumptive taxation in each tax regime as different types of presumptive methods exist in different countries.¹¹⁶ It covers a wide variety of alternative means of determining the tax base, ranging from methods of reconstructing income based on administrative practice.¹¹⁷

2.4.1. Merits and Demerits of Presumptive Taxation

In presumptive tax system, different types of taxes are designed on the basis of their scope of application, the criteria used to determine the tax base and their performance. Hence, the discussion in this section gives attention on the merits and shortcomings of presumptive taxation in general terms.

From the central idea of presumptive tax, it is believed to be an instrument of reducing the compliance and enforcement costs in the achievement of formalization, equity and other objectives of taxing small businesses.¹¹⁸ The precarious trade-offs between efficiency, equity and revenue objectives in the design of a presumptive tax have important implications in regard to its costs.¹¹⁹ It should also allow easy graduation of the small businesses to the standard tax net, where compliance and enforcement are managed through more efficient instruments, such as third party reporting and withholding at the source, improving the efficiency of audits and taxpayer services and optimizing the rate schedule.¹²⁰ In this regard, it should be given serious consideration to the opportunities of increased third party reporting through allowing deductions from gross personal income of expenses on professional services provided by small businesses and self-employed.¹²¹ The standard tax system is seen as costly for small businesses for its record keeping requirements. When the small businesses are taxed under the standard tax system, the compliance costs become regressive and the small business would be encouraged to remain in the hard to tax group. Compliance cost refers to the total time and money spent on

School, Empirical Legal Studies Center Working Paper, No. 10-007, (2010), p. 29-32; Victor Thuronyi, *Presumptive Taxation of the Hard-To-Tax*, International Studies Program, Working Paper 03-25, Andrew Young School of Policy Studies, Georgia State University, 2003, p. 2.

¹¹⁶ Muuz, *Evaluation of the Efficiency of Standard Assessment for Category C Taxpayers in Ethiopia*, p. 109.

¹¹⁷ Thuronyi, *Presumptive Taxation in Tax Law Design and Drafting*, at p. 2.

¹¹⁸ Pashev, *Presumptive Taxation and Gray Economy: Lessons for Bulgaria*, P. 23.

¹¹⁹ *Id.*, P. 5.

¹²⁰ *Id.*, p. 23.

¹²¹ *Ibid.*

learning tax rules, filling out forms, keeping records and performing other tax-related tasks.¹²² Therefore, tax compliance costs are the costs incurred by taxpayers in meeting the requirements laid on them by the tax law and the revenue authorities. It tends to increase with the number of taxes that an entrepreneur is subject to, the complexity of the tax rules, the frequency of submitting tax returns, and the number of levels of government involved in levying and collecting tax.¹²³ If presumptive taxation is designed in a better way, it can improve collection efficiency, reduce evasion and thus even distribute the tax burden more fairly among the small businesses.¹²⁴

From the point of administration, presumptive taxes are policy measures; they are feasible administrative options for controlling small business taxation because they simplify administration and compliance.¹²⁵ As Seth Terkper stated that the presumptive taxes may be the only feasible option for controlling many of small businesses and hence they need to be improved to administer tax procedures with two reasons.¹²⁶ First, the primary and secondary surveys used to determine standard and minimum assessments should be updated regularly to ensure that they represent a fair and reliable basis for estimating small business tax liabilities. Second, revenue authority/organ must establish links between the presumptive regimes and their conventional accounting, data analysis and enforcement programs. By using presumptive taxation, the tax administration can reduce those administrative costs. For this reason, the system may also encourage new businesses to start off as legitimate taxpaying businesses at the very beginning. Thus, in the absence of self-assessment and reporting compliance, the tasks of the tax administration are essentially reduced.¹²⁷

Most significantly, the main concept of presumption is the notion of potential taxability, as something capable of determination independently of self-declaration by the taxable entity, on the basis of presumptive norms.¹²⁸ In so doing, the presumptive approach improves the

¹²² Amin and John, *The Impact of Tax Reform on Private Sector Development*, p. 40.

¹²³ Small and Medium Enterprises Tax Compliance and Simplification; Background note prepared by the OECD Centre for Tax Policy and Administration for a “Round table Discussion” at the 1st Meeting of the Working Group on Taxation, available at <www.oecd.org/globalrelations41873897.pdf> accessed, February 29, 2017.

¹²⁴ *Ibid.*

¹²⁵ Seth Terkper, *Managing Small and Medium-Size Taxpayers in Developing Economies*, Tax Notes International, 2003, p. 213.

¹²⁶ *Ibid.*

¹²⁷ Pashev, *Presumptive Taxation and Gray Economy: Lessons for Bulgaria*, P. 4.

¹²⁸ Indira Rajaram and Kanwarjit Singh, *Report on Presumptive Direct Taxation*: National Institute of Public Finance and Policy, New Delhi, 1995, P. 2. [Here in after, Rajaram and Singh, *Report on Presumptive Direct Taxation*].

technological capability of the tax administration to handle larger numbers of taxpayers without the self-defeating incremental cost of attempting to do so within the existing system.¹²⁹ Scarce administrative resources are best deployed in the devising of presumptive norms applicable to those outside the tax net. Because of whether failure to file, or under-declaration of incomes, that will survive tests of justice and fairness.¹³⁰

However, presumptive taxation has its own problems. It has to be underscored that its design is not necessarily purely advantageous for small businesses. There is always the risk that a presumptive tax can over tax start-up businesses, and under tax established businesses with more ability to pay.¹³¹ But the idea behind it is not to compete with the standard tax schedule in terms of equity. Even though it is introduced as a simple tax meant to improve collection through reduced compliance and enforcement costs, it falls under constant pressures towards equity adjustments in its coverage, rate structure and indicators.¹³² This may not only drive it away from the original objectives of simplicity and efficiency, making it hard to enforce and comply with, but entails significant policy-making costs as well.¹³³

Although presumptive tax system improves horizontal equity by reducing the disparity between compliant and non-compliant taxpayers (wage earners and self-employed), it may deteriorate this equity between eligible and non-eligible taxpayers.¹³⁴ So, its impact in terms of vertical equity is even more ambiguous. Finally, in the presumptive tax system, there is no relief in case when taxpayers incur a loss which leads against fairness, short of encouraging businesses to keep records and there is slower potential disincentive to grow to the standard tax system.¹³⁵

2.4.2. Forms/Types of Presumptive Taxation

Presumptive taxation is a technique that serves to assess taxable income and tax liability of taxpayers without obliging to keep record of income and expenditure. However, there is no uniformity in applying the presumptive tax in each tax regime as different types of presumptive methods exist in different countries. Therefore, the most notable forms/types of presumptive taxation will be discussed as follows.

¹²⁹ *Ibid.*

¹³⁰ *Ibid.*

¹³¹ Pashev, *Presumptive Taxation and Gray Economy: Lessons for Bulgaria*, P. 23.

¹³² *Id.*, p.5.

¹³³ *Ibid.*

¹³⁴ *Ibid.*

¹³⁵ *Designing a Tax System for Micro and Small Businesses*, p. 58.

2.4.2.1. Estimated Assessment

Estimated assessments rely on the tax authority's estimation of a taxpayer's income; they are particularly relevant for taxing business activities in which the understatement of incomes is chronic and widespread.¹³⁶ The estimation of incomes or tax liabilities is usually aided by the use of certain indicators (that is based on '*indicator-based assessment* or *best judgment assessment*') of business activity such as the number of employees, the amount of machinery, and the volume of inventory, the size of production facility, quantity of stocks, quality of means of production, and capacity of supplying a given service.¹³⁷ It can be achieved through the tax authority that may seek to estimate a taxpayer's income and then apply the regular business income tax rate to that estimated income level or the tax authority may simply presume a tax liability owed directly.¹³⁸

As compared to standard assessment of presumptive tax, estimated assessments are viewed as a somewhat more refined and sophisticated presumptive taxation techniques.¹³⁹ In this context, the utilization of indicators as a proxy for a taxpayer's actual income is of crucial importance in estimated assessment. Even though many indicators could be used to estimate the income of a business or a self-employed professional, it is challenging to identify a good one. These indicators may be defined on the basis of some criteria: the levels of recordability of that indicator, the level of concealment, falsification, or substitution of the indicator, and the correlation of the indicator to income and the stability of that correlation over time.¹⁴⁰

Estimated assessment is significant because it reflects the taxable capacity of each taxpayer since it is made on individual basis. It can generally be adjusted to take into account specific conditions of each taxpayer. Estimated assessment based on indicating factors is more effective and relevant than an assessment made on the basis of similar grouping under similar category which does not directly lead in to a closer amount of income.¹⁴¹ In addition, estimated

¹³⁶ Günther & Helaway, *Presumptive taxation in Sub-Saharan Africa: Experiences and Prospects*, p.1.

¹³⁷ *Id.*, p. 2.

¹³⁸ *Id.*, p.15

¹³⁹ *Ibid.* For example, a tax liability is functioned a variety of indicators of business activity, and is not primarily related to occupational or business grouping. It can also generally be adjusted to take account of sudden or severe income shocks faced by a business or an individual.

¹⁴⁰ Rajaram and Singh, *Report on Presumptive Direct Taxation*, p. 43-45.

¹⁴¹ Muuz; *Evaluation of the Efficiency of Standard Assessment for Category C Taxpayers in Ethiopia*, p. 113.

assessments are taken as more advantageous than standard assessments due to their room to consider business or occupation based losses.¹⁴²

On the other hand, estimated assessment opens a room for an individual interaction of tax administration and taxpayers. Due to this reason, discretion is provided to a given tax authority in case of investigating estimated income of a given taxpayer.¹⁴³ This creates corruption and high administrative costs. In addition to this, identifying a better indicator of the estimation method is another challenge to the tax authority.¹⁴⁴ But, in most cases, the question arises how to alleviate the problems of estimated assessment in a little bit. For the successful implementation of an estimated assessment, at least, the requirements identified to be complied with are: 1) the tax administration must have the technical resources to make detailed studies of profitability by type of activity; 2) an adequate number of tax officials must be available to verify information provided by taxpayers about the characteristics of their business; and 3) the system involves discussions between tax officials and taxpayers on the level of the assessment, officials must be strictly supervised and adequately paid.¹⁴⁵

Operation of estimated assessment method has its own features in different countries. For instance, one of the most developed systems of estimated assessments is France's '*forfaits*' (contractual) system for certain small businesses with income below a specified threshold.¹⁴⁶ That is the presumptive systems requiring an agreement between the tax administration and the taxpayers.¹⁴⁷ Their agreement is an advanced agreement as to the taxpayer's tax liability based on estimated income in lieu of actual income.¹⁴⁸ The '*forfait*' system requires an extensive collection of data and development of estimates of business profit expectations by the tax administration. The taxpayer has to supplement this data collection by providing information on

¹⁴² *Ibid.*

¹⁴³ Günther & Helaway, *Presumptive taxation in Sub-Saharan Africa: Experiences and Prospects*, p. 16.

¹⁴⁴ *Ibid.*

¹⁴⁵ Vito Tanzi & Milka Casanegra de Jantscher, *Presumptive Income Taxation: Administrative, Efficiency, and Equity Aspects*, (IMF Working Paper, 1987). P.12. *See also*, IMF, *Tax Administration in Developing Countries, Strategies and Tools of Implementation*, Background Paper for the 1988 World Development Report, 1988, p. 33.

¹⁴⁶ Günther & Helaway, *Presumptive taxation in Sub-Saharan Africa: Experiences and Prospects*, p. 18; *see also*, Victor Thuronyi, *Presumptive Taxation in Tax law and Drafting*, p. 22.

¹⁴⁷ *Designing a Tax System for Micro and Small Businesses*, p.73.

¹⁴⁸ Thomas, *Presumptive Collection: A Prospect Theory Approach to Increasing Small Business Tax Compliance*, p. 121.

purchases, sales, and the value of closing inventory, number of employees, wages paid, and number of cars owned.¹⁴⁹

The *'forfait'* system of estimated approach produces high administrative costs, as it requires the tax administration to prepare a detailed profit estimate of the individual small taxpayer's business profits as a basis for negotiation.¹⁵⁰ In this approach, the system contradicts with the principle of self- assessment, which is a key element of tax system modernization in developing countries. The estimation methods for determining the amount of the *'forfait'*, which are based on extensive statistical analyses conducted by the tax administration and on a detailed classification of industries, involve a lot of sophisticated work.¹⁵¹ Moreover, the application of the *'forfait'* depends on high-quality and honest tax inspectors. This suggests that it may not be appropriate for many countries where tax administration is weak which leads to tax evasion and corruption. Therefore, care should be taken before contemplating the introduction of such a scheme.

2.4.2.2. Standard Assessment

Standard assessment is one variant of presumptive taxation in which a fixed, lump-sum tax is levied on individuals or businesses on the basis of the occupation or business activity. Different occupations are exposed to different lump-sum tax dues; these levies correspond to some average income level presumed to be earned by members of a particular occupation or business grouping.¹⁵² Standard assessments assign the fixed amount of taxes to taxpayers on the basis of occupation or business activity and payments are established by determining the average taxable income of a few taxpayers selected at random.¹⁵³ That means its tax liability is not subjective in the sense that taxpayers in the same business category face the same tax burden. The features, merits and demerits of standard assessment will be discussed in detail under section 2.5.

¹⁴⁹ *Designing a Tax System for Micro and Small Businesses*, p. 73.

¹⁵⁰ *Id.*, p. 74.

¹⁵¹ Thuronyi, *Presumptive Taxation in Tax Law and Drafting*, p. 23.

¹⁵² Günther & Helaway, *Presumptive taxation in Sub-Saharan Africa: Experiences and Prospects*, p.1.

¹⁵³ Yury Valevich, *et al*, Proposals for Further Improvement of the System of Presumptive Income Taxation of Individual Entrepreneurs in Belarus, 3 (2004) (PP/11/04 IPM research center), <<http://www.bsu.by/Cachepdf303183.pdf>> Accessed on February 29/2017. [Herein after, Valevich, Proposals for Further Improvement of the System of Presumptive Income Taxation of Individual Entrepreneurs in Belarus].

2.4.2.3. Rebuttable and Irrebuttable Presumptive Taxation

Presumptive methods can be rebuttable or irrebuttable. Rebuttable method of presumption is an administrative approach to reconstructing the taxpayer's income, and may or may not be specifically described in the statute.¹⁵⁴ If the taxpayer disagrees with the result reached, the taxpayer can appeal by proving his/her actual income, calculated under the normal tax accounting and regular rules showing that his/her actual income liability was less than that calculated under the presumption. The taxpayer can prove a lower tax liability through full disclosure to the tax authorities. Rebuttable presumptive method is a universal feature of tax assessment procedure, required in order to deal with cases where taxpayers either do not fully disclose their financial situations on their returns or fail to file a return.¹⁵⁵ Because of this, the law normally authorizes the tax authority to use indirect methods to determine the taxpayer's income, whether on arbitrary criteria or other means of data available.¹⁵⁶ It can encourage taxpayers to keep proper accounts, because it subjects those taxpayers to a possibility of higher tax liability in the absence of such proper accounts.¹⁵⁷

On the other hand, unlike the rebuttable one, irrebuttable presumptive assessment is specified in the statute or in delegated legislation and tax assessments cannot be challenged by appeal disclosing to the tax authority.¹⁵⁸ The taxpayer is not allowed to prove that his actual income was lower than the presumptive income because it is legally binding and defined precisely. There are two types of irrebuttable presumptive taxation. The first one is minimum tax where the tax liability is no less than that determined under the presumptive rules and requires two tax bases to be calculated and compared.¹⁵⁹ The second is exclusive tax where tax liability is determined under the presumption alone, even if the application of the regular or general rules might lead to a higher tax liability.¹⁶⁰

The other types of presumptive taxation can also be classified into formal and discretionary taxation according to the degree of freedom or discretion that they allow to the tax authorities

¹⁵⁴ Thuronyi; *Presumptive Taxation in Tax Law and Drafting*, p. 3.

¹⁵⁵ *Ibid.*

¹⁵⁶ S.N. Makedonskiy, *Taxation Mechanism based on Simplified and Indirect Evaluation of tax Liabilities: Russian-European Center for Economic Policy*, Moscow, 2005. P. 7, <www.recep.ru/files/documents/Taxation_Makedonskiy_eng.pdf> accessed on March 12, 2017.

¹⁵⁷ Valevich, *Proposals for Further Improvement of the System of Presumptive Income Taxation of Individual Entrepreneurs in Belarus*, p. 2.

¹⁵⁸ Thuronyi; *Presumptive Taxation in Tax Law and Drafting*, p. 3.

¹⁵⁹ *Id.*, p. 4.

¹⁶⁰ *Ibid.*

for the definition of tax liabilities. Formal taxation means determination of tax liability based on the established rules.¹⁶¹ It is considered as less equitable because it does not take into account specific conditions of taxpayer. By contrast, discretionary taxation assumes a high degree of tax authorities' discretion while determining tax liability.¹⁶² Hence, it appears that formal presumptions are less open to corruption and administratively simpler because they apply based on the enacted laws.¹⁶³ A large measure of discretion will generally be rebuttable, because otherwise too much power, and potential for arbitrary action, would be given to the revenue authorities.¹⁶⁴

2.4.2.4. Turnover and Indicators based Presumptive Taxation

Presumptive taxation based on turnover or gross income is one parameter to determine the tax liability of small businesses. Turnover income can be structured in different ways. The one it is to apply the same tax rate to all businesses subject to tax, irrespective of the business activity. But it may fail to consider that profit margins can be substantially different in different business sectors.¹⁶⁵ The other mechanism is to divide the small business communities into a number of business segments with different tax rates.¹⁶⁶ Turnover based taxation can also introduce a progressive tax on gross income. It can be applied as an exclusive way, as a minimum tax, and it is the most popular kind of presumptive taxation, for example, in Albania, Armenian, Kazakhstan, Romania, Russia, Tanzania, and Ukraine.¹⁶⁷ In this type of presumptive tax, the tax burden gets reduced for periods or businesses with below average volume of business transactions. It has the potential of being a better proxy for profit estimation than indicators such as the size of business, type or the number of employees.¹⁶⁸ This helps that small businesses to keep at least some basic books and records without imposing any burdensome accounting requirements on these operators.

¹⁶¹ Valevich, Proposals for Further Improvement of the System of Presumptive Income Taxation of Individual Entrepreneurs in Belarus, p. 3.

¹⁶² *Ibid.*

¹⁶³ *Ibid.*

¹⁶⁴ Thuronyi, *Presumptive Taxation in Tax Law and Drafting*, p. 3.

¹⁶⁵ Michael Engelschalk, *Creating a Favorable Tax Environment for Small Business Development in Transition Countries*, the World Bank, Washington, D.C., 2005, p. 7-8. [Here in after, Engelschalk, *Creating a Favorable Tax Environment for Small Business Development in Transition Countries*].

¹⁶⁶ *Ibid.*

¹⁶⁷ *Ibid.* See also, *Designing a Tax System for Micro and Small Businesses*, p. 60-62.

¹⁶⁸ *Ibid.*

Turnover-based presumptive tax systems reduce risks of disputes over the applicable tax rate and do not require complicated comparisons of profit margins in different small business segments.¹⁶⁹ In the absence of general guideline for the determination of the tax rate in case, there is a substantial design challenge, however, when it comes to fixing the level of standard deduction from turnover or the tax rate to be applied.¹⁷⁰

The second method is indicator-based system of presumptive tax that aims at being more precise than turnover-based systems in estimating the profit potential of the small businesses.¹⁷¹ In this system, the most common indicators are the floor space of business premises, number of employees, value of inventory, capacity of machinery and number of years of operation of the business.¹⁷² The criteria that come into play in the selection of indicators are ease of observation; difficulty of concealment, falsification, or substitution, and stable in relation to income.¹⁷³ However, this brings up a clear conflict between the objective to tax the true potential profit of the small business with the objective to design a simple and transparent system.¹⁷⁴ Policy-makers in transition countries face considerable difficulties designing indicator-based systems that establish an acceptable balance between these objectives; systems tend either to be extremely complicated and unclear or they do not sufficiently differentiate between business activities.¹⁷⁵

An indicator-based system is believed to have some major advantages over turnover-based systems. These are: 1) it is less prone to tax evasion and more complicated to conceal the existence or the size and amount of most of the common indicators in use; 2) it gives less reason for disputes between the business owners and the tax administration over the presumptive tax liability; and 3) it takes the place of even basic bookkeeping requirements and thus may reduce tax compliance costs.¹⁷⁶ However, an indicator-based system has its own difficulty to design and risk causing for businesses in the administration tax in practice. It is also problematic to define indicators that sufficiently reflect the profit potential and a

¹⁶⁹ *Id.*, p. 63.

¹⁷⁰ *Ibid.*

¹⁷¹ Engelschalk, *Creating a Favorable Tax Environment for Small Business Development in Transition Countries*, p. 8.

¹⁷² *Designing a Tax System for Micro and Small Businesses*, p. 69.

¹⁷³ Rajaram and Singh, *Report on Presumptive Direct Taxation*, p. 3.

¹⁷⁴ Engelschalk, *Creating a Favorable Tax Environment for Small Business Development in Transition Countries*, p. 8.

¹⁷⁵ *Ibid.*

¹⁷⁶ *Designing a Tax System for Micro and Small Businesses*, p. 69.

small business owner's ability to pay and sometimes its requirement to apply basic bookkeeping rules nominally may add to compliance costs.¹⁷⁷

2.5. Theoretical Framework of Standard Assessment Method

2.5.1. General Overview

In principle, the standard assessments serve only as minimum tax payments for the various occupational groupings. But in practice, with the tacit acceptance of the tax authorities, the standard assessments increasingly represent final tax liabilities from the various occupational groups covered.¹⁷⁸ It means that in administration of standard assessment, although the tax authority is relieved from assessing tax liability, it is still required to ensure that taxpayers are categorized in the appropriate groups. It prescribes lump-sum taxes by reference to the indicators used in the assessment method.¹⁷⁹ If taxes are imposed in reference only to type of business, it is sufficient for the tax administration to identify the business type in which the tax payer is engaged. But, in order to make efficient collection of revenues, multiple tax rates may be assigned to a business activity by employing different indicators. Examples of the indicators employed included location, seating capacity number of employees, skill level of employees and type of equipment used.¹⁸⁰

Most significantly, standard assessments prescribe a fixed, lump-sum tax payment to be paid by persons or businesses engaged in specific trades and professions. These regimes are not self-executing regimes. In administering standard assessment, tax administration is required to ensure that taxpayers are categorized in the appropriate groups.¹⁸¹ The classification of businesses for standard assessment purposes is based on the indicators used in the regime. If taxes are imposed by reference to the type of business, the tax administration needs to identify

¹⁷⁷ *Id.*, p. 70.

¹⁷⁸ Günther & Helaway, 'Presumptive taxation in Sub-Saharan Africa: Experiences and Prospects', p. 13.

¹⁷⁹ Valevich, Proposals for Further Improvement of the System of Presumptive Income Taxation of Individual Entrepreneurs in Belarus, p. 3.

¹⁸⁰ *Ibid.*

¹⁸¹ Zerihun Aseged, *Standard Assessment of Small Business in Addis Ababa City: Legal and Practical Problems in Focus*, in Tadesse Lencho and Kyle Logue (eds.), *Ethiopian Tax System: Some Contemporary Issues and Problems*, Ethiopian Business law series, Vol. VI, 2014, pp.123-145, p. 126. [Herein after, Zerihun, *Standard Assessment of Small Business in Addis Ababa City*].

the business type in which the taxpayer is engaged.¹⁸² This may be sound but the rules must be capable of identifying the type of business for all the taxpayers involved.

During 1960s and 1970s, several African countries¹⁸³ were utilizing the standard assessment taxation system.¹⁸⁴ Specially, the first attempt in Ghana to tax the small businesses and self-employed individuals was enacted in 1963.¹⁸⁵ Even though, this Act has gone through various amendments over the years, the standard assessment was a scheme in which a fixed lump-sum tax was levied on individuals and businesses on the basis of business activity in which they engaged.¹⁸⁶ The levies correspond to some average income level presumed to be earned by members of a particular occupation or business grouping.¹⁸⁷ Average income is interpreted to mean an income that could be earned by taxpayers, who worked an average number of hours, put forth an average level of effort, took average risk, and used an average technology of the time period.¹⁸⁸ Therefore, taxes based on average income allow taxpayers to retain some profit without being taxed.

In principle, the standard assessments were payments on accounts to be set-off against the amount of income tax actually payable.¹⁸⁹ Even if the lump-sum payments were established as a minimum income tax, practically most tax payers subject to standard assessments paid only the prescribed lump sum amounts.¹⁹⁰ That is with the implied acceptance of the tax authorities, the standard assessments increasingly represented the final tax liabilities from the various occupational groups covered. In contrast to the usually prescribed lump-sum payment under standard assessment, Ghana incorporated graduation for some occupational groups. For example, doctors had to pay varying lump-sum taxes according to the number of years in practice while the lump-sum amounts paid by fishermen were calibrated by the length of their

¹⁸² *Ibid.*

¹⁸³ Some of these countries are Ghana, Nigeria, Mozambique, Lesotho, Sierra Leone, Gabon, Burkina Faso, Cameroon, Rwanda and Ethiopia. The Standard Assessment technique in Ghana has employed different factors such as the number of service years, size of means of conducting business and trade to levy the actual income tax; In Cameroon, lump-sum levies for the agricultural sector have been based on the crop planted, area covered, average yield, and number of livestock. *See also*, Günther & Helaway, *Presumptive taxation in Sub-Saharan Africa: Experiences and Prospects*, p. 13-15.

¹⁸⁴ Günther & Helaway, *Presumptive taxation in Sub-Saharan Africa: Experiences and Prospects*, p. 13-14.

¹⁸⁵ Ofori, *Taxation of the Informal Sector in Ghana: A Critical examination*, p. 17.

¹⁸⁶ *Id.*, p. 18.

¹⁸⁷ *Ibid.*

¹⁸⁸ Valevich, *Proposals for Further Improvement of the System of Presumptive Income Taxation of Individual Entrepreneurs in Belarus*, p. 6.

¹⁸⁹ Ofori, *Taxation of the Informal Sector in Ghana: A Critical Examination*, p. 18.

¹⁹⁰ International Monetary Fund, *Tax Administration in Developing Countries, Strategies and Tools of Implementation*, Background Paper for World Development Report, 1988, p.35.

vessel.¹⁹¹ The main advantage of standard assessment scheme was that it enhanced the vertical equity. Self-employed professionals such as doctors, dentists, and lawyers whose incomes are several times the national average were made to make some payments, though not in direct proportion to their personal efforts.¹⁹² However, despite the advantage, the scheme was beset with some drawbacks that prevented it from achieving the policy objectives which leads to poor performance in mobilizing the revenue of the government.¹⁹³ These drawbacks will discuss in the next section in detail.

2.5.2. Implementation of Standard Assessment

Before moving to the implementation of standard assessment of small business taxation, it is important to conduct a research for the formulation and categorization of these taxpayers. In this regard, M. Zuhtu Yucelik states the major research methodologies to come up with the indicator-standard assessment.

“Firstly, identifying the size and diversity of small businesses operating in the economy to generate a data base for making business categorization called comprehensive Survey of taxpayers. Secondly, based on the survey, businesses should be categorized into groups by using different basis to get as much necessary information as possible termed as categorization of businesses. Thirdly, it picks ample businesses from each category and to determine annual gross turnover in reference to indicators based on presumptive annual turnover. Fourth, the estimated gross turnover, the amount of expense and profit shall be drawn and the expense of businesses can be ascertained by considering costs of all inputs depend on the nature of businesses called presumptive profit ratio. Fifth, it is a multiplication of the annual turnover by the profitability rate to obtain presumptive net income. That it refers to amount of taxable income from the annual turnover. Finally, it can be possible to make standard assessment for a specific location where the research is conducted. The impact of location on business turnover and profit rate is a well-established fact.”¹⁹⁴

Once the tax due is set for each categorized business, it is a common practice to publish the standard assessment in the form of table or matrices that simply show the type of business

¹⁹¹ Günther & Helaway, *Presumptive taxation in Sub-Saharan Africa: Experiences and Prospects*, p. 13; See also, Ofori, *Taxation of the Informal Sector in Ghana: A Critical examination*, p. 18.

¹⁹² Brunetti A. & Weder B. Credibility of Rules and Economic Growth: Evidence from a Worldwide Survey of the Private Sector, *The World Bank Economic Review*, 1998, Vol. 12, No. 3, p.353, quoted by, Ofori, *Taxation of the Informal Sector in Ghana: A Critical examination*, p. 19.

¹⁹³ Günther & Helaway, *Presumptive taxation in Sub-Saharan Africa: Experiences and Prospects*, p. 15.

¹⁹⁴ M.Zuhtu Yucelik and Percy W. Kierstead, Ethiopian presumptive taxation, International Monetary Fund, 1994, Cited in, Zerihun; Standard Assessment of Small Business in Addis Ababa City, p. 129-131.

activity, the indicators used and the corresponding fixed tax.¹⁹⁵ This means that there will be no amount of resources that is used to estimate tax liability for each taxpayer. Tax officials are required only to apply the standard assessment by ensuring that they are in the appropriate category and taxpayers' declaration made during the comprehensive survey can be used to identify the appropriate category and fixed taxes for them.¹⁹⁶ The implementation of standard assessment is cost-effective and doesn't require much technical skill. That is why the method, once formulated, is suitable for weak tax administrations.¹⁹⁷ Lastly, care shall be taken on the duration of the standard assessment in practice, and needs to be revised from time to time, and to bring new business activities to the tax net. Countries' experience shows that the method will not be effective in revenue rising if it is not updated with changing economic situations.¹⁹⁸ Depending upon the laws regulating standard assessments, it is designed to come into force for duration of some years.¹⁹⁹ It is preferable to check whether the standard assessment is outdated or not during its implementation stage.

2.5.3. Merits and Demerits of Standard Assessment

Standard assessment method has been an attractive tax tool in different countries for a number of reasons. First, standard assessment is comparatively simple to administer.²⁰⁰ It reduces tax evasion by small businesses which imply low administrative costs and less open to corruption. For example, a fixed lump-sum tax on self-employed professionals relieves the tax authority of ascertaining or verifying a particular individual's actual income through auditing and investigation; instead, an average income is presumed to be earned in the professions. Hence, their income is no longer assessed from accounting records but from indirect indicators such as size and type of business activity, number of employees, etc. This approach of estimating income on which the tax is levied removes the administrative burden of financial transparency.²⁰¹ Therefore, Standard assessment can relieve tax authorities from the need to go through auditing and income-estimation processes of each and every taxpayer.

¹⁹⁵ *Id.*, p.132.

¹⁹⁶ *Ibid.*

¹⁹⁷ *Ibid.*

¹⁹⁸ Günther & Helaway, *Presumptive taxation in Sub-Saharan Africa: Experiences and Prospects*, p. 13-15.

¹⁹⁹ *Ibid.*

²⁰⁰ Günther & Helaway, *Presumptive taxation in Sub-Saharan Africa: Experiences and Prospects*, p. 14.

²⁰¹ Valevich, *Proposals for Further Improvement of the System of Presumptive Income Taxation of Individual Entrepreneurs in Belarus*, p. 5.

Second, standard assessments are attractive in terms of horizontal equity to the extent that such levies capture small businesses and the self-employed individuals who previously escaped taxation or that operate in a shadow economy.²⁰² This is realized by the reason that narrowness of tax base and exclusion of small business taxpayers operating outside the knowledge of a tax administration can be easily captured into the tax base by a simple formulation of standard assessment for a given sector.²⁰³

Third, in case of standard assessment, there is no discretion on the side of the tax official; instead, lump-sum taxes are pre-determined and derived from tables or matrices that simply show occupation on one side and a corresponding tax liability on the other.²⁰⁴ Due to the problem of weak tax administration and the low salary level of tax officers, it helps to avoid conflicts between tax authorities and taxpayers in estimating amount of taxable income.²⁰⁵ It can also be an effective tool in taxpayer identification; lists of small businesses and professionals can be created, which can potentially be used to make hard-to-tax groups increasingly subject to the regular tax system.²⁰⁶

Finally, standard assessment is used to broadening the tax base that levied on the basis of occupation than individual taxpayer; it can have paramount importance to bring all individuals, who engage in those occupations, to the tax net. There is less chance for escaping tax liability as far as the tax administration enforces the standard assessment on the targeted occupations that reduces tax evasion and hence brings more taxpayers into the tax net.²⁰⁷

Viewed from other perspectives, standard assessment is not without limitation. The following are the major demerits of standard assessment.

Standard assessment does not take into account taxpayer-specific conditions, such as family size and losses in a particular year. This has a negative impact on risk investments and the method violates vertical equity by imposing the same tax liability simply because taxpayers with different income status fall within the same category.²⁰⁸

²⁰² Günther & Helaway, *Presumptive taxation in Sub-Saharan Africa: Experiences and Prospects*, p. 14.

²⁰³ Muuz, *Evaluation of the Efficiency of Standard Assessment for Category C Taxpayers in Ethiopia*, p. 112.

²⁰⁴ Günther & Helaway, *Presumptive taxation in Sub-Saharan Africa: Experiences and Prospects*, p. 14.

²⁰⁵ Valevich, *Proposals for Further Improvement of the System of Presumptive Income Taxation of Individual Entrepreneurs in Belarus*, p. 6.

²⁰⁶ *Ibid.*

²⁰⁷ *Ibid.*

²⁰⁸ Günther & Helaway, *Presumptive taxation in Sub-Saharan Africa: Experiences and Prospects*, p. 14.

Since fixed amount of taxes doesn't depend on actual outcomes of individual entrepreneurs' performance, there may be disincentives to earn income in the sense that the standard assessment is an entry barrier.²⁰⁹ It may deter people from starting a business when they think that the tax is so high that they have little chance to make a profit at all, and it may force people out of business.²¹⁰

Standard assessments violate the principle of vertical equity, to the extent that the same tax liability is imposed on high and low income professionals such as doctors and lawyers. Hence, some low-income professionals are not encouraged to comply.²¹¹ It has also poor performance with respect to revenue mobilization unless the fixed payments are indexed to inflation or increased regularly to account for changing economic conditions.²¹² When fixed lump sum levies are determined for occupation or business groupings whose members may have highly divergent incomes, the tax administration tend to set the levies based on the incomes of the poor performers instead of on the basis of true averages.²¹³

Generally, for countries with weak tax administration and high level of informality, standard assessment seems better and stronger than the estimated assessment. It is fair to assume that standard assessment can eliminate factors that undermine the legitimacy of weak administrations, such as corruption, narrow tax base and involuntary compliance due to the subjective nature of presumptive systems other than standard assessment.

²⁰⁹ *Ibid.*

²¹⁰ *Ibid.*

²¹¹ *Supra note 209*, at p. 14.

²¹² *Ibid.*

²¹³ *Ibid.*

CHAPTER THREE

STANDARD ASSESSMENT OF SMALL BUSINESSES IN THE ETHIOPIAN CONTEXT

3.1. Introduction

This chapter discusses the legal regime of standard assessment of small businesses in Ethiopia. It starts by briefly discussing the historical background of taxation of small businesses in the income tax systems of Ethiopia. It then deals with the development of standard assessment in the tax system and the status of standard assessment before and after the 2002 income tax law reforms in Ethiopia. In addition to this, standard assessment under the current income tax regime of the Federal Government is discussed.

3.2. Historical Background of Taxation of Small Businesses in Ethiopia

Taxation has a long history in Ethiopia, but the modern system of taxation began since 1941 after the departure of Italians from the country.²¹⁴ Since then, the Ethiopian state at different times throughout history has attempted to improve the tax system in order to enhance objectives of increasing revenue productivity and financing development plans by introducing various forms of taxation.²¹⁵

The modern income tax system of Ethiopia began in 1944 when the first income tax law was issued to levy tax on income of individuals and businesses.²¹⁶ Moreover, the tax system in general and the income tax system in particular have undergone several changes. This modern system of taxation is quite different from the traditional system of taxation in Ethiopia. First, legislation on taxation began to be published in the official gazette of legal publications in the *Negarit Gazeta*.²¹⁷ It represented an important development in taxation at least in ensuring that

²¹⁴ Tadesse, *Towards Legislative History of Modern Taxes in Ethiopia*, p. 104.

²¹⁵ Misganaw Gashaw, *Tax Reform Discourse and Its Implication on Development: Evidence from the VAT Introduction in Ethiopia*, *Mekelle University Law Journal*, Vol. 3, No. 1, 2015, p. 3; The modern development of the Ethiopian tax system went through some major revisions and numerous piecemeal amendments. The major tax reforms in Ethiopia occurred in the 1940s, in the aftermath of the Ethiopian revolution of 1974, after the fall of the Derg in 1991 and most recently in the 2002 tax reforms. *See also*, Taddese Lencho, *The Ethiopian Tax System: Excess and Gap*, *Michigan State International Law Review*, 2012, Vol. 20:2, pp. 328-380, p. at 329.

²¹⁶ Taddese, *The Ethiopian Income Tax System*, P. 1.

²¹⁷ Tadesse, *Towards Legislative History of Modern Taxes in Ethiopia*, p. 104.

taxation would be based on written laws rather than the interest of officials. Second, the modern period saw the transformation of the Ethiopian tax system from one that was based predominantly upon in kind payments to a cash-based one; taxation thus represents a monetary obligation regardless of the type of taxes levied.²¹⁸

Although several types of taxes emerged between the 1940s and 1950s, modern income tax laws of Ethiopia were presumptive in their nature. That is to say, tax payments on taxable sources, such as land and business, were fixed on the basis of indicators.²¹⁹ For instance, the land tax of 1942 used fertility of lands as an indicator to determine tax liability.²²⁰ Under the Land Tax Proclamation of 1942, taxes were imposed on the basis of fertility of lands that were classified into fertile, semi-fertile and poor lands.²²¹ Landowners holding fertile land were to pay more per ‘*Gasha*’ (unit of measurement) than landowners holding semi-fertile lands, and semi-fertile landowners were to pay more than those holding poor lands.²²²

The presumptive nature was also observed in the subsequent tax laws on agricultural income. After the 1942 land tax law was repealed, there was a law which revised the modality of land taxation at the time and above all introduced the first modern agricultural income taxation in Ethiopia.²²³ The 1944 Personal and Business Income Tax Proclamation, which was the first modern income tax law outside the agricultural system, marked an additional evidence of an advance towards full monetization of the Ethiopian tax system.²²⁴ It was promulgated and this legislation stipulated that business income taxes were fixed in reference to type of activity.²²⁵ Since businesses were not required to keep any record under this proclamation, presumptive tax liabilities were made on the basis of type of activity and the class in which the business falls.²²⁶

In terms of the tax structure, the 1944 income tax law established a schedular approach by creating three schedules for income taxation in Ethiopia.²²⁷ This approach has remained the

²¹⁸ *Ibid.*

²¹⁹ Zerihun, *Standard Assessment of Small Business in Addis Ababa City*, p. 131.

²²⁰ A Proclamation to Provide for a Tax on Land, 1942, *Negarit Gazeta*, Proc. No. 8, 1st Year, No. 1 (*now repealed*); Cited in Tadesse, *Towards Legislative History of Modern Taxes in Ethiopia*, p.108.

²²¹ *Ibid.* See also, Muuz, *Evaluation of the Efficiency of Standard Assessment for Category C Taxpayers in Ethiopia*, p. 115.

²²² *Ibid.*

²²³ Land Tax Proclamation, 1944, *Negarit Gazeta*, Proc. No. 70, 4th Year, No. 2 (*now repealed*).

²²⁴ *Ibid.*

²²⁵ Personal and Business Income Tax, 1944, *Negarit Gazeta*, Proc. No. 60, 3rd Year, No. 9. (*now repealed*).

²²⁶ Tadesse, *Towards Legislative History of Modern Taxes in Ethiopia*, p.117.

²²⁷ That was a sur-tax on special classes of Schedule ‘B’ taxpayers, applying graduated tax rates to those businesses earning income above a baseline. See Tadesse, *Towards Legislative History of Modern Taxes in Ethiopia*, p.115.

basic structure of income taxation to this day. These were Schedule ‘A’ (personal income), Schedule “B” (income from businesses) and Schedule “C” (sur-tax imposed on some categories of businesses).²²⁸ Under schedule “B” there were three classifications of businesses; class A, class B, and class C (the modern and present equivalent of category A, B and C taxpayers).²²⁹ Tax rates were proportional to the level of businesses. By looking into the low level of taxes required from Class C, it may be possible to equalize taxpayers in this class to the current category “C” taxpayers.²³⁰

The absence of record keeping was one of the main features of Ethiopian Income Tax System until 1956. That is to say, it was after the enactment of the Income Tax Decree of 1956 that businesses began to be required to follow a different set of rules in record keeping and calculating tax liability.²³¹ For the first time, by introducing a monthly accounting system, businesses other than those identified as small ones were obliged to keep statements about their income and expenses for the purpose of calculating tax liability.²³² Even if the content of the three schedules of the Ethiopian income tax have changed very little since the 1956 income tax law, it ended up in the classification of businesses into categories, except for small businesses that were exempted from the proper record keeping and were required to pay tax at a fixed rate, in accordance to rules prescribed by the Finance Minister.²³³

After the 1956 Income Tax Decree was repealed, subsequent legislations have amended the threshold and presumptive methods of small business taxation. This assessment method occurred following the formulation and promulgation of the Income Tax Proclamation of 1961.²³⁴ This income tax law was a better-known income tax law in modern income tax history of Ethiopia because it remained in force for a long time until 2002.²³⁵ Under this proclamation, the estimated income tax assessment approach was introduced to be applied if no records and books of account were 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

²²⁸ *Id.*, p.116.

²²⁹ *Ibid.* See also Muuz, *Evaluation of the Efficiency of Standard Assessment for Category C Taxpayers in Ethiopia*, p. 116.

²³⁰ *Ibid.*

²³¹ The Income Tax Decree, 1956, *Negarit Gazetta*, Decree No. 19, 16th Year, No.1, Art. 43 (*now repealed*). [Here in after, Income Tax Decree No. 19/1956].

²³² *Ibid.*

²³³ *Ibid.*

²³⁴ The Income Tax Proclamation, 1961, *Negarit Gazetta*, Proc. No. 173, 20th year, No. 13. (*now repealed*). [Herein after, Income Tax Proc. No. 173/1961].

²³⁵ Tadesse, *Towards Legislative History of Modern Taxes in Ethiopia*, p. 119.

its income within the time specified in the law.²³⁶ The basis for estimating tax liability was a gross turnover. In the Ethiopian tax system, the name ‘category ‘C’ taxpayers’ was introduced for the first time by the Income Tax Regulations issued pursuant to the Legal Notice 258/1962.²³⁷ As per this Regulation, small businesses (category ‘C’ taxpayers) - identified as those businesses whose annual turnover did not exceed 6,000 ETB-were subject to the presumptive income tax regime of standard assessment.²³⁸ This proclamation continued to be effective holding the estimated income tax assessment until it was repealed by a subsequent Income Tax Proclamation No. 227/2001.²³⁹

3.3. Development of Standard Assessment

Standard assessment method was developed and applied in Israel since the 1950’s as the means of tax assessment for more than one hundred business and occupational groupings.²⁴⁰ In such a case, a tax assessment guide utilized by tax inspectors as a device for computing tax liabilities. Under the Israeli ‘*tachshiv*’ system (standard taxation) careful examination of these businesses are made on the basis of key indicators (production factors).²⁴¹ Unlike the ‘*forfait*’, which sets forth limits on the turnover, ‘*tachshiv*’ does not establish such limitations.²⁴² Because the ‘*forfait*’ method in France is based on contractual system, (that the determination of income is a matter of negotiation between the taxpayer and the tax inspector), comprises small businesses whose income is below the established level.²⁴³

As mentioned in the previous section, the history of standard assessment has begun in Ethiopia with the introduction of modern income tax laws in the 1940s. From the outset, tax payments on taxable sources, such as land and business, were fixed based on some indicators.²⁴⁴ There was

²³⁶ The Income Tax Proc. No. 173/1961, art. 40.

²³⁷ The Income Tax Regulation, 1962, *Negarit Gazetta*, Reg. No. 258, 22th Year, No.1. Art. 25 (*now repealed*).

²³⁸ *Ibid.*, art. 25 (C).

²³⁹ The Income Tax (Amendment) Proclamation, 2001, *Federal Negarit Gazetta*, Proc. No. 227, 7th Year, No. 9. Art. 2(4), [Here in after, Income Tax (Amendment) Proc. No. 227/2001].

²⁴⁰ Gunther and Helaway, *Presumptive Taxation in Sub-Saharan Africa: Experiences and Prospects*, p.11

²⁴¹ S.N. Makedonskiy; *Taxation Mechanism based on Simplified and Indirect Evaluation of tax Liabilities: Russian-European Center for Economic Policy, Moscow, p. 17.,(2005).* <www.recep.ru/files/documents/Taxation_Makedonskiy_eng.pdf> accessed on March 12, 2017. For example, the key indicators in *tachshiv* are location, number of seats (for restaurants, cafes and hair dresser shops), qualification level of employees, the nature of the used equipment, water consumption, quality of soil and average crop yield (for the agricultural producers).

²⁴² *Ibid.*

²⁴³ *Ibid.*

²⁴⁴ A Proclamation to Provide for a Tax on Land No. 8/1942, *Negarit Gazeta*, Year 1, No. 1, art. 3 (ii) (*now repealed*), Cited in, Tadesse, *Towards Legislative History of Modern Taxes in Ethiopia*, p. 120.

an observation of presumptive nature of standard assessment tax experiences.²⁴⁵ In addition, under the Individual and Business Income Tax Proclamation of 1944, business taxes were fixed on the basis of non-turnover indicators. To mention as an example, traders include brokers, commission agents, contractors, general importers and exporters, sub-contractors and wholesale dealers.²⁴⁶ On the other hand, retailers were classified into many business types.²⁴⁷ In the premises category, we meet with businesses like bars, biscuit factories, breweries, cinemas, cotton mills, distilleries and flour mills, in which, all these business sectors had their own fixed tax levies, which were not determined on taxpayer level as in the case of estimated assessment, and the proxies used were pure indicators.²⁴⁸

Furthermore, prior to the enactment of the Income Tax Decree of 1956, the practice of standard assessment on all businesses was continued. According to the Income Tax Decree of 1956, income taxation was brought under record keeping requirements for companies, associations that were liable to keep records and file businesses to pay income tax on the basis of actual income inferred from these records.²⁴⁹ But, small businesses were, even still, taxed on the basis of standard assessment method of presumptive taxation.

With regard to small business taxation, the application of standard assessment was continued and supported by more detailed assessment guides for more than 150 businesses and professions since the 1960s in Ethiopia.²⁵⁰ A shift in the assessment method occurred following the formulation of the Income Tax Proclamation of 1961.²⁵¹ Moreover, as the Income Tax Proclamation of 173/1961 introduced estimated assessment for all businesses that did not maintain records (including small businesses) and its base for estimating tax liability was gross

²⁴⁵ For instance, under the Personal and Business Income Tax Proclamation of 1944, Schedule 'C' was assessed on the basis of sur-tax imposed on some categories of businesses, that was a sur-tax on special classes of Schedule 'B' taxpayers (excess profits tax); under the Payment of Tax by All Individuals and Businesses proclamation of 1949, Schedule 'C' was assessed based on Sur-tax on Schedule B taxpayers; Under Income Tax Decree of the 1956, Schedule 'C' was created and assessed to cover income from businesses, professionals, vocational occupations, from exploitation of wood and from all other sources not previously mentioned (in effect, Schedule C was a catch-all basket). *See also*, Tadesse, *Towards Legislative History of Modern Taxes in Ethiopia*, p.155-156.

²⁴⁶ *Id.*, p. 116.

²⁴⁷ *Ibid.* These are bakers, barbers, book sellers, boot and shoe sellers, butchers, chemists and druggists, dry cleaners, electric and radio dealers, fancy goods and dealers, fruiterers and green grocers, goldsmiths and jewelries, grocers, etc.

²⁴⁸ Tadesse, *Towards Legislative History of Modern Taxes in Ethiopia*, p. 116.

²⁴⁹ *Ibid.* The Income Tax Decree, 1956, *Federal Negarit Gazette*, Decree No. 19, 16th year, No. 1, Art. 14 (*now repealed*).

²⁵⁰ Günther & Helaway, *Presumptive taxation in Sub Saharan Africa: Experiences, and Prospects*, p. 12.

²⁵¹ The Income Tax Proclamation, 1961, *Negarit Gazette*, Proc. No. 173, 20th Year, No. 13. (*now repealed*).

turnover.²⁵² The practice typically involved estimation of daily sale of businesses on the basis of taxpayers' declaration or tax assessors' estimation, and the estimated daily sale was multiplied by the number of working days assigned for the particular business to arrive at annual turnover.²⁵³ The annual turnover was then multiplied by the profitability rate of that business to get the taxable income and then finally to calculate the taxable income under the normal tax rate of business income under schedule C.²⁵⁴

After the 1974 Ethiopian Socialist Revolution, there had been a major impact upon the structure and content of Ethiopian income tax system. The entire tax system reform at the time reflected the paradoxical and inconsistent approach of radically changing some parts of the income tax system while keeping the main framework of the system in place.²⁵⁵ For instance, the income tax law of 1961 underwent significant revisions both in its content and form.²⁵⁶ After this, the 1978 Income Tax Amendment Proclamation, expanded the traditional reach of schedule "C" of the Income Tax (which was mostly intended for income from business activities) by turning it into a catch-all-basket of all income not mentioned in any of the other schedules and laws of Ethiopian income tax system.²⁵⁷ This Income Tax Proclamation came at the height of socialism, gained some notoriety for raising tax rates and burdens to heights never reached before and after in the history of the Ethiopian income tax system.²⁵⁸

The 1961 Income Tax Proclamation, which became the basis for a modern income tax law in Ethiopia and remained for about four decades, has resulted in a number of challenging tasks for the tax authority in the practice of estimated assessment, which was the main reason for the re-introduction of standard assessment on all small businesses in 2001.²⁵⁹ To list a few main problems that the assessment method presented: 1) it was generally source of frequent conflicts between taxpayers and the officers over the estimated amount; 2) it resulted in mal-practices such as corruption, since estimation of the daily sale lied on the tax officers; and 3) calculating

²⁵² *Id.*, art. 40.

²⁵³ Zerihun, *Standard Assessment of Small Business in Addis Ababa City*, p.132.

²⁵⁴ *Ibid.*

²⁵⁵ Tadesse, *Towards Legislative History of Modern Taxes in Ethiopia*, p. 120.

²⁵⁶ A Proclamation to Amend the Income Tax, 1978, Proc. No. 155, Negarit Gazeta, 38th year, No. 3.

²⁵⁷ Income Tax (Amendment) Proclamation No. 155/1978. Cited in Tadesse, 'The Ethiopian Income Tax System', P. 263. The use of catch-all-basket to capture unmentioned sources did not take root in the practice of income taxation; the catch-all-basket provisions have disappeared in subsequent income tax reforms of Ethiopia.

²⁵⁸ Bekele HaileSelassie, *Salient Features of the Major Ethiopian Income Tax Laws*, Journal of Ethiopian Law, vol. 15, 1992, p. 177-178.

²⁵⁹ See the Federal Democratic Republic of Ethiopia House of Peoples' Representatives, hearing on the Draft Income Tax Amendment Proclamation before the Standing Committee for Budget and Economic Affairs, (1993E.C), Cited in Zerihun, *Standard Assessment of Small Business in Addis Ababa City*, p.132.

tax liability had been time consuming and cost ineffective.²⁶⁰ Hence, the method was not administratively simple. Therefore, it was believed that estimated assessment was not appropriate for the Ethiopian tax system and considerable revenue is forgone because standard assessments have not been updated for more than a decade.

3.3.1. Status of Standard Assessment before 2002 Income Tax Laws

Since the current Ruling Party came to power in 1991, tax reforms have been undertaken at least four times in Ethiopia as follows.²⁶¹ The first stage (1992/93-1995/96) took the form of piecemeal changes. The second stage of the tax reform program (1996/97-2000/01) was expanded in scale and breadth, and brought major changes in the tax system. The third stage (2001/02-2005/2006) was the period for implementation of the studies undertaken during the second stage and improvement in the tax administration. The fourth stage (2006/07) has introduced Standard Integrated Government Tax Administration System (SIGTAS) and Business Process Re-engineering (BPR) as part of the efforts to enhance the efficiency of the tax administration. The tax reform goals were broadening the tax base, strengthening the enforcement capacity of the tax and customs authorities and promoting equity in the tax system. In other words, the reform can also include increases or decreases in tax rates, brackets or thresholds, the introduction of new taxes and the abolition of old taxes, change in administrative practices and procedures. The reform also improved application of the business income tax by replacing the earlier assessment method of presumptive tax that had been based on estimates with a more simplified standard method less vulnerable to corrupt practices.²⁶² The government has also revised the outdated profitability rate that had been used for the computation of taxes.²⁶³

Hence, one of the tax reforms was the re-introduction of standard assessment in lieu of the estimated assessment so that the tax system could be equitable and administratively simple.²⁶⁴ Accordingly, the Income Tax (Amendment) Proclamation of 2001 reintroduced the application

²⁶⁰ *Ibid.*

²⁶¹ Amin and John, *The Impact of Tax Reform on Private Sector Development*, p. 16.

²⁶² Alemayehu Geda and Abebe Shimeles, *Taxes and Tax Reform in Ethiopia 1990-2003*, United Nations University, UNU-WIDER Research Paper No. 2005/65, 2005, p. 4.

²⁶³ *Ibid.*

²⁶⁴ Income Tax (Amendment) Proc. No. 227/2001, art. 2(4). It is stipulated that to replace Article 40 of the Income Tax Proclamation of 1961 and it stated that standard assessment shall be used to determine the income tax liability of category "C" taxpayers. The standard assessment shall be a fixed amount of tax determined by the regulations, to be issued by the Council of Ministers, establishing a schedule of standard assessment amounts that reflect variations in the type, size, and location of businesses.

of standard assessment on all small businesses and it was recognized that the incorporation of standard assessment was to eliminate those practical problems of estimated assessment. The proclamation recognized that standard assessment must be preceded by a one year period for business survey.²⁶⁵ It suspended the estimation of daily sales and introduced a transitional rule whereby small businesses were to pay a tax equal to the tax paid in the previous year, adjusted upward by a coefficient of 6% increase for inflation.²⁶⁶ But, the 2001 Income Tax (Amendment) Proclamation was limited in scope and time of application, and the reform of the income tax system of Ethiopia as a whole was left to the 2002 Income Tax Proclamation that replaced the income tax laws of Ethiopia in place since 1961.²⁶⁷ The 2002 Income Tax Proclamation introduced a number of reforms but simply endorsed the standard assessment system introduced by the 2001 Income Tax (Amendment) Proclamation. Like the 2001 Proclamation, the 2002 Income Tax Proclamation retained principal indicators for the standard assessment would be based on type, location and size of businesses.²⁶⁸ That is to say, it did not bring any change on the standard assessment regime.

3.3.2. Standard Assessment of the 2002 Income Tax Laws

In the history of modern taxation system in Ethiopia, there were many difficulties of tax laws, which caused for the emergence of the 2002 tax system reforms. Among the main problems: 1) income brackets among different schedules were not uniform; 2) reformers were more concerned about their revisions than the impact of their reform upon taxpayers in general, and revision of taxes was the visible discriminatory treatment of various categories of taxpayers; 3) there was high marginal tax rates for individual taxpayers engaged (especially, in rental of buildings); and 4) there were discrepancies that arise between different pieces of tax legislations.²⁶⁹ These were the major reasons why the Ethiopian Government undertook what might justifiably be called ‘comprehensive’ income tax reforms culminating with the passing of

²⁶⁵ Income Tax (Amendment) Proc. No. 227/2001, art. 2(4) (ii).

²⁶⁶ *Ibid.*, art. 2(4) (iii).

²⁶⁷ The main issues covered under the 2001 Proclamation were introduction of Taxpayers Identification Number, Standard Assessment for small businesses, withholding schemes on some transactions and the levy of 2% minimum tax on Categories ‘A’ and ‘B’ taxpayers. The Proclamation had only 3 Articles. Taxpayers Identification Number (TIN) was introduced for the first time by the 2001 Income Tax (Amendment) Proclamation; and its introduction was made it possible for the tax authorities to employ unique fingerprints and assign numbers which are unique to every individual taxpayer in Ethiopia. *See* Article 2 (1 & 2) and art. 2(4) of the Income Tax (Amendment) Proc. No. 227/2001.

²⁶⁸ Income Tax Proc. No. 286/2002, art. 68 (2). (*now repealed*).

²⁶⁹ Tadesse, *Towards Legislative History of Modern Taxes in Ethiopia*, p, 121-123. For example, during the first decade of Derg Rule, the marginal tax rates for individuals reached 89% and the corporate tax rates reached 50% with additional dividend taxes at the rate of 25%; *See also* Income Tax (Amendment) Proclamation No. 155/1978.

income tax laws in 2002.²⁷⁰ The 2002 income tax laws put an end to the incremental approach to revision of income tax laws and repealed all previous income tax laws in force up to that time, except the autonomous income tax regimes in agriculture and mining sector.²⁷¹

Many of the 2002 tax reforms of the country have equity maximizing effects in the Ethiopian tax system, mainly to encourage investment, stimulate economic growth, improving revenue collection, and ensuring fairness of the tax system.²⁷² Some of these reforms include strengthen the tax collection process, encourage voluntary compliance, to ensure tax administration, the reduction of tax rates from the steep marginal income tax rates, the broadening of the income tax bases, (for example, income of small businesses), the introduction of uniform income brackets and tax rates for major sources of income and strengthening the presumptive tax regimes for small businesses.²⁷³ The presumptive tax regime is a new method of standard assessment with a view to raising more revenues and in the process expanding the income tax base of the Ethiopian tax system.²⁷⁴

In terms of modernization of the income tax system, especially in bringing together scattered pieces of income tax legislation in a single body, the 2002 income tax laws were the most successful compared from the previous income tax reforms attempt in Ethiopia. Nonetheless, it retained the schedular structure of Ethiopian income tax system and introduced the content of the existing schedules.²⁷⁵ The Income Tax Proclamation No. 286/2002 provided for the taxation of income in accordance with four schedules, schedule “A” income from employment; schedule “B” income from rental of buildings; schedule ‘C’ income from business, and schedule ‘D’ income from other sources.²⁷⁶ Schedule “C” was operated primarily upon the principle of self-assessment, although the involvement of the tax authorities in the assessment process is quite extensive and far-reaching in Ethiopia. For purposes of book-keeping obligations and assessment, schedule “C” taxpayers were sub-classified into three categories: A,

²⁷⁰ *Id.*, p. 124.

²⁷¹ Income Tax Proclamation No. 286/2002, art. 119. (now repealed).

²⁷² Aloysius Bongwa, *Managing Ethiopian Cities II, Informality in Ethiopia: Taxing the Hard to Tax*, (Institute for Housing and Urban Development Studies,) Rotterdam, Netherland, 2009, p. 23; Taddese Lencho, ‘*Articulating Ethiopia’s Current Tax Policy: Sources and Fundamental Objectives*,’ in Taddese Lencho and Kyle Logue(eds.), *Ethiopian Tax System: Some Contemporaray Issues and Problems*, Ethiopian Business Law Series, Vol.VI, 2014, pp, 1-26, *Cited in*, Aschalew Ashagre, ‘*የግብር ከፋዮች ቅሬታዎች አፈታት ሥርዓት በኢትዮጵያ*, Mizan Law Review, Vol. 8, No.1 September 2014, pp. 190-236, at p. 194.

²⁷³ Taddese, *The Ethiopian Income Tax System*, P. 120-121.

²⁷⁴ Income Tax Proc. No. 286/2002, art. 68. (now repealed).

²⁷⁵ Tadesse, *Towards Legislative History of Modern Taxes in Ethiopia*, p, 124.

²⁷⁶ Income Tax Proc. No. 286/2002, art. 8.

B, and C, primarily for purposes of assessment.²⁷⁷ From these categories of taxpayers under schedule “C” (category “A”, category “B” and category “C”)²⁷⁸, the two categories (A and B) were in principle subject to the rule of self-assessment and must maintain books and records and fill out tax return forms and pay the taxes due.²⁷⁹ Category “C” taxpayers were representing small, informal or simply hard-to-tax groups, which were relieved from the regime of self-assessment and subject to the presumptive income tax regime known as standard assessment, which was based on type, size and location of the business.²⁸⁰

Moreover, the income tax law of 2002 had detailed provisions on the assessment of income and taxation thereof of small businesses. A presumptive assessment method was instituted for small businesses, with standard assessment tables for all types of small businesses attached to the 2002 income tax law.²⁸¹ These small businesses were relieved from the basic income tax law obligation of maintaining books and records due to the smallness of their size. Since these businesses did not maintain books and records or were not required to anyway, their income tax liability was assessed through indirect methods enunciated in the standard assessment rules and tables of the Ethiopian income tax laws. At the time of initiation of the Income Tax Proclamation No. 286/2002, there was an expectation about the efficiency of the provision of standard assessment to assess income tax liability of category “C” taxpayers.²⁸² The expectation emanates from the nature of standard assessment and its supposed solution for easing the problems that used to be manifested.

With regard to the standard assessment of the 2002 income tax proclamation, it put the underlying principle and ways to implement the system rather come up with the details of such assessment method. In so doing, the Council of Ministers has been expected to decide the maximum threshold for small businesses and to come up with model standard assessment schedules and guides.²⁸³ After this, the Council of Ministers issued the Income Tax Regulation that raised the small businesses whose annual turnover is estimated by the Tax Authority as being up to 100,000 Birr. At the same time, the regulation provided two model Schedules of

²⁷⁷ *Id.*, art. 66(1); Income Tax Reg. No. 78/2002, art. 18 & 19.

²⁷⁸ Income Tax Reg. No.78/2002, art.18. But these categories of taxpayers’ annual turnover amount are amended by the Federal Income Tax Proc. No. 979/2016; cutting through the technicality of the income tax laws, the categories of businesses may be conveniently named “large,” “medium” and “small” businesses respectively.

²⁷⁹ *Id.*, art.19.

²⁸⁰ Income Tax Proc. No. 286/2002, art.67 & 68, (*now repealed*); Income Tax Reg. No. 78/2002, art. 21.

²⁸¹ *Ibid.*, art. 66; and Income Tax Reg. No. 78/2002, art. 21& 22.

²⁸² Muuz, *Evaluation of the Efficiency of Standard Assessment for Category C Taxpayers in Ethiopia*, p. 108.

²⁸³ Income tax Proc. No. 286/2002, art. 68(2) & 2 (16), (*now repealed*).

standard assessment, which were blueprints for standard assessment tables throughout the country, which are reflective of businesses' difference in terms of type and size.²⁸⁴

In adopting the schedules of the Regulation, the Ministry of Finance and Economic Development (MoFED) has taken to conduct the study and preparation of the schedules. Even though there has not been a comprehensive survey designed for estimating the type and size of small businesses for categorization purpose, the above institutions have based their study on the size and diversity of taxpayers that were found in the list of the Tax Authority.²⁸⁵ At the time, the main focus areas of the formulation were categorization of businesses and setting annual turnover, amount of exempt income, profit ratio, and fixed taxes for each type of businesses.²⁸⁶

Based on the categorization of businesses, schedule one provides the classification of 69 types of businesses. The scales of these businesses were not based on the indicators for the 69 businesses standard assessment instead it was based on annual turnover of each sector.²⁸⁷ Therefore, the main proxy used in the schedule is annual turnover. According to this Schedule, which is annexed at the end of the income tax regulation, each business is classified into 19 parts in 5000 Birr difference on each business of their annual turnover. This may raise difficulty and complicate to administer feasibly based on the design of presumptive tax system for those creating many divided tax rates of 69 sectors. In the discussion of the types of presumptive tax system, we have said that turnover has the potential of being a better proxy for profit estimation than indicators. As a result of this, it helps that small businesses oblige to keep at least some basic books and records without imposing any burdensome accounting requirements on these operators.²⁸⁸ However, category “C” taxpayers are duty bound to declare their annual turnover, they have no legal obligation to keep any kind of record for the turnover-based standard assessment. From this, without the obligation of record keeping, the Income Tax Regulation obliges these taxpayers to declare their annual turnover during the time of tax year provided in

²⁸⁴ Zerihun, *Standard Assessment of Small Business in Addis Ababa City*. P. 134. The Regulation incorporates third schedule that describes the amount of taxable income for the variety of 69 category C taxpayers in Schedule One. The second schedule contains Attorneys, Flourmills, Transport Services, Driving trainers, and some other taxpayers with respective level indicators.

²⁸⁵ *Ibid.*

²⁸⁶ የመደበኛ ቁርጥ ግብር አወሳሰን ስራ ላይ ለማዋል የቀረበ ሀሳብ. (1994 E.C), unpublished, workshop paper presented for Tax Authorities of Regional Governments, Ministry of Finance and Economic Development, Addis Ababa; የቁርጥ ግብር አወሳሰን ፅሁፍ ላይ የተደረጉ ዋና ዋና ለውጦች; (1994 E.C, unpublished, Office of Tax Reform Program, Addis Ababa), *Cited in*, Zerihun; *Standard Assessment of Small Business in Addis Ababa City*.

²⁸⁷ Income tax Reg. No. 285/2002, art. 22(1).

²⁸⁸ *Designing a Tax System for Micro and Small Businesses*, p. 60.

the law for tax payment.²⁸⁹ So we can say that, schedule one has not been successful in determining the taxpayers' actual income, which leads to that they have been suffering under the estimated assessment and declaration of income may not be effective without mechanisms to keep records of turnover.

On the other hand, schedule two of the Income Tax Regulation deals with small businesses engage in transport, attorney, flour mill and renting combine harvester and tractor. It came closer to the standard assessment system as it used external indicators rather than the subjective turnover for fixing the tax due.²⁹⁰ All these businesses use sector-specific indicators in combination with number of years in operation and annual turnover.

As we can understand from the two scheduler tables in the Income Tax Regulation, the fixed taxes are calculated by using annual turnover, profitability rate and tax rates. The average annual profitability rate shows variations in business sectors and ranges from 10% to 70% depending on the type of businesses. Most of the higher and lower profitability rates are imposed on businesses engaged in service and sale of goods respectively.²⁹¹ The opposite is true for the amount of exempted income. The fixed taxes are derived from the conventional tax calculation of the upper turnover of each subdivision of the schedules.²⁹²

3.4. Standard Assessment under the Current Federal Income Tax Law

3.4.1. General overview

Before moving to discuss the standard assessment in the current income tax laws, we have to raise issues whether taxation of small businesses is the jurisdiction of the Federal or Regional Governments under the current income tax of Ethiopia. Income taxes are administered at both the Federal and Regional levels.²⁹³ The Constitutional distribution of revenue powers over

²⁸⁹ Income tax Reg. No. 285/2002, art. 22(1); see also, Income tax Proc. No. 286/2002, art. 68(2), (*now repealed*).

²⁹⁰ The external indicators of Attorney, Public Transport, Dry Freight Transport, Tanker Trucks, Flour Mills, Horse Cart, Driving Training School are level of license, number of seats, carrying capacity in quintal, Carrying capacity in liters, source of power generation (Hydropower, diesel or electricity), Purpose of service (public or freight transport, Kind of training (either car or motorcycle), respectively; See also, Table of Schedule 2 annexed in the Council of Ministers Income Tax Reg. No. 78/2002.

²⁹¹ Zerihun, *Standard Assessment of Small Business in Addis Ababa City*, p. 135.

²⁹² የመደበኛ ቁርጽ ግብር አወሳሰን ስራ ላይ ለማዋል የቀረበ ህሳብ, (1994 E.C), unpublished, workshop paper presented for Tax Authorities of Regional Governments, Ministry of Finance and Economic Development, Addis Ababa); Cited in Zerihun, *Standard Assessment of Small Business in Addis Ababa City*.

²⁹³ Constitution of the Federal Democratic Republic of Ethiopia, 1995, *Federal Negarit Gazette*, Extra- Ordinary Issue, Proc. No. 1, 1st Year, No. 1, art. 96 (3) & 97 (4) [Herein after, FDRE Constitution]

income taxes is allocated to the Federal and the Regional Governments based on the criteria like the identity of an employer or organization of a business.²⁹⁴

Jurisdiction over the income of businesses is allocated on the basis of the nature of the business organizations.²⁹⁵ Taxation of the income of sole proprietor businesses is the exclusive preserve of the Regional Governments; taxation of the income of businesses organized as companies is the concurrent jurisdiction of the Federal and Regional Governments; taxation of state-owned enterprises is the jurisdiction of the Federal Government if it owns those enterprises and of the Regional Governments if they own the enterprises.²⁹⁶ However, there is no difference between the two tax regimes in terms of income tax bases upon which tax is to be levied. Of the tax bases given to regional states under the Constitution, we may mention taxation of small businesses (called category “C” taxpayers).²⁹⁷ These taxpayers are subjects of Regional State jurisdiction (unless they are organized as companies) by virtue of Article 97(4) of the Constitution.

In the current income tax laws of Ethiopia, it is a good improvement to legislate both the Income Tax and Tax Administration Proclamations separately. However, before the coming of the Proclamations in 2016, it was uncommon in the previous tax laws to govern both laws independently rather than the substantive and procedural parts have been governed under the 2002 Income Tax Proclamation. The separation of these tax laws have become necessary to introduce modern and efficient tax system that supports the economic development and to make the tax system fair and bring income that are so far not subject to tax into the tax net.²⁹⁸ Moreover, it is essential to enact a separate Tax Administration Proclamation governing the administration of domestic taxes with a view to render the tax administration system more efficient, effective and measurable.²⁹⁹ In addition, it is used to establish a system for review of taxpayers’ complaints on tax decisions which is accessible, well organized and capable of efficient disposition of cases in the tax administration system.

²⁹⁴ Tadesse, *The Ethiopian Income Tax System*, p. 248.

²⁹⁵ Federal Income Tax Proc. No. 979/2016, art. 3 (1) (a) and art. 19 (1-2).

²⁹⁶ FDRE Constitution, arts. 96 (3), 97 (4), (7) & 98 (2).

²⁹⁷ Taddese Lencho, *Income Tax Assignment under the Ethiopian Constitution*, *Mizan Law Review*, Vol. 4, No. 1, 2010, p. 44.

²⁹⁸ The Preamble of the Federal Income Tax Proc. No. 979/2016.

²⁹⁹ The Preamble of the Federal Tax Administration Proclamation, 2016, *Federal Negarit Gazette*, Extra- Ordinary Issue, Proc. No. 983, 22nd Year, No. 103, [Here in after, Federal Tax Administration Proc. No. 983/2016].

Under the new Federal Income Tax Proclamation No. 979/2016, there are many reforms and additional substantive provisions compared with that of the 2002 Income Tax Proclamation. Some of these are the number of schedules of income is increased from four (Schedule A-D) in to five (Schedule A-E),³⁰⁰ the annual gross income of each category of the business under Schedule “C” is increased.³⁰¹ Many more definitional terms used under article 2 of the same proclamation, mining and petroleum operations under schedule “C” business income taxes,³⁰² administrative and procedural rules based on the application of Tax Administration Proclamation and presumption of business taxes.

In relation to standard assessment, which puts as a caption in chapter six of the new Federal Income Tax Proclamation, is the presumption of business taxes. Under this caption, Category ‘C’ taxpayer shall pay business income tax for each tax year in accordance with the mode of payment of tax to be determined by Regulations to be issued by the Council of Ministers.³⁰³ In this case, business income refers, the taxable business income, which is to be determined, levied and collected annually on the taxable income of the taxpayers. As per article 2(4) and 21 of the Income Tax Proclamation No. 979/2016, it is clearly stipulated the business income of a taxpayer for a tax year but shall not include an amount that is exempt income. The taxable business income of a taxpayer for a tax year shall be the total business income of the taxpayer for the year reduced by the total deductions allowed to the taxpayer for the year.³⁰⁴ It shall be determined in accordance with the profit and loss, or income statement, of the taxpayer for the year prepared in accordance with the financial reporting standards subject to Regulations issued by the Council of Ministers, and Directives issued by the Minister.³⁰⁵ The Income Tax Regulation of 78/2002, which was issued under the repealed Income Tax Proclamation, shall continue to apply to the extent that it is not inconsistent with the proclamation of 979/2016 and until such time as it is replaced by new Regulation.³⁰⁶ However, following the enactment of this Income Tax Proclamation, the Council of Ministers cannot still issue the new Regulation to implement the Proclamation. The Regulation is still functional even if most of the provisions

³⁰⁰ Federal Income Tax Proc. No. 979/2016, art. 8.

³⁰¹ *Id.*, art. 3. Category A are all companies/bodies and other forms of businesses whose annual turnover exceeds 1,000,000 ETB; Category B are all forms of businesses, other than companies, whose annual turnover is less than 1,000,000 ETB but more than 500,000 ETB and category “C” businesses are all businesses, other than companies, whose annual turnover is less than 500, 000 ETB).

³⁰² Federal Income Tax Proc. No. 979/2016, art. 36-44.

³⁰³ *Id.*, art. 49.

³⁰⁴ *Id.*, art. 20 (1).

³⁰⁵ *Ibid.*, art. 20 (2).

³⁰⁶ *Id.*, art. 101 (6).

are inconsistent and more modified with the new Income Tax and Tax Administration Proclamations. So, for the effective and efficient implementation of the tax laws, it should be wait the issuance of the Regulations to both Proclamations by the Council of Ministers, respectively.

On the other hand, in case of administrative and procedural rules, the Tax Administration Proclamation shall apply for the purposes of the administration of the new Income Tax Proclamation with regard to record keepings, assessment of tax, and collection of International Air Transportation income tax.³⁰⁷

3.4.2. Record-Keeping Obligations/Documentation

In the record keeping obligation, the Federal Tax Administration Proclamation stipulates that for the purposes of a tax law, a taxpayer shall maintain books of account and documents as may be required under the tax law and such documents shall be maintained in a manner so as to enable the taxpayer's tax liability under the tax law to be readily ascertained.³⁰⁸ From this, one can understand that the law puts all business income taxpayers including category "C" taxpayers have the obligation to maintain books and records. However, it is clearly provide that category "C" taxpayers may keep a record of gross income and shall keep such other records as may be specified in the Regulations.³⁰⁹ In fact, under the current governing Income Tax Regulation, category "C" taxpayers shall pay the tax on the basis of books of account if they maintain such book of account acceptable to the Tax Authority.³¹⁰ Therefore, we can say that the Proclamation does not impose as an obligation (but optional), these taxpayers are relieved from the basic income tax law obligation of maintaining records or are not required to anyway.³¹¹ Hence, their income tax liability is assessed through indirect methods articulated in the standard assessment rules and tables of the Ethiopian income tax laws.

3.4.3. Tax Assessments

The concept of tax assessments are normally raised and to be imposed on the profit of a taxable business in relation to an accounting period. The overriding and prevailing objective of tax

³⁰⁷ *Id.*, art. 81.

³⁰⁸ Federal Tax Administration Proc. 983/2016, art. 17(1).

³⁰⁹ Federal Income Tax Proc. No. 979/2016, art. 82(3).

³¹⁰ Income Tax Reg. No. 285/2002, art. 21(3).

³¹¹ Federal Income Tax Proc. No. 979/2016, art. 82(3).

assessment function is to ensure that all taxpayers, within a defined tax jurisdiction, are brought into the tax net and assessed correctly in order to plug all possible leakages.³¹² The differences in the rules of tax assessment among the schedules are not as harsh as the other points of difference, but significant differences exist, contributing to the differences in income tax burdens among various categories of taxpayers.³¹³ It is meant the determination of the tax liability of a person who is subject to income tax.

In the Tax Administration Proclamation, before making the assessment and imposing of any tax liability, the tax officers have the responsibility to identify the person or bodies which bear the burden of tax in order to create a smooth relationship between the Tax Authority and the taxpayers.³¹⁴ Concerning its meaning, tax assessment has defined in the Tax Administration Proclamation on the basis of its types. “Tax assessment” means a self-assessment, estimated assessment, jeopardy assessment, amended assessment, or any other assessment made under a tax law.³¹⁵ Based on this, there are three main types of tax assessments, which differ from one another in the degree of participation required from the taxpayer or tax administrator in determining tax liability.

3.4.3.1. Self-Assessment

According to the tax administration law, self-assessment means an assessment treated as having been made by a self-assessment taxpayer under the same Proclamation.³¹⁶ A self-assessment taxpayer who has filed a self-assessment declaration in the approved form for a tax period shall be treated, as having made an assessment of the amount of tax payable for the tax period to which the declaration relates being that amount as set out in the declaration.³¹⁷ This gives an opportunity for the taxpayer to assess his tax liability. Taxpayers calculate and pay their own taxes without the intervention of tax officials. So, from the perspective of the taxpayer, it is more acceptable and deemed to be a fair way of imposing tax liability.³¹⁸ When a self-assessment taxpayer liable for income tax under schedule “B” or “C” of the Income Tax Proclamation has filed a self-assessment declaration in the approved form for a tax period and

³¹² Tax Assessment Procedure in Nigeria, *Federal Inland Revenue Service*, Circular Information No. 2006/06, 2006, p. 1.

³¹³ Taddese, *The Ethiopian Income Tax System*, P. 282.

³¹⁴ Federal Tax Administration proc. 983/2016, art. 6.

³¹⁵ *Id.*, art. 2 (32).

³¹⁶ *Id.*, art. 2 (28).

³¹⁷ *Id.*, art. 25 (1).

³¹⁸ Aschalew, *Tax Law Teaching Material*, P. 95.

the taxpayer has a loss for the year, the taxpayer shall be treated as having made an assessment of the amount of the loss being that amount as set out in the declaration.³¹⁹ This means, schedule “B” or “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. Tax shall be assessed on the basis of the records and books of account if it is maintained by the taxpayers are considered satisfactory by the tax authority. In practice, self-assessment is poor in Ethiopian tax administration system. This is leading to focus on legal enforcement as a mechanism to collect tax revenues.

3.4.3.2. Estimated Assessments

It is an assessment where the taxpayers are not required to maintain books of accounts and records, then the tax authority resorts to assess income tax by estimation. When a taxpayer has failed to file a tax declaration for a tax period, the authority may, based on the evidence as may be available and at any time, make an estimated assessment in the case of a loss under schedule “B” or “C” of the Income Tax Proclamation, the amount of the loss for the tax period.³²⁰ In other words, the tax officials, without arbitrarily, must assess the tax in accordance with the available evidence and the circumstantial evidence that is associated with the income to be assessed in a fair and equitable manner. In this case, the authority shall serve to the assessed taxpayer a notice in writing, the amount of tax assessed, or loss or excess input tax carried forward, the amount assessed as penalty (if any), the amount of late payment interest, the due date for payment of the tax, and the manner of objecting to the assessment.³²¹ Thus, based on the Tax Administration Proclamation, assessment by estimation shall apply only for the purposes of a tax that is collected by assessment.

3.4.3.3. Jeopardy Assessments

Jeopardy assessments, also known as “protective assessment”, are introduced which may be issued in advance of the date on which the return is normally due in order to secure the early collection of tax that would otherwise be in jeopardy or where there is some danger of tax being lost by delay.³²² Under the tax administration, jeopardy assessment is implemented when the

³¹⁹ Federal Tax Administration proc. 983/2016, art. 25 (2).

³²⁰ *Id.*, art. 26 (1) (a) & (7) and art. 2 (10).

³²¹ *Ibid.*, 26 (2) (a-f).

³²² Fayyad Cassim, *Jeopardy Assessments under the Tax Administration Act 28 of 2011*, Tax Law (Master Thesis), University of Pretoria, 2014, p. 28.

authority may, based on the evidences available, make such assessment of the tax payable by a taxpayer in the circumstances of advance tax declaration or preservation of funds and assets deposited with financial institutions.³²³ In this case, it applies only when the taxpayer has not filed a tax declaration for the tax period and the tax is collected by assessment.³²⁴ Moreover, the authority shall serve to the assessed taxpayer a notice in writing of jeopardy assessment specification, as same as estimated assessments. To this end, a tax declaration filed by a taxpayer for a tax period after notice of a jeopardy assessment has been served on the taxpayer for the period is not a self-assessment declaration.³²⁵

In addition, other type of assessment regulated by the proclamation is amended assessment in which the tax authority may amend the original tax assessments (whether the self-assessment, estimated assessment or jeopardy assessment) by making alterations, reductions, or additions, based on the evidences as may be available, to the original assessment of a taxpayer for a tax period to ensure the correct amount of the loss for the tax period in the case of a loss under schedule “B” or “C” of the Income Tax Proclamation.³²⁶

The other issue in relation with presumptive business taxation under the new Federal Income Tax Proclamation is taxation of International Air Transportation business of non-residents. Non-resident taxpayers are taxed at a fixed rate when they have loaded trading stocks in Ethiopia and exported to abroad. A non-resident conducting an International Air Transportation business shall pay business income tax at the rate of 3% of the gross amount derived by the non-resident for the carriage of passengers, livestock, mail, merchandise, or goods embarked or loaded in Ethiopia and destined for a place outside Ethiopia.³²⁷ From this, a non-resident is clearly defined in the same proclamation. According to article 5(7) of the Income Tax Proclamation of 979/2016, a non-resident is any person who is not a resident of Ethiopia. Based on this business income tax rate, the non-resident taxpayer shall file a tax declaration with the authority for each quarter by the last day of the month following the end of the quarter and shall be due on the due

³²³ Federal Tax Administration proc. 983/2016, art. 2 (12), 27 (1), 23 and 42.

³²⁴ *Ibid*, art. 27 (2); in addition to this, jeopardy assessment may be made before the date on which the taxpayer’s tax declaration for the period is due; and in accordance with the law in force at the date the jeopardy assessment was made. *See* art. 27 (3) of the same proclamation.

³²⁵ *Ibid.*, art. 27 (8).

³²⁶ Federal Tax Administration proc. 983/2016, art. 2 (2) and art. 28 (1) (a). In this case, as provided under the same provision, the amendment of a tax assessment may be the case of fraud, or gross or willful neglect by, or on behalf of, the taxpayer, at any time.

³²⁷ Federal Income Tax Proc. No. 979/2016, art. 50(1).

date for filing the tax declaration for the quarter.³²⁸ Therefore, the non-resident taxpayer has the obligation to pay this fixed business income tax rate within three months of the due date. If the taxpayer fails to pay the tax in any reason, the tax authority may issue a certificate to the Ethiopian Civil Aviation Authority to refuse clearance from any airport in Ethiopia to any aircraft owned or chartered by the non-resident until the tax due has been paid.³²⁹ In this case, when the amount of business income tax collected from the exports of goods results in underpayment of income tax due for three months or quarterly, the taxpayer is required to pay the difference in the declaration of the obligation to pay.³³⁰ This fixed rate of the income tax of International Air Transportation business of non-residents is one method of standard assessment of income tax from businesses.

³²⁸ *Id.*, art. 87(1, 2) & (4).

³²⁹ *Ibid.*, art. 87(3).

³³⁰ *Ibid.*, art. 87(1).

CHAPTER FOUR

STANDARD ASSESSMENT OF SMALL BUSINESSES IN BDCA: LEGAL AND PRACTICAL ANALYSIS

4.1. Standard Assessment under the ANRS Income Tax Laws

Before dwelling on the analysis of the new income tax law of the ANRS in relation to standard assessment of small business taxation, it is better to call attention to the enacting power of tax laws given to the region in the FDRE Constitution. The Amhara Region, as it is one of the Regional States in the Federal structure of Ethiopia, has the right to enact its own tax laws, levy and collect taxes and duties on revenue sources reserved to it in both the federal and its regional constitutions.³³¹ Hence, in accordance with powers vested in it under the Revised Constitution of the ANRS, the State Council has issued Income Tax and Tax Administration Proclamations independently.³³² However, even if the Region has the power to issue its own tax laws with respect to tax sources, it for a while used Federal tax laws to levy and collect Regional taxes.³³³

As soon as the Federal Government has proclaimed current Income Tax and Tax Administration Proclamations in 2016, the ANRS immediately exercises its legislative power of issuing its own Income Tax and Tax Administration Proclamations. However, the exercise of the legislative power over taxation still remains a formal matter because the Region has yet to fully exercise its taxation powers. The ANRS has issued its own tax laws by using the Federal tax laws as a model with the result that there is virtually no difference in substance between the two regimes of Income Tax and Tax Administration Proclamations, especially, relating with standard assessments of small business taxation being focus to this research.³³⁴ Hence, surprisingly, each and every provision (even the number of articles put the same place) in the ANRS current Income Tax and Tax Administration Proclamations are just harmoniously similar to the Federal

³³¹ FDRE Constitution, art. 52 (2) (b & e), and The Revised Constitution the Amhara National Regional State Approval proclamation, 2001, *Zikire-Hig*, Proclamation No. 59, 7th Year, No. 2, art. 49 (3) & (11). [Here in after, the ANRS Constitution, Proc. 59/2001].

³³² The Amhara Income Tax Proc. No. 240/2016; and the Amhara Tax Administration Pro. No. 241/2016.

³³³ Taddese Lencho, *Income Tax Assignment under the Ethiopian Constitution: Issues to Worry About*, Mizan Law Review, Vol. 4, No. 1, 2010, p 43- 45.

³³⁴ Even the preamble of the Federal new income tax and the tax administration proclamations are used verbatim. For example, the preambles of both the Federal and the Amhara Region current income tax proclamations state that “it has become necessary to introduce modern, simple and efficient tax system that supports the economic development and which is in accord with the level of economic development achieved so far.” The same is also used in both federal and the region tax administration proclamations.

current income tax and tax administration laws; the region has not even bothered to separate out provisions that are clearly inappropriate from the vantage of its income tax and tax administration jurisdictions. One can observe the best example that both regimes are using the same provision under Article 58 of their Tax Administration Proclamations. Its caption states ‘Appeal to the Federal Supreme Court’. According to this provision, a party to a proceeding before the Federal High Court who is dissatisfied with the decision of the Federal High Court may, within 30 days after being served with notice of the decision, files a notice of appeal to the Federal Supreme Court.

Most importantly, small business taxation is one of the applicable areas of tax regime in the ANRS income tax and tax administration laws. In addition, standard assessment has been instituted for small businesses, with standard assessment tables for all types of small businesses attached to the 2003 Income Tax Regulation.³³⁵ The Regulation has detailed provisions on the assessment of income tax of small businesses even if it is inconsistent with the current Income Tax Proclamation of the region. However, it is applicable until the issuance of the new income tax regulation. With regarding to the scope of the application of small businesses or category “C” taxpayers, it is the same as the federal income tax law. They are identified as those business taxpayers, being a person other than a body, whose annual gross income/turnover does not exceed 500,000 Birr and they are subject to the presumptive tax regime of standard assessment, which is based on type, size and location of the business.³³⁶

Moreover, category “C” taxpayer shall pay business income tax for each tax year in accordance with the mode of payment of tax to be determined by Regulations to be issued by the Council of Regional Government.³³⁷ As per Article 93 (1) of the ANRS current Income Tax Proclamation, the State Council may issue Regulations necessary for the proper implementation of the proclamation. However, like the Federal income tax law, the State Council has failed to issue new Regulation to apply the modes of payment of small business taxation in particular and implementing the current Income Tax Proclamation in general. Hence, Regulation No. 4/2003, which was issued under the repealed income tax proclamation, shall continue to apply to the

³³⁵ See, Amhara Income Tax Proc. No. 76/2002, art. 67, (*now repealed*); Amhara Income Tax Reg. No. 4/2003, art. 23 and 24.

³³⁶ Amhara Income Tax Proc. No. 240/2016, art. 3 (1) (c).

³³⁷ *Id.*, art. 48.

extent that it is not inconsistent with the proclamation of 240/2016 and until such time as it is replaced by new regulation.³³⁸

The regulation is still functional even if most of its provisions are inconsistent and need to be modified with the new Income Tax and Tax Administration Proclamations. So, for the effective and efficient implementation of the tax laws, we need to wait the issuance of the regulations to the new income tax and tax administration by the Council of Regional Government. In addition, ANRS BFED shall change the annual gross income thresholds for the classification of a taxpayer and revise the taxpayer standards at least within five years.³³⁹ The change and revision of the annual turnover thresholds needs to be made after ascertaining economic analysis of the Region to classify a taxpayer as category “A” taxpayer, category “B” taxpayer and category “C” taxpayer. This revision of the taxpayer standards threshold is issued by directives for the proper implementation of the income tax proclamation and regulations.

Regarding to the standard assessment of small businesses in the ANRS tax administration law, it shall apply for the purposes of the administration of the new Income Tax Proclamation with regard to record keeping obligation and the tax assessment methods.³⁴⁰ Here, it is not necessary to discuss each provision briefly for the application of small business taxation. Because these provisions in the ANRS Income Tax and Tax Administration Proclamations are the verbatim and paste copy of the current Federal Income Tax and Tax Administration Proclamations. Thus, since this issue, such as record keeping obligation and the tax assessment methods are discussed clearly in sections 3.4, I prefer not to deal on detail under this section. However, the only difference about presumptive taxation of small business is the taxation of International Air Transportation businesses of non-residents. Taxation of International Air Transportation businesses, which is conducted by the non-residents of Ethiopia, is not governed under the ANRS income tax law. Therefore, it is the jurisdiction of the Federal Government.³⁴¹

4.2. Profile of BDCA and its Small Businesses

Bahir Dar City is located in the Northwestern Ethiopia, the Southern shore of Lake Tana, the source of the Blue Nile or Abay River, at a physical distance of 565 km away from Addis

³³⁸ *Id.*, art. 95(6).

³³⁹ *Id.*, art. 3 (4).

³⁴⁰ See the Amhara Tax Administration Proc. No. 241/2016, arts. 17, and 25-28; Amhara Income Tax Proc. arts, 79 (3), and 81 (4).

³⁴¹ FDRE Constitution, art. 51 (10) & 96 (7).

Ababa. It was established in 1922 and its geographical location on astronomy imaginary line is 11 038' N latitudes and 37 010' E longitudes with average altitudinal elevation of 1801 meter above sea level.³⁴² The city has an approximated area of 15,455 hectare of which 2,258 hectares of the land is covered with water bodies and it accounts 17.2% from the total area of the land.³⁴³ With regards to the administrative structure and governance of the city, it is serving as a capital city for ANRS. According to article 45 (1) of the Revised Constitution of the ANRS Approval proclamation 59/2001, the regional council has the power to establish, (in addition to the Regional, Woreda and Kebele administrative units), city administrative hierarchies and thereby determine by law their respective powers and duties as may be find it necessary. On the basis of this constitutional power, the Regional Council has enacted the Amhara National Region Urban Centers Establishment, Organization and Definition of their Powers and Duties proclamation No.91/2003. Based on the proclamation, (BDCA as one of the city administrations in the Region), has been exercising a level of self-rule or as an autonomous local government.³⁴⁴ Hence, the city has layers of administration organs, which are created through ordinary Regional Statutes rather than the Regional Constitution.³⁴⁵ These are the City Council, one leading Mayor, Mayor's Committee and Manager of City Services, a City Court as a judicial organ, and other Executive Offices and Commissions.³⁴⁶ The city council, which is comprised of representatives of residents, is the highest body of the city governance and exercises legislative power on different matters.³⁴⁷ The Mayor is the chief executive, chairman of mayor's committee, and the representative body of the city administration.³⁴⁸

The city has, after making the reform of 17 kebeles since 2014, nine sub-cities and three satellite towns. These nine sub-cities are the following; Sefene-selam, Gish Abay, Tana, Belay

³⁴² Bahir Dar City Administration Finance and Economics Department, Strategic Plan Presented in the yearly bulletin of the city. Unpublished material, (2004), *Cited by*, Jantirar Abay, 'Land Allocation and the Publicness of Lake Tana Area in Bahir Dar City', Ethiopian Institute of Architecture, Building Construction and City Development, (MSc Thesis in Development), Addis Ababa University, 2012, p. 27.

³⁴³ *Ibid.*

³⁴⁴ The Revised Proclamation for the Establishment, Organization and Definition of Powers and Duties of Urban Centers of the Amhara National Region, 2003, *Zikere-Hig*, Proc. No. 91, 9th Year, No. 2, art. 8 (1), [Here in after, Proclamation No. 91/2003]. It stated that a city administration established at any level shall have the power to issue local policies and regulations and the executive and judicial powers it needs to administer the city in accordance with the National Regional Constitution and other laws.

³⁴⁵ The ANRS Constitution, Proc. 59/2001, art. 84(2). The Regional Constitution is issued based on the Constitutional power of the Regional State to draft, adopt, and amend its own constitution. It is the supreme Regional law, whose amendment is undertaken only through a stringent procedure.

³⁴⁶ Proclamation No. 91/2003, art. 9.

³⁴⁷ *Id.*, art. 11. All powers of the city administration shall be vested in the city council, and the council shall provide for the appropriate exercise of the powers and duties of the city administration.

³⁴⁸ *Id.*, art. 19.

Zelege, Hidar 11, Ginbot 20, Shembit, Fasilo and Shumabo. In addition, three nearby satellite towns are Meshenti, Zeghe and Tis Abay. Bahir Dar City is one of the “metropolitan cities”³⁴⁹ administration of the Region organized during 2003, the State Government empowers the city to administer its affairs and collect taxes, to approve urban plans to properly manage and administer its revenue and expenditure.³⁵⁰ The sub-cities administrations are organized in a similar fashion as executive offices and mandated to administer matters in their jurisdiction.

It is worth mentioning that BDCA has the mandate to collect taxes and other types of revenue sources within the city.³⁵¹ The city administration has various sources of revenue. It receives revenue from different sources, including income taxes from employees within the city, municipal taxes, rented houses and sales of municipal property, municipal-service fees, and other locally raised revenues, such as penalties and arrears, their main source of revenue is land-lease fees. In addition to these, turnover taxes as well as fees play key role in securing revenue for the city administration.

According to the data obtained from the BDCA Revenue Office, there are more than 17,103 taxpayers in the city in which 11,912 of them are category “C” taxpayers and the remaining 5,191 are category A and category B taxpayers. Hence, the small business (that is category C taxpayers) represents 69.5% of the city’s total taxpayers. As shown in the table provide below in the past four consecutive years, the highest and least numbers of taxpayers under category “C” taxpayers are registered in Sefene-Selam and Shumabo sub-cities respectively.

Table 1. List of Statistics on Category ‘C’ Taxpayers in BDCA from 2013-2016 Tax Years.

SN	Sub-city	No of Taxpayers under Category ‘C’ from			
		2013-2016			
		2013	2014	2015	2016
1	Sefene-Selam	2943	4143	3193	3570
2	Gesh-Abay	745	1019	901	944
3	Tana	930	2053	1150	1181
4	Belay Zelege	549	653	739	900

³⁴⁹ Metropolitan city administration is one of the sub-categorization of city administration level where the resident population of the city at the center is 150,000 or where the size of average annual income/ Potential revenue collected in the city, specifically other than land lease sale, is birr 10,000,000 (Ten million birr) and more; and more than 80% of the total population of the city residents, engage in an occupation other than agriculture. See the The ANRS Revised Cities’ Organizational Category Determination and Establishment, Council of the Regional Government Regulation, 2009, *Zikire-Hig*, Reg. No. 65, 14th Year, No. 5. Art. 6 (1(a-e)).

³⁵⁰ Proclamation No. 91/2003, art. 8 (2) (j); The proclamation has categorized the city as a City Administrator. As per the given power and duties the City Council started to administer the resources of the city in general.

³⁵¹ *Ibid.*

5	Hidar 11	1242	534	1248	1876
6	Ginbot 20	1024	407	1228	1392
7	Shembit	716	310	717	869
8	Fasilo	522	1156	530	637
9	Shumabo	498	688	485	543
Total		9,169	10,963	10,191	11,912

Source: Tax Education and Communication Case Team Officer, BDCA Revenue Office, April, 2017.

From the above table, we can observe that the number of category “C” taxpayers in each sub-city have been fluctuating from year to year. The reasons for this fluctuation are graduation of many small businesses into category “B” and category “A” status in which requiring them to maintain books and records, leaving or changing the location of the businesses.³⁵²

4.3. Administration of Small Business Taxation

As it has been discussed before, the FDRE Constitution provides that both Federal and Regional administer the state budget.³⁵³ With respect to effective administration of tax revenue, an organ is assigned at each tier of the government to assess and collect taxes, service charges and other revenues. Most significantly, the Regional responsibilities and duties necessitate states to have their own revenue to finance their expenses. To this effect, the ANRS Revenue Authority has carried out remarkable activities. Before the establishment of the authority in 2005, the Region’s tax administration was assigned to a single department within the BFED. After five years, the authority is restructured pursuant to a new establishment law, Proclamation No.168/2010.³⁵⁴ Under the preamble of this Proclamation, it is stated that it is necessary to establish the Region’s State Revenue Authority as an autonomous government body having complete organizational structure, skilled manpower, modern information technology and efficient working system with a view to effectively discharge its responsibilities. Furthermore, the authority has the objective to establish modern revenue assessment organs to collect taxes and share revenues. Hence, the Region has the power to levy and collect taxes and duties on revenue sources reserved to the states and to draw up and collection, to promote voluntary

³⁵² Interview with Aemiro Zerihun, he was the tax officer of BDCA Finance and Economic Office before 2006 and now Coordinator of Tax Education and Trainings Core Process at BDCA Revenue Office, *on the factors that fluctuate the number of small business taxpayers in the city, April 28, 2017*[Here in after, Interview with Aemiro Zerihun].

³⁵³ FDRE Constitution, art. 52 (2(e)) and art. 97.

³⁵⁴ A proclamation to provide for the Re-establishment, and Arrangement of Power’s and Duty’s of the Amhara National Regional State Revenue’s Authority, 2010, *Zikire-Hig*, Proc. No.168, 15th Year, No. 4. [Herein after, ANRS Revenue Authority Proc. 168/2010].

compliance by causing taxpayers discharge their tax obligations, to collect timely and effectively regional tax and city service revenues and to ensure tax laws and regulations by preventing and controlling tax fraud and tax evasion.³⁵⁵

The proclamation empowers the authority to open branch offices and tax centers at different levels of government organs, at Zonal, Wereda level including City Administrations.³⁵⁶ Accordingly, BDCA is one of the revenue branch offices of the tax authority for the execution of the assessment and collection of taxes, service charges and other revenues legally specified by tax laws. Thus, enforcement of tax laws are assigned to revenue units established in the city administration revenue office and at sub-city levels.

BDCA Revenue Office is the responsible organ for the administration and enforcement of tax laws in the city, particularly taxes applicable on categories “A” and category “B” taxpayers.³⁵⁷ Hence, the most important task of the office is assessment and collection of taxes from these taxpayers. However, concerning the tax assessment and administration of category “C” taxpayers, sub-cities are empowered, which are accountable to the city revenue office.³⁵⁸ Accordingly, sub-cities are assigned for taxation of small businesses. They have the duty to assess and collect the business income tax from these taxpayers in their own respective jurisdictions and report the amount of tax revenues collected along with the number of taxpayers list, at the end of the tax year.³⁵⁹ Hence, they are administering the presumptive tax regime of small businesses. Sub-cities are subordinate to the city’s revenue office and are responsible for ensuring tax harmonization.

Structurally, BDCA revenue office is composed of the following seven core processes under the head of Manager and Deputy Manager of the office. These are: Tax Assessment and Collection Follow-up, Tax Education and Communication, Human Resource Management, Information Technology Administration and Development, Tax Audit Core Process, Planning and Research Core Process, and Customers Service Core Process.³⁶⁰ The Manager of the office has the power to administer, support, coordinate, supply necessary materials to the office, facilitate trainings related to tax administration, and implement the strategic and annual plans prepared by city

³⁵⁵ ANRS Revenue Authority Proc. 168/2010, art. 4.

³⁵⁶ *Ibid.*, art. 5.

³⁵⁷ Interview with Aemiro Zerih, *on the duties of Revenue Office in BDCA*, April 28, 2017.

³⁵⁸ Interview with Aemiro Zerih, *on the powers of sub-cities revenue office in BDCA*, April 28, 2017.

³⁵⁹ *Ibid.*

³⁶⁰ Interview with Zewdu Kiflie, Deputy Manager of the BDCA Revenue Office, *on the structure of Bahir Dar City Revenue Office*, April 28, 2017.

administration and the tax authority.³⁶¹ It has also the duty to control effective expenditure in accordance with the approved budget and prepare reports to the authority on the activities, total collected income tax revenues and financial operations, follow-up each core processor's duty for the effective administration of the city's tax system.³⁶²

Tax Assessment and Collection Follow-up Core Process is the main core processor unit. It has the power to make tax assessment, to follow-up and identify the new businesses and occupational professionals who are operating outside the tax network and incorporate them to be subjected to the tax system.³⁶³ In addition, it is responsible to identify whether small businesses are graduated to either category "B" or category "A" tax payers status which are required to keep and maintain books of account and records.³⁶⁴ The Unit's tax assessors are responsible for preparing and maintaining tax assessment and collecting the tax levies effectively. In the case of tax assessment under category "C" taxpayers, which are not required to keep records and books of account, the tax assessors face a challenge from the taxpayers, such as underreporting and concealing the actual income of daily sale.³⁶⁵ As a result, fairness and trust between the tax authority and in dealing with taxpayers to the best of tax administration is questionable. In addition, if taxpayers do not trust the tax administration to report and collect tax fairly, it has an impact on voluntary compliance of the taxpayers.

4.4. Standard Assessment and its Implementation in BDCA

As it has been discussed in chapter three, the historical background of standard assessment in Ethiopia was used to determine the income tax liability of category "C" taxpayers. This category of taxpayers is still the most problematic sector of businesses. Standard assessment is a fixed amount of tax determined in accordance with the Council of Ministers Regulation established schedules.³⁶⁶ In fact, small business taxpayers pay taxes at fixed rate on the income estimated by the tax authority rather declaring their income by themselves. Since, the daily sale

³⁶¹ *Ibid.*

³⁶² *Ibid.*

³⁶³ በአማራ-ብሄራዊ ክልላዊ መንግስት የገቢዎች ባለስልጣን፣ የገቢ አሰባሰብና ክትትል ዋና የስራ ሂደት፣ የባለሙያዎች የስራ ማንዋል፣ ባህር ዳር፣ ጥቅምት/2006 ዓ.ም፣ ክገፅ 3-4), [Here in after, ANRS Revenue Authority, Income Tax Assessment and Follow-up Case Team, Manual for the Implementation of Tax Assessors Work].

³⁶⁴ *Ibid.*

³⁶⁵ Interview with Zemenu Abebe, Coordinator of Tax Assessment and Collection Follow-up Core Process of BDCA Revenue Office, *on the standard assessment of small businesses*, April 21, 2017.

³⁶⁶ Federal Income Tax Proc. No. 979/2016, art. 49.

or income of the business is estimated by tax officers of the authority, the taxpayers have little room to address their view.

When the 2002 tax reform program resulted in comprehensive Federal Income Tax Proclamation, the Amhara income tax law was enacted. However, it was the verbatim of the Federal income tax law. Both level of governments ordained the tax law in line with the powers of taxation in the FDRE Constitution. Currently, the income tax laws of the Region regulate small businesses to be taxed on the basis of standard assessment.³⁶⁷ The method needs to be made taking variations in type, size and location of businesses. To implement the standard assessment rule, the Income Tax Regulation and Directives issued by the Region's BFED came up with standard assessment schedules for different businesses.³⁶⁸ The consecutive directives for the application of standard assessment stipulate that the fixed taxes for most of the businesses are based on annual turnover.

In adopting the schedules of the Regulation, the ANRS BFED is the leading organ to conduct the study and preparation of the schedules. There are two schedules in the Income Tax Regulation that deals with small businesses.³⁶⁹ Schedule one incorporates fixed taxes for the majority of small businesses in reference to annual turnover than indicators. The second schedule includes both annual turnover and indicator for transport, attorney and flour mills sectors and the corresponding fixed taxes for each business. Despite of the power given to the BFED to revise the standard assessment matrices that annexed with the Income Tax Regulation No. 4/2003, it has been revised three times, (i.e. the 2003, 2008 and 2012 income assessments), in the past fifteen years in the city in particular and the Region in general.³⁷⁰ In these occasions, the tax assessment was conducted once for the result of the estimation used as a standard for the assessment of income of taxpayers that serve for the next five consecutive years. According to article 72 of Income Tax Proclamation No. 76/2002, the tax authority has five (5) years to amend the assessment from the due date of the declaration if a taxpayer has submitted a declaration of income within the time limit.

³⁶⁷ Amhara Income Tax Proc. No. 240/2016, art. 48 and Income Tax Reg. No. 4/2003, art . 23.

³⁶⁸ Income Tax Reg. No. 4/2003, art. 29; The ANRS Revenue Authority Proc. No. 168/2010, art. 17 (3). The BFED of the Region may issue directives for the proper implementation of the Income Tax Regulation and directly related to the implementation of tax policy issues.

³⁶⁹ Standard assessment matrices that annexed with the Income Tax Regulation No. 4/2003.

³⁷⁰ Interview with Mr. Yedemie Yeshalem, Deputy Director of Revenue Authority of the ANRS, *on the time of conducting standard assessment of small businesses in Amhara Region, April 28, 2017.*

4.4.1. The 2003 and 2008 Income Tax Assessment

Before the introduction of standard assessment method to tax small businesses in 2003, the city was used the estimated assessment to collect taxes on the bases of type, location, goodwill, number of customers, and paid tax history of the business.³⁷¹ Based on these indicators, the tax assessors made the estimation of daily sale income of each segment of businesses and their assessment became final decision after the head of Finance and Economic Office signed on the decision of the assessment.³⁷² But this type of assessment had many challenges for tax administration. Among these, lack of technical knowledge on the process of estimation, limited trained human power, non-appearance of tax assessors from business premises, lack of cooperation, the prevalence of underreporting by taxpayers, and subjectivity of the assessors that prone to abuse and corruption.³⁷³

Due to those problems, standard assessment has become the mechanism for the implementation of small business taxation to reduce compliance of the taxpayers. It was designed to simplify tax administration, to reduce more expenses (resources), and to simplify the assessment and collection of business income on the due date of tax payment in the city.³⁷⁴ It could be a fixed amount of tax determined in the regulation establishing a schedule of standard assessment amounts that reflect variations in the type, size, and location of the business.³⁷⁵ After the formulation of standard assessment schedules, BDCA was planned and expected to collect more business income tax revenues as compared with the previous experiences.³⁷⁶ At the time, most taxpayers in the city were taxed on the basis of estimation rather records of account.³⁷⁷ Therefore, the revaluation of taxpayers' status was gotten due attention by the city administration to collect more amount of tax revenues.

At the time of the 2003 income assessment, the Income Tax Regulation No. 4/2003 categorized 110 small businesses in its attached schedules of standard assessment that was reflective of

³⁷¹ በአማራ ብሔራዊ ክልላዊ መንግስት የገንዘብና ኢኮኖሚ ልማት ቢሮ የገቢ ግብር አዋጅ ረቂቅ እና የመደበኛ ቁርጥ ግብር አወሳሰን አጭር ማብራሪያ (ለውይይት የቀረበ)፣ ባህር ዳር፣ 1994 ዓ.ም፣ ገፅ 1. (ያልታተመ)፣ (Available in Bureau of Finance and Economic Development) [Herein after, ANRS Bureau of Finance and Economic Development, Drafting the income Tax Proclamation, Short Explanation in implementing Standard Assessment].

³⁷² *Ibid.*

³⁷³ BDCA Finance and Economic Office, Discussion for Conducting Estimated Daily Sale of Busines, p. 7.

³⁷⁴ *Id.*, p. 3-5.

³⁷⁵ Income Tax Proc. No. 76/2002, art. 69 (2). (*now repealed*); Income Tax Reg. No. 4/2003, art. 20 (3).

³⁷⁶ በአማራ ብሔራዊ ክልላዊ መንግስት፣ በባህር ዳር ከተማ አስ/ገ/አ/ልማት ጽ/ቤት፣ የቀን ገቢ ግምት ለማካሄድ የቀረበ የመወያያ ሃሳብ፣ ባህር ዳር፣ 1994 ዓ. ም. ገፅ 6 (ያልታተመ) (Available at BDCA Finance and Economic Office). [Herein after, BDCA Finance and Economic office, Discussion for conducting Estimated Daily Sale of Businesses].

³⁷⁷ *Ibid.*

businesses' difference in terms of type and size.³⁷⁸ From the schedule, categorization of each type of business was similar with that of the Income Tax Regulation No. 78/2002. Based on type of businesses, the schedule introduced 19 sub-divisions in each business in 5000 Birr difference of annual turnover. However, the standard assessment system designed for administrative simplicity seems complicated for creating an overly divided tax rates, which are around 2090, for 110 business sectors. According to the schedule of the regulation, fixed taxes are calculated by using annual turnover, profitability rate and tax rates.³⁷⁹ The average annual profitability rate shows variations in business sectors and ranges from 10% to 30% depending on the type of businesses.³⁸⁰ Most importantly, the businesses in the schedule have turnover based standard assessments, so that enforcing the fixed taxes was the basic concern in verifying its turnover or gross income of the business.

Practically, estimation of daily sale was the method that opted for finding out taxpayers' turnover in order to apply the formulated schedule. Then, at the time of income assessment, BDCA took the issue of estimating daily sale and formed daily sale Estimation Committees from Business Communities, Finance and Economic Office, Trade and Investment Office, the City Administration Office, and from the City Revenue Offices.³⁸¹ These Committees were coordinated by one organ called Advisory Committee, which was established at the top to supervise the overall tasks of the estimation.³⁸² The task of the Estimated Committees was only to make assessment of estimation daily sale of businesses under category "C" taxpayers rather than companies and large business enterprises.³⁸³ Because it is presumed that businesses out of category "C" taxpayers are expected to comply with the standards of financial statements.

At the time of estimation, daily sale should be the gross sale of goods and services per day. The amount of estimated income should be set to reflect the average amount of maximum and minimum turnovers within the number of working days allotted for each business.³⁸⁴ However, estimating and calculating of daily sale were not an easy task to the Estimated Committees.

³⁷⁸ The ANRS Income Tax Regulation incorporates schedule that describes the amount of taxable income for the 110 businesses categorized in the schedule. Bear in mind that the threshold has changed.

³⁷⁹ See the schedule attached in the Income Tax Reg. No. 4/2003.

³⁸⁰ *Ibid.*

³⁸¹ የግብር ከፋዮችን ገቢ ለማጥናትና በግምት ለመወሰን የገቢ ገማች ኮሚቴ ለማቋቋም የወጣ መመሪያ ቁጥር ገመ2/1995 ዓ.ም፣ ገፅ 3፣ ባህር ዳር፣ (Available at ANRS Finance and Economic Development Bureau) [*Herein after*, A Directive to Establish Daily Sale Estimation Committees in the 2003 Income Tax Assessment].

³⁸² *Ibid.*

³⁸³ *Id.*, p. 2.

³⁸⁴ *Id.*, p. 4.

They considered the factors such as, expenses declared by the taxpayers, goodwill of the business, identity of suppliers and customers of the business, list of services/goods for sale and their cost of production, the frequency in which the taxpayer buys/ produces goods or services, size of business, and quality of goods/services for sale.³⁸⁵ On the other hand, due to the large number of small businesses in the city,³⁸⁶ the task remained difficult for the Committees to deliver estimation for all the targeted businesses. The main problems of the Estimated Committees were excessiveness and subjectivity of estimations that caused to dissatisfaction of taxpayers.³⁸⁷ On the other hand, taxpayers were not volunteering to provide actual information of their annual turnover. Besides this, underreporting of their daily sale income was the cause for the high exposure of estimations by the Committees.³⁸⁸ Hence, it was difficult to simplify tax administration that results inequitable tax burden on the small business taxpayers.

With regards to the second round of income assessment of 2008, it was the same as the previous standard assessment tax system. It was conducted by revising the 2003 income assessment after the lapse of the five year income tax assessment period. The ANRS Revenue Authority issued and prepared a directive to implement the tax assessment of the taxpayers.³⁸⁹ After the lapse of the 2003 standard assessment, the 2008 income assessment was needed taking in to account the following considerations: 1) it was planned to encourage private sectors in a free market economy policy; and 2) it was formulated to eliminate the tax burden of businesses rendering occupational services by decreasing the maximum thresholds of Turn Over Tax (TOT) rates.³⁹⁰ The scope of the assessment was to make income assessment of category “C” taxpayers and come up with the new businesses in to the tax network by establishing fair and effective tax administration.³⁹¹ At the time of income assessment, the numbers and structural organizations of daily sale Estimation Committees were the same as the 2003 income tax assessment.³⁹²

Although the BDCA Revenue Office claimed that the standard assessment has brought sharp increase in government revenue in the 2008 income assessment, the Estimated Committees

³⁸⁵ ANRS Bureau of Finance and Economic Development, Drafting the Income Tax Proclamation, Short Explanation in implementing Standard Assessment, p. 1.

³⁸⁶ According to different sources of data from the BDCA Revenue Office more than 75% of the whole taxpayers in the city are category “C” taxpayers. See table one under section 4.2.

³⁸⁷ Interview with Aemiro Zerihun, *the problems occurred during the 2003 income assessment*, April, 28/2017.

³⁸⁸ *Ibid.*

³⁸⁹ በአማራ ብሔራዊ ክልላዊ መንግስት የደረጃ "ሐ" ግብር ከፋዮችን የቀን ገቢ ለመገመትና ለመወሰን የወጣ መመሪያ ቁጥር ገብ-4/2000 ዓ.ም፣ ገቢ ግብር ቁጥር፣ [Herein after, A Directive by ANRS Finance and Economic Development Bureau No. RA-4/2008].

³⁹⁰ Preamble of a Directive by ANRS Finance and Economic Development Bureau, No. RA-4/2008.

³⁹¹ *Ibid.*, art. 4.

³⁹² A Directive by ANRS Finance and Economic Development Bureau, No. RA-4/2008, art. 5.

expressed their concern over the estimation difficulty they faced. To list, the main problems were under-reporting of daily sales by the taxpayers, lock out the business at the time of assessment, fraud and hide annual turnover, and fear of inequitable tax burden on the taxpayers.³⁹³ In addition to this, the Estimated Committees and the tax officers were contributed a negative impact to implement the assessment effectively at the time. Among the challenges: supply of insufficient materials to conduct the assessment, incompetency of the Committee, less follow-up system, nonappearance of some assessors at business premises, and subjectivity of estimation without any circumstantial or third party information were the main obstacles of the assessment.³⁹⁴ Due to this fact, the above mentioned problems led to grievances of the taxpayers who expressed their concern over the estimation procedures as well as the consequent unfairness in estimates.

After assessment was conducted, the BFED carried out to issue a modified standard assessment table showing the total number of category “C” taxpayer’s taxable income, the standard assessment rate and total working days of such businesses within a year.³⁹⁵ In this table, there were 101 business sectors and each business has other related types of business segments which were taxed on the same average annual profitability rate and working days in a year.³⁹⁶ The standard assessment table of the 2008 income assessment was included the minimum and maximum working days of 220 and 365 in a year, respectively.³⁹⁷ However, most of the business sectors under category “C” taxpayers had 300 working days. In addition, the average annual profitability rate of the standard assessment table was shown variations in each business sectors.

4.4.2. The 2012 Income Assessment

In the 2012 income assessment, the ANRS Revenue Authority was convinced to re-evaluate the income status of businesses paying their tax liability on the basis of estimation. The survey was mainly targeted on category “C” taxpayers.

³⁹³ የባህር ዳር ከተማ አስተዳደር ገቢዎች ጸ/ቤት፣ የ2000 ዓ.ም በጀት ዓመት ማጠቃለያ ሪፖርት ለአብከመ ገቢዎች ባለስልጣን እና ለሌሎች የከተማው አስተዳደር ቢሮዎች የተላኩ፣ ቁጥር ባገ/112/001፣ ገፅ 26 [Available at BDCA Revenue Office].

³⁹⁴ *Ibid.*

³⁹⁵ See the Income Tax Reg. No. 4/2003, art. 23 (5); Table of standard assessment attached in A Directive by ANRS Finance and Economic Development Bureau No. RA-4/2008.

³⁹⁶ For example, the standard assessment table attached in directive no. RA-4/2008, Edible Oil and its by-product is one of the business sectors having annual profitability taxable rate 10% of average and 300 working days in a year. Under this business, there are three related business segments taxed based on the above taxable rate and working days. These are; manufacturing Oil, retailing Oil, and sale of by-product Oil.

³⁹⁷ Standard assessment table attached in A Directive by ANRS Finance and Economic Development Bureau No. RA-4/2008.

The authority raised two main grounds for the revision of the 2008 income assessment tax liability of the small businesses; 1) the 2008 standard assessment method was out of date and did not reflect the 2012 economic situations of the taxpayers; and 2) it was necessary to subject the informal and unregistered businesses into the tax network.³⁹⁸ Besides, it was the need to establish better information flow between the tax authority and taxpayers for rising government revenue.³⁹⁹ The economic and business environment in the Region as well as BDCA was changed in 2012. Even if it was hardly possible to contest the changing circumstances, the economic inflationary trend might bring another meaning to the issue. In this period, the real value of money was greatly affected by the high increase of economic inflation in the region in particular and in the country at large. The other reason raised by the authority was the negative impact of the informal and new businesses, (that were operating outside the tax net), on the revenue base and equity of the tax system. Due to such businesses have been increasing in number, the city was losing a huge amount of revenue from these informal sectors and this was against the increase of the tax base.⁴⁰⁰

In order to implement the plan of the 2012 income tax assessment, it involved from 4-6 member of the Estimated Committees.⁴⁰¹ The representatives of these Committees were selected from Finance and Plan Office, Trade and Transport Office, Business Communities, Economic and Environmental Development Office.⁴⁰² Estimations made by these Committees were used as a standard for the assessment of income of taxpayers for the next five consecutive years till 2017.⁴⁰³ In addition, the Assessment Inspection Committees were also established from each office listed above in BDCA.⁴⁰⁴ The duties and responsibilities of the Inspection Committees were to follow-up and collect information from the Estimated Committees in the sub-city levels

³⁹⁸ በአማራ ብሄራዊ ክልላዊ መንግስት ንግድና ኢኮኖሚ ልማት ቢሮ፣ የ2004 ዓ.ም በጀት ዓመት የደረጃ “ሐ” ግብር ከፋዮች የቀን ገቢ ለመገመትና ለመወሰን የወጣ መመሪያ ቁጥር ገቢ-11/2004 ዓ.ም፣ [Herein after, Directive by ANRS Bureau of Finance and Economic Development, No. RA-11/2012]. This directive was issued on the basis of the power given to the Bureau of Finance and Economic Development in accordance with article 69 and 119 of the Income Tax Proc. No. 76/2002 (*now repealed*) and article 29 of the Income Tax Reg. No. 4/2003.

³⁹⁹ *Ibid.*

⁴⁰⁰ Interview with Zewdu Kiflie, *on the reason of the 2012 income assessment in BDCA*, April 28, 2017.

⁴⁰¹ Directive by ANRS Bureau of Finance and Economic Development, No. RA-11/2012, art. 5 (3)

⁴⁰² *Ibid.*, art. 5 (3) (a).

⁴⁰³ See the Preamble of Directive by ANRS Bureau of Finance and Economic Development, No. RA-11/2012. Since this period is already expired, the revenue office is currently conducting an assessment survey to set a new threshold to be applicable for the coming five years.

⁴⁰⁴ *Id.*, art. 5 (3) (b).

and then report to the revenue office.⁴⁰⁵ They also gave immediate response to problems in the process of estimation.

Subsequently, as reported by BDCA Revenue Office, the Committees were surveyed more than 8,649 business establishments for three months (from April 2 to June 30 E.C).⁴⁰⁶ In the report, the city administration planned to collect Birr 365, 435,262 from the total businesses conducting in the city. However, out of this only Birr 251,805,649 was collected at the end of the fiscal year.⁴⁰⁷ The task was simply a duplication of the 2008 situation in which estimation of daily sale found to implement the standard assessment on most types of small businesses.⁴⁰⁸ There were challenges faced by the Estimated Committees at the time of income assessment. Business communities did not want to report the true and actual income of their daily sale to the Committees due to fear of over estimation.⁴⁰⁹ In addition, some of the Estimated Committees were absent in working hours and did not perform their respective duties efficiently.⁴¹⁰

After the estimated assessment, BFED has prepared the standard assessment schedule for small businesses.⁴¹¹ Based on the categorization of businesses, the schedule of category “C” taxpayers’ taxable income has provided the classification of 109 business sectors.⁴¹² The total numbers of business types in the 2012 schedule of small businesses were greater than the previous numbers of business sectors of estimated assessment. Hence, some new business sectors were found at the time of income assessment due to economic development of the Region.⁴¹³ Like the 2008 income tax assessment, the schedule of small businesses taxpayers’

⁴⁰⁵ *Id.*, art. 13 (2).

⁴⁰⁶ የባህር ዳር ከተማ አስተዳደር ገቢዎች ጸ/ቤት፣ የ2004 ዓ.ም በጀት ዓመት ማጠቃለያ ሪፖርት ለአብዛኛው ገቢዎች ባለስልጣን እና ለሌሎች የከተማው አስተዳደር ቢሮዎች የተላኩ፣ ቁጥር ባ/072/113፣ ገፅ 43 [Available at BDCA Revenue Office].

⁴⁰⁷ *Ibid.*

⁴⁰⁸ Interview with Zemenu Abebe, Coordinator of Tax Assessment and Collection Follow-up Core Process at BDCA Revenue Office, *on the mechanism of standard assessment of small business in the city*, May 11, 2017. The income assessment of taxpayers, who are not categorized under small businesses, are either Category ‘A’ or Category ‘B’ taxpayers. Hence, they are obliged to pay their tax on the basis of accounts otherwise the Tax Authority can conduct estimation of income by using the procedures of estimated assessment.

⁴⁰⁹ *Ibid.*

⁴¹⁰ *Ibid.*

⁴¹¹ በአማራ ብሔራዊ ክልል ውስጥ ለሚገኙ የደረጃ “አ” ግብር ከፋዮች የግብር አወሳሰን መመሪያ ቁጥር ገቢ-12/2004 ዓ.ም [Herein after, A Directive by ANRS Bureau of Finance and Economic Development, No. RA-12/2012].

⁴¹² The standard assessment table of category “C” taxpayers’ taxable income is attached in the Directive of ANRS Bureau of Finance and Economic Development, No. RA-11/2012.

⁴¹³ For example, the new business sectors are; Chat trade, Soil fertilizer trade, Tractor and Combiner service, Mill trade, Massage service, Wood welding motor service, “Frane Shera” repair, and Rapor writer service. In addition to these businesses, the Bureau of Finance and Economic Development issued a directive to include other nine new business sectors, which were not included in the 2012 standard assessment schedule. These are; Computer game service, Color painting service, Plump repair, Supply and sale of Telecom materials, Loading and downing services, Tequando sport trainer, “Kerkeha” wood trade, and Renting of business center with its material. *See*,

taxable income has also shown the taxable income of total annual sales. Hence, the 2012 standard assessment schedule of small businesses taxpayers' taxable income is still applicable BDCA as well as in the Region. From the standard assessment schedule, the average annual profitability rates are ranging from 10% to 30% depending upon the nature of business service sectors, and total working days of such businesses within a year.⁴¹⁴ In so doing, BDCA revenue office has already identified the number of working days for different businesses mainly based upon the requirement that for how many days the business operates in a week.⁴¹⁵ If the business is presumed to operate 7 days in a week, it will have 365 working days. For those businesses with 5 working days per week, the total number becomes 300 days. Business sectors have minimum and maximum working days of 150 and 365 in a year, respectively. However, more than 90% of these businesses have 300 working days.⁴¹⁶

It is worth mentioning here that after conducting and estimating the daily sale of business sectors, the tax assessment officer has to process the collected data and calculate the tax liability of the taxpayers. Calculating the tax liability is based on the working standard assessment schedule of small business taxpayers' taxable income. With the comprehensive set of records and assessment notification for each taxpayer, the tax liability can be calculated based on the following procedures.⁴¹⁷ Firstly, the estimated daily sale is multiplied by the number of working days for each business in order to get annual turnover of such business. Secondly, the calculated annual turnover is placed within the appropriate threshold of the standard assessment schedule. Thirdly, the upper limit threshold of the standard assessment is multiplied by profitability rate of that business to reach at taxable income. Finally, the taxable amount is calculated in accordance with the income tax rates of schedule "C" of the Income Tax Proclamation. For example, if the daily sale of fruit and vegetable trader is estimated 90 Birr, his annual turnover is 27,000 Birr. Because of the working days of such business are 300 in a year. This annual turnover falls in the threshold '25,001 to 30,000 Birr'. However, it is the upper limit (30,000 Birr) that is taken to calculate tax liability. Then to reach at the taxable income, 30,000 Birr (upper limit) \times 13% = 3900 Birr. Because as to the 2012 schedule of small businesses

በአብዛኛው የገንዘብና ኢኮኖሚ ልማት ቢሮ፣ የገቢዎች መቶ መቶ መቶ የሌላችው የገቢዎች ዘርፎች የትርፍ መቶ መቶ መቶ ምጣኔና የሥራ ቀናት ለመወሰን የወጣ መመሪያ ቁጥር ገቡ-13/2005 ዓ.ም.

⁴¹⁴ See, Standard assessment table of category "C" taxpayers' taxable income is attached in the Directive No. RA-11/2012.

⁴¹⁵ Interview with Zemenu Abebe, Coordinator of Tax Assessment and Collection Follow-up Core Process of BDCA Revenue Office, *on business sector working days in a year*, April 21, 2017.

⁴¹⁶ See *Supra* note 411.

⁴¹⁷ Interview with, Ato Melese Muluken, Tax Assessment and Follow-up Officer of Tana Sub-City Revenue Office, *on the steps to calculate tax liability of the taxpayers*, May 19, 2017.

taxpayers' taxable income, the average annual profitability rate of fruit and vegetable trade is 13%. After this, taxable income can be calculated in accordance with the income tax rates of schedule "C" of the Income Tax Proclamation.

As we can understand from the above practical example, estimation is used by BDCA revenue office for the implementation of standard assessment. From this perspective, it is inconvenient to make distinction between estimated and standard assessment method. Since estimated assessment is basically relied on the estimation of daily sale of each taxpayer. Although the main objective of standard assessment is to avoid contract between tax assessors and taxpayers to eliminate estimation of daily sales, the practice of standard assessment is not different from estimation assessment. The turnover based standard assessments could not relieve the authority from enforcing the fixed taxes without recourse to estimation of daily sale. As a result, subjectivity and excessiveness of estimations are the problems faced by taxpayers.⁴¹⁸ In addition, the revenue office of the city could not survey all businesses on equal footing due to the time-consuming nature of estimation.⁴¹⁹ Hence, the above problems have been the main sources of inequity of the tax administration system.

In the case of transport and attorney services, estimation of daily sale cannot be used to determine the tax liability instead the tax authority has been able to assess their tax liability by simply verifying the external indicators set for such sectors.⁴²⁰ Even if turnover is one of the parameters, the verification of the indicators is found to be simpler and sufficient for determining tax due.⁴²¹ For instance, for transport sectors, the city revenue office is able to get the required information of each taxpayer from official documents (e.g. title-deed) showing the indicators used in the schedule. The same experience has also shared by attorney sector in which taxpayers have placed into the appropriate category by looking into the level of attorney from their license.

⁴¹⁸ Interview with Mastewal Baye, Owner of Café and Restaurant in Ginbot 20 Sub-City; Interview with Mohammed Adem, shop owner in Sefene-Selam sub-city; Interview with W/ro Amelmal Erikyehun, fruit and vegetable trader in Sefene-Selam sub-city, May, 17/2017. They have the same idea on the discretionary power of the tax assessors.

⁴¹⁹ Interview with Zemenu Abebe, *on the limitation of income assessment in the given time*, April 21, 2017.

⁴²⁰ Presumptive taxes of transportation and attorney services based on external indicators are still working in the Schedule attached under Income Tax Regulation No. 4/2003. Interviews with W/ro Yeshimebet Kassa, Tax Assessment and Follow-up Officer of Tana Sub-City Revenue Office, *on how to tax transport and attorney services*, May, 19/2017.

⁴²¹ *Ibid.*

Generally, since estimation of daily sale is still conducted at the end of each fiscal year, it is the main cause of conflict or disagreement between small business taxpayers and the revenue office in the city. The followings are some of the major striking issues between the taxpayers and tax officers.

1. Over-Estimation of Income Assessment⁴²²; Mostly, it is accepted that the estimation has resulted in unimaginable tax liability on significant number of taxpayers, though difficult to state accurately. So, these taxpayers are not ready to comply with the obligations of the new categorization. In this case, if a taxpayer whose daily sale was estimated some amount of Birr in the previous tax year assessment, this amount of daily sale could not be consider in the next fiscal year estimated assessment even without any increase of his/her business transaction. Hence, it has criticized the new assessment which brought to him/her more than the previous estimated amount of daily sale that leads to him/her graduation from category “C” to category “B” or category “A”. The consequence of this graduation is clear that the taxpayer is expected to keep books of account. He/she must also register for VAT which is not expected by him/her. Therefore, the taxpayer thinks that he/she is paying beyond his/her ability to pay. Thus, he/she neither has trust in the tax assessors of the revenue office nor in the overall tax estimation, assessment and collection procedures. This creates frustration of tax administration and inequitable tax treatment.

2. Subjectivity of Estimation⁴²³; It has worried that turnover-based presumptions cannot be easily ascertained due to the high chance of concealment and falsification of business turnover. Even if the assessors can employ various circumstantial references to estimate and know the daily sale of small business taxpayers, it may be difficult for them to take the references, such as goodwill of the business and number of customers. In such a case, estimates have based on personal judgment of the tax assessors and there may be a room for subjectivity.

3. Underreporting of the Daily Sale⁴²⁴; when the tax assessors make estimations, most of the small business taxpayers are not volunteer to tell the actual daily sale of their businesses. This understatement of daily sale is the main challenge to the tax officers/assessors. The taxpayers have a tendency of understating daily sale and exaggerating expenses as a result of fear of high

⁴²² See *Supra note*, 418.

⁴²³ *Ibid.*

⁴²⁴ Internview with Ato Amanu Tarekegn, Tax Assessment and Follow-up Officer of Ginbot 20 Sub-City Revenue Office, *on the challenge faced at the time of income assessment*, on May, 19/2017. This problem is also disclosed by Tana sub-city, Sefene-Selem sub-city and Fasilo sub-city Tax Assessment and Follow-up Officers.

tax burden. Basically, as discussed in chapter two, understatement of business income is the main feature of presumptive tax systems that totally relied on turnover of businesses. The income tax laws do not incorporate mechanisms to identify the annual turnover of most of the businesses.⁴²⁵ Hence, underreporting of daily sale can be the main problem for the revenue office in the city due to the low level of tax culture and weak administrative capacity.

4. Limited Tax Knowledge; Most small business taxpayers, but not all, have inadequate tax knowledge in BDCA.⁴²⁶ In fact, the main duties and responsibilities of Tax Education and Communication Core Process is creating tax awareness to the taxpayers through different mechanisms, such as face to face trainings, via pamphlets, and by using different media.⁴²⁷ However, they do not exactly know how the tax is assessed or calculated as well as the procedures in the tax assessment and computations are not objectively understood by most of the taxpayers.⁴²⁸ In practice, they have a negative perception against tax officers and assessors in case of estimated assessment by concealing and locking the businesses. The tax administrator is weak to conduct comprehensive tax education to enhance taxpayers' compliance. Therefore, it can be conclude that the BDCA revenue office is not being effective in designing and implementing sustainable system to make this procedures objective, transparent, and understandable to the taxpayers. However, it uses the opportunity to intimidate and threaten them, by referring to penalties as the sole weapon to make taxpayers comply with tax laws, rather than using tax education as a tool to bring more businesses into the tax network.⁴²⁹

From the above discussions, one of the main causes for the controversy between the tax assessors and small business taxpayers is the problem of standard assessment formulation that shall not have verifying mechanisms for most of categorized businesses in the schedule, other than estimation of daily sale to identify business turnover. Although article 69 (2) of the Income Tax Proclamation No. 76/2002 envisaged a fixed amount of taxes that reflect variations (in the type, size, and location of businesses), formulation of standard assessment could not consider these localization of tax burdens. This leads to the tax officers to rely on estimation of daily sale for the implementation of standard assessment on small businesses. Since estimation is based on tax officers' subjectivity and taxpayers are not willing to declare their actual income, the task is

⁴²⁵ Amin Abdella and John Clifford, *The Impact of Tax Reform on Private Sector Development*, p. 23.

⁴²⁶ Interview with Aemiro, *on the limited knowledge of the business taxpayers in BDCA*, April 28, 2017.

⁴²⁷ *Ibid*, *on the mechanisms of tax education for the taxpayers in BDCA*, April 28, 2017.

⁴²⁸ *Ibid*.

⁴²⁹ Amin Abdella and John Clifford, *The Impact of Tax Reform on Private Sector Development*, p. 66.

always frequent dispute and lack of satisfaction, especially among similar business income earning taxpayers. Therefore, still estimated amounts are the main source of disagreement between small business taxpayers and the tax officer because of personal judgments' and unreflective of taxpayers' capacity. This system relies heavily on the excessive discretionary power of the tax officers, which create inconsistencies in the treatment of the taxpayers, and a loophole for corruption.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1. Conclusion

Presumptive taxation of small businesses, which is widespread especially in developing countries, is used to simplifying compliance and administrative costs. Generally, presumptive taxation is an administrative approach of constructing tax bases from those indirect proxies due to absence of books and accounts of taxpayers. It is the use of indirect means to ascertain tax base, which differ from the usual rules based on the taxpayer's accounts.

Presumptive taxation is believed to be an instrument of reducing the compliance and enforcement costs in the achievement of formalization, equity and other objectives of taxing small businesses. It can improve collection efficiency, reduce evasion and thus even distribute the tax burden more fairly among the small businesses. It is a feasible administrative option for controlling small business taxation because it simplifies administration and compliance. However, presumptive taxation has its own demerits. It has to be underscored that its design is not necessarily purely advantageous for small businesses. Even though it is introduced as a simple tax meant to improve collection through reduced compliance and enforcement costs, it falls under constant pressures towards equity adjustments in its coverage, rate structure and indicators. There is no relief in case when taxpayers incur a loss which leads against fairness, short of encouraging businesses to keep records and there is slower potential disincentive to grow to the standard tax system.

There are different forms or types of presumptive taxation. Among these are standard assessments, estimated assessments, rebuttable and irrebuttable presumptive taxation, turnover based and indicators based presumptive taxation. The classification of presumptive taxation into standard and estimated assessments is based on the requirements whether tax liability shall be assessed at taxpayer or occupation level. Under estimated assessment, tax liability reflects the taxable capacity of each taxpayer since it is made on individual basis or personal circumstances. Even if it is suitable for ensuring some degree of equity by taking individual specific factors into consideration, the method opens a room for an individual interaction between tax administration and taxpayers. This leads potential for conflicts and corruption in tax system as

tax officials enjoy substantial discretionary power in determination of taxes. On the other side, standard assessment determines tax liability at occupation level without considering individual specific conditions. It assigns the fixed amount of taxes to taxpayers on the basis of occupation or business activity that limits the role of tax officials to ensuring whether taxpayers are in the right category. The main advantages of standard assessment are broadening tax base, administrative simplicity, certainty and efficiency.

Standard assessment is one of the types of presumptive taxation in which a fixed, lump-sum tax is levied on individuals or businesses on the basis of the occupation or business activity. Based on this, it assigns the fixed amount of taxes to taxpayers that are established by determining the average taxable income of a few taxpayers. In this case, tax administration is required to ensure the taxpayers are categorized in the appropriate groups. Thus, its tax liability is not subjective. Standard assessment is comparatively simple to administer and attractive in terms of horizontal equity. But it has its own limitations. Among its limitations, it does not take into account taxpayer-specific conditions, such as family size and losses in a particular year. It violates the principle of vertical equity, to the extent that the same tax liability is imposed on high and low income professionals. Standard assessment deter people from starting a business when they think that the tax is so high that they have little chance to make a profit at all, and it may force people out of business.

In Ethiopia, development of standard assessment has passed through two stages, i.e. before and after the 2002 income tax laws. Following the adoption of the 2001 Income Tax (Amendment) Proclamation, standard assessment was re-introduced for the purpose of simplicity and equitable tax administration. It has been envisaged to provide fixed taxes for small businesses in consideration of size, type and location of businesses. The incorporation of standard assessment was to eliminate those practical problems of estimated assessment but limited in scope and time of application. After the legislation of the 2002 Income Tax Proclamation, individuals carrying out business were eligible for the presumptive tax system as far as their annual turnover did not exceed 100,000 Birr. These small businesses, (referred as category “C” taxpayers), were relieved from the basic income tax law obligation of maintaining books and records due to the smallness of their size. As a result, their income tax liability was assessed through indirect methods based on the standard assessment rules and tables provided by the income tax laws. On the other hand, in the current Federal Income Tax Proclamation, small businesses are category “C” taxpayers whose annual income turnover is less than or equal to 500,000 Birr.

Before the introduction of standard assessment method, BDCA finance and economic office was used the estimated assessment to collect tax revenues from small businesses on the bases of type, location, goodwill, number of customers, and paid tax history of the business. After the demise of estimated assessment at the time, the Region in general and the city administration in particular has passed the practice of standard assessment through three main events; the 2003, the 2008 and 2012 income assessments. During 2003, the Income Tax Regulation and Directives issued by BFED came up with standard assessments for different businesses. It was the mechanism for the implementation of small business taxation to reduce compliance of the taxpayers, to simplify tax administration, and to reduce more expenses. It was shown that the fixed taxes for most of the businesses were based on annual turnover. However, in practice estimation of daily sale was the method that opted for finding out taxpayers' turnover in order to apply the formulated schedule. Estimating and calculating of daily sale were not an easy task to the Estimated Committees that led to excessiveness and subjectivity of estimations and caused to dissatisfaction of most small business taxpayers.

During the income estimations carried out in 2008 and 2012, the practice has been reminder of what happened in 2003 income assessment. Even if standard assessment has been introduced to bring administrative simplicity and stability of taxation, the use of estimation of daily sale in the two events has made the objective of standard assessment unachievable. The absence of better mechanisms to identify the annual turnover for most of the categorized businesses in the schedule were the main failures that brought during estimated assessment period. As a result, the estimated officers and taxpayers in the city were engaged in continued debate over the amount of estimated turnover. The subjectivity of estimations and incompetency of tax officers has been the main cause of tax debates. In addition, under-reporting of daily sale, lock out the business at the time of assessment, fraud and conceal the total amount of transactions, and fear of inequitable tax burden were another challenges. As a result, tax payers were faced with the problem of uncertainty of tax liability that was against the simple administration of standard assessment. In the subsequent directives proclaimed by BFED, other inputs were used by the tax authority to reach at the final tax levy. These were number of working days, profitability rate and the tax rates under schedule "C" of the Income Tax Proclamation. The practice gives still no value for the fixed taxes provided in the standard assessment schedule.

This research also pointed out that there are practical problems for the application of standard assessment of small businesses in BDCA. The problems are caused by estimation of daily sale

that arise conflicts between small business taxpayers and the revenue office in the city. The first one is over-estimation of income assessment. In case of over-estimation, it is accepted that the estimation has resulted in unimaginable tax liability on significant number of taxpayers, though difficult to state accurately. Hence, these taxpayers are not ready to comply with the obligations of the new categorization. Secondly, subjectivity of estimation is another headache for ineffective administration of small businesses. It has stressed that turnover-based presumptions cannot be easily ascertained due to the high chance of concealment and falsification of business turnover. Thirdly, at the time of income assessment, most of the small business taxpayers are not volunteer to tell the actual daily sale of their businesses. This understatement of daily sale is the main challenge to the tax officers/assessors. Finally, inadequate tax knowledge of the business taxpayers is another obstacle.

5.2. Recommendations

Based on the findings of this research, the following points are recommended for the proper implementation of standard assessment of small business taxation in BDCA in particular and the ANRS at large.

1. Since small businesses are taxed on the basis of estimation of daily sale, the presumptive income tax regime will continue to suffer from subjectivity of estimations and hence cause conflicts between the businesses and the authority. Thus, estimation of daily sale shall not be used so as to bring stability and predictability of small businesses taxation in BDCA.
2. As far as small businesses are subjected to the assessment of the tax by the tax officers, there are no well-defined rules for such assessments, which can lead to similar businesses being taxed for different amounts on an arbitrary basis. There should be a better-defined methodology for presumptive tax assessment that would help to improve and modernize the situation.
3. Awareness creation activities for tax assessors in the tax authorities in BDCA should in particular focus on the standard assessment method of businesses, assessment techniques and on the need to create effective cooperation. There should be a need to check how impartial the treatment of business taxpayers by the tax assessors and to try to maintain impartiality as it plays a great role in securing and administering business taxation. The authority should study the impartiality and ethical integrity of its officers by using different techniques, for example, giving special trainings.

4. The basic problem in the implementation of standard assessment is the difficulty to categorize schedular businesses due to lack of indicators. Hence, the income tax laws should specifically determine and incorporate annual turnover identifying mechanisms for most of the businesses and the corresponding fixed taxes. So, in the extension of indicators in schedular businesses categorization, there should be a turnover reporting mechanisms and localization of tax liability by considering the nature and capacity of taxpayers.
5. Concerning the accessibility of the income tax laws, there is a considerable time lag among the issuances of implementing directives of standard assessment, thereby leaving room for subjectivity of tax assessment in BDCA. Directives on standard assessment system are not readily accessible and available to the taxpayers, which lead lack on simple record keeping. Besides the expansion of tax education to the business communities, the authority/revenue office should access the availability of these documents, help to increase the transparency of taxation and hence reduce the potential for confusion or malpractice, such as underreporting and hide the daily sale of the business.

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Interviews

1. Interview with Ato Aemiro Zerihm, Coordinator of Tax Education and Trainings Core Process at BDCA Revenue Office, *on the factors that fluctuating the number of small businesses taxpayers in the city, April 28, 2017.*
2. Interview with Ato Amanu Tarekegn, Tax Assessment and Follow-up Officer of Ginbot 20 sub-city Revenue Office, *on the challenge faced at the time of tax assessment, on May, 19/2017.*
3. Interview with W/ro Amelmal Erikyihun, fruit and vegetable trader in Sefene-Selam sub-city, *on the personal judgments’ and excessive discretionary power of the tax officers at the time of daily sale estimation, May, 17/2017.*
4. Interview with, Ato Melese Muluken, Tax Assessment and Follow-up Officer of Tana Sub-City Revenue Office, *on the steps to calculate tax liability of the taxpayers, May 19, 2017.*
5. Interview with Mastewal Baye, Owner of Café and Restaurant in Ginbot 20 Sub-City, *on the personal judgments’ and excessive discretionary power of the tax officers at the time of daily sale estimation, May, 17/2017.*
6. Interview with Ato Mohammed Adem, shop owner in Sefene-Selam sub-city, *on the personal judgments’ and excessive discretionary power of the tax officers at the time of daily sale estimation, May, 17/2017.*

7. Interview with Mr. Yedemie Yeshalem, Deputy Director of Revenue Authority of the ANRS, *on the time of conducting standard assessment of small businesses in Amhara Region, April 28, 2017.*
8. Interviews with W/ro Yeshimebet Kassa, Tax Assessment and Follow-up Officer of Tana Sub-City Revenue Office, *on the external indicators transportation and attorney services*, on May, 19/2017.
9. Interview with Ato Zemenu Abebe, Coordinator of Tax Assessment and Collection Follow-up Core Process of BDCA Revenue Office, *on the standard assessment of small businesses*, April, 21/2017.

Annex 1

Interview Guide Questions for Employees in the Tax Authorities

Personal Detail of Respondent

Name of the Respondent (if he or she consented) _____

Type of the Study: A Master Thesis in Law (LL.M Thesis)

Title: Standard Assessment of Small Businesses in Bahir Dar City Administration: Legal and Practical Analysis

Objective of this Interview: To gather information as to the remarks of the tax authority and small business taxpayers on the application of standard assessment with respect to the relevant income tax laws and investigating the practical problems for applying standard assessment on small businesses in BDCA. So, you are kindly requested to respond to the interviews as the information you give will be helpful for effective accomplishment of the study and as it will be kept confidential and analyzed anonymously unless you consented for the disclosure of your identity and personal views. Thank you, in advance, for your co-operation.

1. How does the tax authority/revenue office implement standard assessment of small business taxation?
2. What are the methods that your office/authority uses to calculate the tax liability of small businesses after estimation of daily sales?
3. What activities the authority/revenue office takes with a view to subject new businesses or occupational individuals in to the tax network?
4. Has the authority faced any challenges/problems in relation to estimation of annual turnover? If so, could you explain it to me?
 - a. Do the taxpayers accept the estimation of the office/authority?
 - b. What do you think are the main causes for such disagreements between the office and the taxpayers?
 - c. What do you recommend as a solution?
5. What are the criterion/ parameters the tax authority/revenue office employs in order to graduate category “C” taxpayers into category “B” or category “A” taxpayers?
6. Do you think the revenue office is effective in raising the awareness of the tax payer about the obligation to pay tax?

Annex 2

Interview Guide Questions for Taxpayers

Personal Detail of Respondent

Name of the Respondent (if he or she consented) _____

Type of the Study: A Master Thesis in Law (LL.M Thesis)

Title: Standard Assessment of Small Businesses in Bahir Dar City Administration: Legal and Practical Analysis

Objective of this Interview: To gather information as to the remarks of the tax authority and small business taxpayers on the application of standard assessment with respect to the relevant income tax laws and investigating the practical problems for applying standard assessment on small businesses in BDCA. So, you are kindly requested to respond to the interviews as the information you give will be helpful for effective accomplishment of the study and as it will be kept confidential and analyzed anonymously unless you consented for the disclosure of your identity and personal views. Thank you, in advance, for your co-operation.

1. Do you have any grievances while tax assessors determine estimation of daily sale? If yes, what are the causes for your grievances?
2. After knowing tax obligations under the standard assessment procedures, do you ever been certain of the correctness of the tax liability you assess and pay for the tax authority? If no, what are those situations that make you uncertain about the tax liability you assessed?
3. Do you believe that standard tax assessment method is implemented effectively?