Characterization of Taxable Units and Tax Bases under the Income Tax Schedules of Schedule 'A' and 'B' of the Federal Income Tax Proclamation of Ethiopia: A Commentary

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Abstract

The income tax structure of Ethiopia is substantively schedular. The Federal Income Tax Proclamation incorporates five income tax Schedules (Schedule 'A', 'B', 'C', 'D' and 'E'). The first four provide their own taxable unit and tax base, the basic two elements which determine the scope of any income tax schedule. The last Schedule, on the other hand, is all about exemptions. This paper aims to briefly overview the income tax schedules and most importantly to examine how taxable units and tax bases are characterized under the first two Schedules. In doing so, an assessment is also made on the developments and gaps of the current income tax regime. The paper uses a doctrinal legal research method and based on the critical analysis of relevant legislations and literatures, it is found that the current income tax regime unveils some developments such as incorporating informative definitional provisions. However, the regime still suffers from shortcomings, such as characterization overlaps and clarity problems with potential administrative difficulties. To curb these, the paper among other things, calls for the enactment of directives or advance rulings.

Key words: Income Tax Schedules, Characterization, Taxable unit, Tax base

Introduction

There are two theoretical models of income tax structure; schedular and global.[1] In the global income tax structure a single tax is imposed on all income of the taxable unit, regardless of the nature of the income while

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[1] Lee Burns and Richard Krever, Individual Income Tax, *in* Victor Thuronyi (ed.), *Tax Law Design and Drafting*, Vol. 1, International Monetary Fund, 1996, p. 1. [Here in after, Lee Burns and Richard Krever, Individual Income Tax].

under a schedular income tax structure, separate taxes are imposed on different categories of income.[2] Beyond structural choice, the primary income tax legislation of a country is also expected to determine the basic elements of taxation such as the taxable unit, tax base, tax rate, and the tax administration procedures.[3]

The current income tax regime of Ethiopia is predominantly schedular. The Federal Income Tax Proclamation No. 979/2016 (here in after the Proclamation), has five Income Tax Schedules: Schedule 'A', 'B', 'C', 'D', and 'E' each respectively devoted to income from employment, rental of buildings, business, other sources and exempt income.[4] The first four Schedules are provided, each having their own taxable unit, tax base, taxable income and applicable tax rates. The scope of a certain income tax schedule is basically determined by the characterization of its taxable unit and tax base. Taxable unit is a question of who is a tax payer of a concerned schedule, while tax base refers to the income sources taxable under a schedule. Thus, understanding these two elements is important to effectively comprehend the current income tax regime of Ethiopia. With this view, the author intends to shed a light on the taxable unit and tax base characterization under the Income Tax Schedules of the Federal Income Tax Proclamation. However, since the page limitation of the Journal does not allow, this paper deals the issue in the context of Schedule 'A' and 'B'.[5]

To present the issue clearly, the paper is organized in two parts. Part one is dedicated to make brief introductory remarks on Ethiopia's Income Tax System and Income Tax Schedules'. The main theme of the paper is dealt under part two. This part has two sections where a critical analysis is made on the characterization of taxable units and tax bases' of Schedule 'A' and

[2] *Ibid*. In reality, there are no pure global or schedular systems of income taxation. There is so much inter-penetration of the two systems in actual income tax systems, with the so called global income tax systems partaking from the schedular income tax systems and vice versa. See Ault Hugh J., and Brian J. Arnold, *Comparative Income Taxation: A Structural Analysis*, 3rd ed., Aspen Publishers, 2010, p. 198.

[3] Frans Vanistendael, Legal Framework for Taxation, *in* Victor Thuronyi (ed.), *Tax Law Design and Drafting*, Vol. 1, International Monetary Fund, 1996, p. 3.

[4] Federal Income Tax Proclamation No. 979/2016, Federal *Negarit Gazzeta*, 22nd year, No. 104, Art. 8. While the first four Schedules are dedicated to taxation of certain income sources, the last one provides a simple list of exempt income.

[5] Therefore, this paper should be taken as part one of the commentary. The taxable units and tax bases characterization of Schedule 'C' and 'D' will be discussed in the coming issues of this Journal. Schedule 'E' will not be part of the discussion since it has no its own taxable unit and tax base. It is not designed to tax certain income sources, but, to list income sources exempted from taxation under the first four income tax schedules.

'B' of the Proclamation, under section one and two respectively. The paper winds up with concluding remarks.

Part I: A Glimpse of Ethiopia's Income Tax System and Income Tax Schedules'

Previously, there were four separate income tax systems with different legislation and income sources. Namely the main income tax system, the petroleum, the mining and the agricultural income tax regimes.[6] However, the current Proclamation merges the first three income tax regimes within a single statute. Thus, it is logical to consider the Proclamation as the principal legal source of the existing income tax system of Ethiopia. In fact, it is a federal law. Yet, the income tax laws of the regional governments are a direct replica of the federal laws.[7] It is only the agricultural income tax that remains with separate legislation and where regional governments have enacted their own law, independent of the federal ones. The reason for this is because the Federal Constitution makes agricultural income tax exclusively a regional power of taxation.[8]

As noted above, the Proclamation has five income tax schedules. However, it is hard to conclude that the Proclamation is purely schedular. For instance, the Proclamation has a single comprehensive definition of "income", which is applicable across the board or to all income tax schedules.[9] This is mainly the feature of a global income tax structure.[10] In addition, the Proclamation has not designed a schedule for each income source (which of course is unmanageable to do so). That is why Schedule 'D' is dedicated to tax not a single category of income source but a collection of several income sources.[11] Besides, the Proclamation also taxes income sources not explicitly

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[6] The main income tax system was represented by the Income Tax Proclamation No. 286/2002, Federal *Negarit Gazeta*, 8th year, No. 34 [here in after, the Previous Income Tax Proclamation]. For the others see the Petroleum Operations Income Tax Proclamation No. 296/1986, *Negarit Gazeta*, 45th year, No. 7; the Mining Income Tax Proclamation No. 53/1993, *Negarit Gazeta*, 52nd year, No. 43; and the Mining Income Tax (Amendment) Proclamation No. 23/1996, Federal *Negarit Gazeta*, 2nd year, No. 11.

[7] For instance, compare the Proclamation with the Amhara National Regional State Income Tax Proclamation No.240/2016. It is easy to tell that the latter is a simple replica of the Federal Proclamation.

[8] Constitution of the Federal Democratic Republic of Ethiopia Proclamation No. 1/1995, Federal *Negarit Gazeta*, 1st year, No. 1, Art. 97 (3). [Here in after the FDRE Constitution].

[9] The Proclamation, Art. 2 (14).

[10] Lee Burns and Richard Krever, Individual Income Tax, p. 2.

[11] The Proclamation, Arts. 51 – 63. A dozen income sources are made taxable under Schedule 'D'.

named under any of the income tax schedules.[12] Hence, it is safe to say that the Proclamation is substantively schedular, but not pure.

The schedular income tax system has two basic doctrines; the doctrine of source and mutual exclusivity.[13] The doctrine of source answers the question, which income is subject to the concerned schedule.[14] To answer this question, our immediate reference will be the tax base of the schedule. Since income tax laws are applied on benefits qualified as income, it is important to define this term. In view of this, Art. 2 (14) of the Proclamation defines income as "every form of economic benefit, including non-recurring gains, in cash or kind from whatever source derived and in whatever form paid, credited, or received." The following general points can be said about this definition.

First, it is only economic benefit that is considered as income. This phrase is telling that the benefit should be assessed in monetary terms. Thus, benefits which cannot be assessed in monetary terms such as spiritual and psychological satisfactions are not treated as 'income'. Second, the phrase, '*from whatever source*' implicates that the source of the gain is immaterial. This expression may open a door for arguments whether it includes gains from immoral and/or illegal activities. There are divergent views regarding taxation of income from such activities. While those against taxation argued that taxing the income will make governments a silent partner in illegal or immoral activities; those in favor claim that a dollar of profit from unlawful activity will buy just as much as a dollar of lawful profit, hence, the income should be subject to the same income tax principles applicable to those incomes considered as lawful.[15] The issue will be addressed based on whether Ethiopia taxes crimes or not.

Third, the form of the benefit is immaterial. It can be in cash or in kind. Fourth, the frequency of the gain is also immaterial. The phrase '*including*

[12] *Id*, Art. 63.

[13] Olowofeyeku Abimola A. *et a.l*, *Revenue Law: Principles and Practice*, 3rd ed., Liverpool Academic Press, 2003, p. 72. [Here in after, Olowofeyeku *et al*., *Revenue Law: Principles and Practices*].

[14] *Ibid*.

[15] Yosef Alemu, 'Taxing Crime: 'The Application of Ethiopian Income Tax Laws to Incomes from Illegal Activities', *Jimma University Journal of Law*, 2012, Vol. 4, No. 1, pp. 154-176. This material is written based on the previous Income Tax Proclamation (which had similar expression), and argued for the taxation of income from criminal activities. The experiences of other countries like USA, Canada, UK, Australia, New Zealand and Ireland where courts permit taxation of incomes from illegal activities are also discussed.

non-recurring gains' implies that the benefits could be periodically maturing (recurring gains) or benefits accruing to the beneficiary irregularly or only once (non-recurring gains). Fifth, the phrase '*in whatever form derived, credited or paid*' implies that the Proclamation includes not only gains received or realized but also imputed or receivable economic benefits. Benefits are received when the gain is at the disposal of the beneficiary, while receivable benefits refer to benefits in which the beneficiary has a right/entitlement to, though not yet paid in to his pocket.[16]

In a schedular income tax structure, each schedule has its own definition of income or description of its own tax base. The first four Schedules of the Proclamation determine their own source of income or tax base (one technique of defining is by listing).[17] If each Schedule determines its own income, then, the relevance of having the comprehensive definition of "income" under Art. 2 (14) of the Proclamation may be questioned. However, this definition may be important to charge residual income sources, i.e., income sources not named and explicitly categorized under the Schedules. In such instances, as long as the benefit fits to the comprehensive definition of income, it can be subject to 15% income tax as per Art. 63 of the Proclamation.

The other important doctrine is the doctrine of mutual exclusivity, which in short goes; once, a certain income source is attributed to one of the schedules, it is thereby excluded from the other income tax schedules.[18] This doctrine is manifested under the Proclamation through the following points. First, each schedule has separate income tax base. For this purpose, the Schedules contain provisions that either define the scope of the income tax bases or list out the income sources taxable under each Schedule.[19] Second, the Schedules are provided with exclusive income brackets and tax rate structures, which assures uniformity under each Schedule.[20] Schedule 'D' is an exception to this element, since; it has no income brackets and also contains diverse tax rate structures for the number of sources taxable under

[16] For more about this, see the Proclamation, Art. 2 (5) and (19).

[17] In this regard, see the Proclamation, Arts. 12 (1), 15 (2) and 21 (1) for Schedule 'A', 'B' and 'C' respectively.

[18] Olowofeyeku et al., *Revenue Law: Principles and Practices*, p. 72.

[19] See the Proclamation, Arts. 10 (1) and 12 for Schedule 'A'; Arts. 13 (1) and 15 for Schedule 'B'; Arts. 18 (1) and 21 for Schedule 'C' and each provisions of Schedule 'D'.

[20] *Id*, Art. 11 for Schedule 'A'; Art. 14 for Schedule 'B'; and Art. 19 for Schedule 'C'.

the Schedule. Third, the rules for computation of taxable income are separate and distinct for each Schedule. In income tax, there is gross income and taxable income.[21] The tax is not to be imposed on gross income but on taxable income, which is computed after the gross income is reduced by the permitted deductions. However, this is not the issue for taxpayers of Schedule 'A' where the tax is imposed on gross employment income. Except for a few cases, the same is true for Schedule 'D'.[22] Deductions are best known for taxpayers of Schedule 'B' and 'C', hence; the issue of calculating taxable income is more of a concern for the two.[23]

Fourth, the tax preferences which could be exemptions or deductions are basically unique to each Schedule. Except for a few instances, it is difficult to name such treatments valid for all Schedules.[24] Fifth, there are differences in the rules of assessment and method of accounting, among the Schedules. While Schedule 'A' and 'D' use a withholding scheme as the primary vehicle for collection of the taxes,[25] taxpayers of Schedule 'B' and 'C' 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.[26] With regard to tax accounting, the Proclamation recognizes

[21] *Id*, Art. 2 (12) of reads; "Gross income", in relation to a person, means the total income taxable under Schedules 'B' or 'C' derived by the person without deduction of expenditures;

[22] Among the income sources taxable under Schedule 'D', deductions are allowed for taxpayers of capital gains tax. See *id*, Art. 59.

[23] See *id*, Arts. 15 (5) and (7) for Schedule 'B'; and Arts. 22-33 for Schedule 'C'.

[24] This can be gathered, for instance, from the reading of the list of exempt income under Schedule 'E'. Most (if not all) of the exemptions are attributable to a certain Schedule, i.e., no exemption work for all Schedules. The same goes to deductions. There are few exceptional circumstances; we can find preferences provided for both Schedule 'B' and 'C' such as floor exemption for individual taxpayers (the first 7200 Birr) and deduction of interest expenditure. See *id*, Arts. 14 (2), 15 (7) (d), 19 (2) and 23.

[25] Regarding, how withholding works see Arts. 88-98 of the Proclamation. In fact, in few exceptional cases, the two Schedules use self-assessment. Schedule 'A' for cases of Art. 93 of the Proclamation, where a self-withholding duty is imposed on an employee employed by an international organization or working in an embassy, diplomatic mission, or other consular establishment in Ethiopia of a foreign government or employed by an entity exempt by law from tax withholding obligations. In case of Schedule 'D' earning from casual rental of property, disposal of investment assets, windfall profit, undistributed profit and repatriated profit are possible sources subject to the regime of self-assessment while the rest income sources of the Schedule are collected through withholding agents. See *id*, Art. 64 (5). Art. 83 (7) of the Proclamation also reads; "A taxpayer who has Schedule 'D' income for a tax year that is not discharged by the withholding of tax from the income shall file a tax declaration within two months after the date of the transaction giving rise to the income."

[26] The degree of self-assessment, of course, varies according to the categories of taxpayers under those Schedules. The Proclamation, under Art. 3 (1), categorize the taxpayers in to three categories. Category 'A' which constitutes a body taxpayer and individual taxpayers with annual gross income of Birr 1, 000, 000 or more; category 'B' referring to individual taxpayers with annual gross income of Birr 500, 000 or more but less than 1, 000, 000 and category 'C' constituting individual taxpayers with an annual gross income of less than Birr 500, 000. Then, the book keeping standard is different for each category.

two methods of tax accounting; cash basis (which requires to include only income received by the taxpayer) and accrual basis (which requires the taxpayer to include not only received amounts but also amounts receivable).[27] Art. 2 (5) of the Proclamation is telling that taxpayers of business and rental income tax (i.e., Schedule 'B' and 'C') may use a cash basis or accrual basis method of accounting, while the other tax payers of the Proclamation (i.e., Schedule 'A' and 'D' taxpayers) will use a cash basis method of tax accounting.[28] Sixth, though the Proclamation recognizes the principle of aggregation, it is Schedule bounded. According to Art. 8 (2) of the Proclamation, a taxpayer that derives income from different sources subject to tax under the same Schedule for a tax year shall be taxable under the Schedule on the total income for the year. So, there is no cross Schedule aggregation. In the case of Schedule 'D', there is no aggregation even between income sources under the same schedule (it contains separately taxable income sources). Seventh, the tax periods of the Schedules are also different. Art. 2 (38) of the Federal Tax Administration Proclamation No. 983/2016 (here in after the Tax Administration Proclamation) defines 'tax period' as "the period for which the tax is reported to the Authority."[29] Schedule 'A' adopted a monthly accounting; Schedule 'B' and 'C' adopted

While category 'A' and category 'B' taxpayers are required to maintain adequate books and records (the latter's being imposed with a lesser standard than the formers), category 'C' are subject to a presumptive tax regime, which nonetheless requires them to declare their annual turnover to the tax authorities. See the Proclamation, Arts. 49, 82 and 83.

[27] The Proclamation, Art. 2 (5). This provision is dedicated to define what "derive" amounts for the purpose of income tax. However, from the reading of this provision we can also understand that both cash basis and accrual basis of tax accounting are recognized under the Proclamation.

[28] However, within the taxpayers of Schedule 'B' and 'C', category 'A' taxpayers are always required to use accrual basis of accounting while category 'B' taxpayers are allowed to account on a cash basis. See *id*, Arts. 33 (1), 82 and 83 (5). See also the Federal Income Tax Regulation No. 410/2017, Federal *Negarit Gazeta*, 23rd year, No. 82 (here in after, the Regulation), Art. 58 (2); which states that category 'B' taxpayers may voluntarily account on accrual basis. This means accrual accounting is optional for them while not for category 'A' taxpayers. Regarding category 'C' taxpayers, as a rule, they are not required to maintain books of account (subject to the presumptive taxation). However, they may be required to record matters stipulated under Art. 59 of the Regulation.

In this regard, it should also be noted that Ethiopia has shifted from the General Accepted Accounting Principle (GAAP) to the International Financial Reporting System (IFRS). This has implications for tax accounting and book keeping requirements under tax laws; hence, taxpayers of the Income Tax Proclamation too should be adhering by it. See the Financial Reporting Proclamation No. 847/2014, Federal *Negarit Gazeta*, 20th year, No. 81.

[29] Federal Tax Administration Proclamation No. 983/2016, Federal *Negarit Gazeta*, 22nd year, No. 103.

annual accounting; and Schedule 'D' has adopted event based or realization.[30]

Part II: A Critical Legal Analysis on Characterization of Taxable Units and Tax Bases under the Income Tax Schedules 'A' and 'B'

As stated in the introduction, taxable unit and tax base are the two most important elements that determine the scope of a certain income tax schedule. Throughout this paper, the term 'taxable unit' is employed to mean, a person subject to taxation under a schedule as a tax payer,[31] and 'tax base' is used to refer to the income sources subject to tax under the schedule. The taxpayers under the Proclamation can generally be categorized as Ethiopian residents and non-residents, while the tax base may be an Ethiopian source income or a foreign income.[32] This has to do with the income tax jurisdiction of the Proclamation. According to Art. 7 of the Proclamation, residents of Ethiopia are subject to tax with respect to their worldwide income;[33] while, non-residents are subject to tax in Ethiopia only with respect to their Ethiopian source income.[34]

Therefore, the Proclamation uses the combination of the resident and the source principles to assume jurisdiction. Related to this is the possibility for conflict of tax jurisdiction with other countries. This leads to the problem of double taxation, which is about the imposition of a similar tax on the same person/income.[35] Double taxation (among other things) defeats the principle

[30] The Proclamation, Arts. 10, 13 and 18 for Schedule 'A', 'B' and 'C' respectively. The irregular nature of the sources under Schedule 'D' is a factor for its tax period being event based. For those subject to annual accounting, they have 'tax year' (its definition can be referred from Art. 2 (21) of the Proclamation). See also the Proclamation, Arts.83 and 84.

[31] *Id*, Art. 2 (22) defines taxpayer as "a person liable for tax under this Proclamation."

[32] *Id*, Arts. 5 – 7.

[33] *Id*, Art. 5 defines residents. Accordingly, "a resident individual is an individual who: has a domicile in Ethiopia; or is a citizen of Ethiopia who is a consular, diplomatic, or similar official posted abroad; or is present in Ethiopia, continuously or intermittently, for more than 183 days in a one-year period" and "a resident body is a body that: is incorporated or formed in Ethiopia; or has its place of effective management in Ethiopia."

[34] *Id*, Art. 6 lists income sources which considered as Ethiopian source income and any income source not in the list is considered as a foreign income. Non-residents will pay tax per the Proclamation, if the income they derived falls under the list. Any income not in the list will be considered as "foreign income" and it is residents of Ethiopia who are required to pay tax on it (since they are taxable on their world wide income).

[35] Marius Eugen Radu, 'International double taxation', *Procedia - Social and Behavioral Sciences*, No. 62, 2012, pp. 403 – 407. Available at www.sciencedirect.com> last accessed September 18, 2019. The conflict may be a source – source (when both countries assume jurisdiction on the same income assuming they are the source); a residence-residence (when both countries consider the same person as

of equity (taxpayers with same income will pay a different amount of tax) and adversely affects the international trade and investment.[36] Countries try to avoid the problems of double taxation by taking measures either unilaterally (under their domestic tax laws) or bi/multilaterally (by concluding tax treaties).[37] The solution could be adopting either tax credit (deduction method) or exemption method.[38] Under the exemption method, once the income is taxed in one jurisdiction, it will not be taxed again in another jurisdiction; while the tax credit/deduction method allows only for the reduction of the amount of income tax paid on that income in the other jurisdiction.[39] Coming to the Proclamation (Ethiopia), it adopts tax credit as a unilateral measure,[40] and also allows the application of tax treaties (with a major prevailing status over the Proclamation) which may adopt either the exemption or deduction method.[41]

Having the above general introductory remarks in mind, the subsequent sections are devoted to critically examine the characterization of taxable units and tax bases of the first two Income Tax Schedules of the Proclamation.

1. Schedule 'A': Income from Employment

1.1. Taxable Units of Schedule 'A'

Schedule 'A' deals with employment income tax.[42] Based on the scope of this paper, the proper question to start with is who are the tax payers of the employment income tax? In this regard, Art. 10 (1) of the Proclamation reads that "… Employment income tax shall be imposed… on an *employee*

their resident per their definition of 'resident'); or a source-residence (when one country impose tax on a person as a resident and the other impose tax on the same income of that person based on the fact that they are the source of the income).

[36] *Ibid*.

[37] Thomas Dickescheid, 'Exemption vs. Credit Method in International Double Taxation Treaties', *International Tax and Public Finance*, Issue 11, 2004, Kluwer Academic Publishers, pp, 721–739.

[38] *Ibid*.

[39] *Ibid*.

[40] Read: the Proclamation, Art. 45 for taxpayers of Schedule 'C' and Art. 64 (3) and (4) for taxpayers of Schedule 'D'. For taxpayers of Schedule 'A' and 'B', see the Regulation, Arts. 20 and 25 respectively. The detailed conditions to claim credit/deduction are provided under these proclamations, the basic ones being; the tax imposed under foreign jurisdictions should also be income tax (not other types of tax) and it should be evidenced to the satisfaction of the tax authority.

[41] The Proclamation, Art. 48

[42] The Proclamation, Arts. 10 - 12 and the Regulation, Arts. 7 - 20 are dedicated to govern this Schedule.

who receives employment income …" (emphasis added). Here, 'employee' is provided as the taxpayer. Art. 2 (7) of the Proclamation, on the other hand, defines employee as follows;

> *Employee means an individual engaged, whether on a permanent or temporary basis, to perform services under the direction and control of another person, other than as an independent contractor, and includes a director or other holder of an office in the management of a body, and government appointees and elected persons holding public offices.*

Based on this definition, it is possible to make the following discussion. First, the word '*individual*' in the definition indicates that employment income tax is imposed on natural persons only. It is not surprising, since employment by its nature requires the direct services of natural persons. Second, the phrase, '*whether on a permanent or temporary basis*', indicates that the period of employment is immaterial to be considered as an employee. The case of 'unskilled employee' can be raised here.[43] The fact that the individual did not work for a single employer, for not more than 30 days (during the calendar year), does not bar the income tax laws, to consider the individual as an 'employee'. Third, there should be a direction and control on the individual by another person. The phrase '*direction and control*' is the essential element of the definition. It is the main test to identify whether or not the nature of the relationship is an employee-employer relationship. The phrase '*direction and control*' is not defined under the Proclamation. However, the definition (of employee) excludes independent contractors, because they do not fit to the direction and control element of employee. Art. 2 (15) of the Proclamation defines 'independent contractor' as "an individual engaged to perform services under an agreement by which the individual retains *substantial authority to direct and control* the manner in which the services are to be performed" (emphasis added). Like employee, independent contractor is also defined as an individual.[44] What basically differentiates the contractor from an employee

[43] According to Art. 54 (1) (c) of the Regulation 'unskilled employee' is "an employee who has not received vocational training, does not use machinery or equipment requiring special skill, and who is engaged by an employer for a period aggregating not more than thirty (30) days during a calendar year."

[44] Here, it is not clear why the Proclamation defines independent contractor as "an individual" since both natural and legal persons may assume the task. For instance, in the context of the Civil Code of Ethiopia, a legal person can be a contractor. Art. 2610 of the Civil Code of the Empire of Ethiopia, 1960, *Negarit Gazzeta*, Extraordinary Issue, Proc. No. 165, 19th year, No. 2 (here in after, the Civil

is that it has "substantial authority" to direct and control the undertaking. This inversely implies that an employee has no substantial authority on the manner in which the services are to be performed. Once again, the Proclamation has no definition for the phrase substantial authority. This in effect may open a door for potential conflict between the two relationships (i.e., employment and independent contract).

The next logical question is who directs and controls an employee? As can be gathered from the above definition, it is by "another person". For an employee, the employer is obviously this 'another person'. Employer is defined as "a person who engages or remunerates an employee."[45] Thus, it can be both a legal or natural person and it is alternatively-either the one who recruits the employee or the one who makes payments to the employee. However, since the current Proclamation employs the phrase *another person*, the employer is not the only one to direct and control an employee.[46] The expression "another person" broadens the number or identity of persons with the role to direct and control the employee (the term 'employer' may sometimes narrow the scope). Direction and control may be effected by the employer directly or through instruments of the agent in the command chain. The newly enacted Labor Proclamation No. 1156/2019 (here in after the Labor Proclamation) introduces 'private employment agency' and one of the functions of this agency is deploying of employees *under its authority* to the service of a service user enterprise, by entering in to a contract of employment with such employees (emphasis added).[47] Thus, such agencies may also fall under the expression "another person".

Fourth, the definition provides illustrative examples of individuals who are considered as employees. This may be helpful in clarifying some doubts. For instance, it can be used as a base to interpret the definition or to include/exclude some individuals from employment income tax. Besides, the fact the list includes directors, managers and government appointees as

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Code) reads; "A contract of work and labor is a contract whereby *one party, the contractor*, undertakes to produce a given result, under his own responsibility, in consideration of a remuneration that the other party, the client, undertakes to pay him." (Emphasis added).

[45] The Proclamation, Art. 2 (8).

[46] The previous Income Tax Proclamation, Art. 2 (12), used the expression "… under the direction and control of the *employer*" (emphasis added). So, it was only the employer that was considered the one who directs and controls an employee.

[47] Labor Proclamation No. 1156/2019, Federal *Negarit Gazzeta*, 25th year, No. 89, Art. 2 (13) (b).

employees may avoid possible confusions or tendencies not to consider these individuals as employees. One of the reasons for this is that the scope of application of employment laws commonly excludes such individuals in order to strengthen workers associations. For example, the Labor Proclamation has excluded managerial employees; members of the Armed and Police Force; employees of the state administration, judges of courts of law, prosecutors and others whose employment relationship is governed by special laws, from its scope of application.[48]

However, it may be questioned whether some of the individuals in the list fit to the *direction and control* element of employee, in the strict sense of the phrase.[49] For instance, a director (including members of a Board of Directors (BODs) of companies, public enterprises, etc.),[50] government appointees and elected persons holding public offices (such as members of the House of People's Representatives, Ministers and the Prime Minister), the holder of an office in the management of a body (such as the manager of a company).[51] If having "substantial authority" is a defining feature of independent contractors that distinguishes them from employees; are not these individuals retain such substantial authority in their undertaking? The author is not saying that these individuals are not or should not be considered as employees. The concern is regarding the parameters to consider someone as an employee and to exclude the others. By not defining the phrases, "direct and control" and "substantial authority" it seems that the Proclamation leaves specifics to the facts and circumstances of each case. In fact, the Proclamation as a primary legislation may not be expected to define each

[48] *Id*, Art. 3 (2) (c) and (e). Art. 2 (10) of the Labor Proclamation defines Managerial employee as follows;

An employee, who by law, or delegation of the employer, is vested with powers to lay down and execute management policies, and depending on the type of activities of the undertaking, with or without the aforementioned powers an employee who is vested with the power to hire, transfer, suspend, lay off, dismiss or assign employees and includes a legal service head who recommend measures to be taken by the employer regarding such managerial issues, using his independent judgment, in the interest of the employer.

[49] Here, the author refers to direct controlling of the employees, not indirect or stakeholders controlling mechanisms. If we are going to consider stakeholders control (such as through regulators, media or through the system of checks and balances) or any other forms of indirect controls as "direction and control" where it ends since such control is also available even for independent contractors.

[50] The Proclamation, Art. 65 (1) (b) also talks about exemption of allowances paid to board members of public enterprises and public bodies, from employment income tax. This means, they are considered as employee for the purpose of employment income tax.

[51] See the definition of "manager" under Art. 2 (19) (b) of the Tax Administration Proclamation. It includes members of BODs of a company, and general manager of a body.

and every term, though providing basic guidelines would be helpful. However, this role seems totally left to interpreters and those with delegated powers.[52]

In other countries, tax authorities have enacted guidelines. For instance, in Sierra Leone, after the National Revenue Authority found out that quite a number of employers do not deduct the correct tax from the remuneration of their employees because they are treated as independent contractors instead of employees which has led to a huge loss in revenue overtime, it came up with factor tests to create a clear distinction between an employee and an independent contractor.[53] The determination of whether a person is an employee or independent contractor involves looking at a number of factors: basically two. First, whether the hirer has a legal right to control the manner in which the work is to be performed and second, the degree of integration of the service provider within the hirer's business.[54] The Internal Revenue Service (IRS) of the United States of America (USA) also adopts a 20 factor test (with descriptions for each) which the IRS can take in to account to determine whether a person qualifies as an employee or independent contractor.[55] In South Africa, non-executive directors (directors who do not

[52] The Proclamation, under Art. 99, empowers the Council of Ministers to issue Regulations necessary for the proper implementation of the Proclamation and the Ministry of Finance to issue Directives necessary for the proper implementation of the Proclamation and Regulations issued by the Council of Ministers.

[53] Domestic Taxes Business Brief 005 (2016): Distinction between Employee and Independent Contractor, Published 18th April 2016. Available at <https://www.nra.gov.sl/sites/default/files/DTBB005-2016%20%28Difference%20between%20an%20employee%20and%20an%20%20%20%20Independent%20contractor%29.pdf> last accessed, July 3, 2019.

[54] *Ibid*. The second factor will depend on the following: Whether the service provider is engaged on a continuous basis or the relationship is organised around the completion of a one-off piece of work; where the service is performed; whether the hirer controls the timing and scheduling of work; whether the hirer provides the working tools and relevant facilities; and whether wages/salary payment method or various methods of payment, including lump sum per job.

[55] IRS 20 Factor Test: Independent Contractor or Employee? Available at <https://www.oregon.gov/ODA/shared/Documents/Publications/NaturalResources/20FactorTestforIndependentContractors.pdf> last accessed, July 3, 2019. The 20 tests are; level of instruction, amount of training, degree of business integration, extent of personal services, control of assistants, continuity of relationship, flexibility of schedule, demands for full-time work, need for on-site services, sequence of work, requirements for reports, method of payment, payment of business or travel expenses, provision of tools and materials, investment in facilities, realization of profit or loss, work for multiple companies, availability to public, control over discharge and right of termination. A worker does not have to meet all 20 criteria to qualify as an employee or independent contractor, and no single factor is decisive in determining a worker's status. The individual circumstances of each case determine the weight IRS assigns different factors. See also; Kwak Jane P, 'Employees versus Independent Contractors: Why States Should Not Enact Statutes That Target the Construction Industry; Note', *Journal of Legislation*, Vol. 39, Issue. 2, (2013), p. 295.

participate in the day-to-day management of a company and who are independent of management on all issues) are considered as independent contractors rather than an employee.[56] It is submitted that non-executive directors provide their independent input to the management of the company, and in doing so are awarded for the result of their productive capacity, which is indicative of non-executive directors being independent contractors.[57]

Hence, it is better if the Ministry of Revenue or Ministry of Finance enact a directive with clear indicators of direction and control or may issue advance rulings.[58] It should be noted that the distinction made between employee and independent contractor, under labour laws may not be applicable for the purpose of tax laws, since the two regimes serve different purposes. Some argued for the broader understanding of employee under labour laws to the extent of including all workers depending on the sale of their labour or capacity to work.[59] In other words, the simple fact an individual provides a service independently should not be used to exclude the person from the ambit of employee. This argument is made with a view to extend the protections under labour laws to many individuals as much as possible.[60]

The following points should also be noted regarding taxable units of Schedule 'A'. First, individuals meeting all the elements of the definition of employee will not be the taxpayers of Schedule 'A' if they are fully exempted. For instance, Art. 65 (1) (p) of the Proclamation exempted

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[56] Linda van Schalkwyk and Rudienel, 'Non-Executives Directors: Employees or Independent Contractor for Tax Purposes?' Journal *of Economic and Financial Sciences*, 2013, Vo. 6, No. 2, pp. 401-420. [Here in after, Linda and Rudienel, 'Non-Executives Directors: Employees or Independent Contractor for Tax Purposes?'

[57] *Ibid*. Non-executive directors are therefore not making their productive capacity available to the company, as would be the case with employees, and therefore cannot be classified as employees based on the service agreement.

[58] Advance rulings provide taxpayers with the opportunity to obtain a more or less binding statement from the tax authorities concerning the treatment of a transaction or a series of contemplated actions. The rulings could be private which addressed to a specific taxpayer who has requested guidance from the authorities or public where the rulings are intended for the general population of taxpayers whose situations fall within the factual transactions described in the authority's rulings. See Taddese Lencho, 'The Ethiopian Tax System: Excesses and Gaps', *Michigan State Journal of International Law*, Issue 20, No. 2 (2012), pp. 365-369.

One of the new developments made by the recent tax legislations is the inclusion of advance rulings in to the sources of tax law. See the Tax Administration Proclamation, Arts. 68-75; where recognition is made to advance rulings (both private and public) and it is the Ministry of Finance that is empowered to issue the rulings.

[59] Judy Fudge *et al*., 'Employee or Independent Contractor? Charting the Legal Significance of the Distinction in Canada', *Canada Labour and Employment Law Journal*, 2011, pp. 193-230.

[60] *Ibid.*

domestic servants.[61] Domestic servants are not defined under the tax laws. However, the definition provided for personal/private employment service under the Labor Proclamation may be adopted to understand who domestic servants are for the Income Tax Proclamation. Art. 2 (16) of the Labor Proclamation defines employment of private service as "an employment of a non-profit careening, cleaning, guardianship, gardening, driving and other related services for the employer and his family consumption." Art. 54 of the Regulation also excluded unskilled employees[62] and expatriate professionals (if the conditions are fulfilled) from employment income tax.[63]

There are other types of employees explicitly included under the Labor Proclamation, who the Income Tax Proclamation has not made a clear statement about. For instance, apprentice and home workers are considered as employees for the purpose of the Labor Proclamation.[64] Are they taxpayers of Schedule 'A'? Regarding, apprentices as long as they meet the definitional elements of employee (per Art. 2 (7) of the Proclamation); there is no reason to exclude them from being a taxable unit of the Schedule. However, this seems not the case for home workers. Art. 46 (1) of the Labor Proclamation reads that "There shall be a home work contract when a natural person habitually performs work, for an employer, in his home or any other place freely chosen by him in return for wages *without any direct supervision or direction by the employe*r" (emphasis added).[65] From this, it is possible to discern that home workers lack the "direction and control"

[61] Of course, the provision talks about exemption of salaries paid to domestic workers. This may be construed as, benefits other than salaries paid to such workers are taxable. However, since the exclusion of domestic workers is justified by administrative difficulties and social justice, it will not be feasible or appropriate to tax any income of such workers.

[62] As seen above, this refers to an employee who has not received vocational training, does not use machinery or equipment requiring special skill, and who is engaged by an employer for a period aggregating not more than thirty (30) days during a calendar year. Administrative inconvenience/economic reason (not regularly employed by a single employer hence hard for the tax authorities to trace the income of such employees through an employer and also costly to do so) and social reason (mostly such employees are low income earners) are the main possible reasons for the exemption.

[63] The Regulation, Art. 54 (1) (a) reads "employment income of not exceeding five years paid to expatriate professionals recruited for transfer of knowledge by investors engaged in export business in accordance with a directive to be issued by the Minister is income tax exempt."

[64] The Labor Proclamation, Arts. 46-52.

[65] Sub –article two of the same reads; "An agreement for the sale of raw materials or tools by an employer to a home worker and there sale of the product to the employer or any other similar arrangements made between the employer and the home worker shall be deemed a homework contract."

element of employee, hence, are not taxable units of Schedule 'A'. Rather, they are fit to be independent contractors.

Second, the taxpayers of Schedule 'A' can be residents or non-residents. Thus, Ethiopian resident employees are expected to pay employment income tax on their Ethiopian and foreign source employment income, while non-resident employees will be taxable under the Schedule if they received Ethiopian source employment income.[66]

1.2. Tax Bases of Schedule 'A'

If employment income tax is imposed on an employee, the next logical question will be on which income of the employee. Art. 10 (1) of the Proclamation reads "… Employment income tax shall be imposed… on an employee who receives *employment income* …" (emphasis added). Thus, the base for Schedule 'A' is "employment income". The definitional provision of the Proclamation, Art. 2 (9), rather than defining 'employment income', simply cross refers to Art. 12 of the same. The latter provision provides an illustrative list of income categories which are considered as employment income. Accordingly, the following income categories are provided as the tax bases of Schedule 'A'.

The first category constitutes "salary, wages, an allowance, bonus, commission, gratuity, or other remuneration".[67] These terms denote several types of payments to an employee, arising from the employment relationship.[68] These payments can be made "in respect of a past, current, or

[66] The Proclamation, Art. 6 (1) lists Ethiopian source employment income. Accordingly, employment income derived by an employee shall be Ethiopian source income: a) to the extent that it is derived in respect of employment exercised in Ethiopia, wherever paid; or b) if it is paid to the employee by, or on behalf of, the Government of the Federal Democratic Republic of Ethiopia, wherever the employment is exercised. Contrary reading, foreign employment income will be income derived in respect of employment exercised outside Ethiopia and not paid by, or on behalf of the Government of the Federal Democratic Republic of Ethiopia. If the employee has paid foreign income tax on its foreign employment income, he is allowed for a foreign tax credit under Art. 20 of the Regulation.

[67] *Id*, Art. 12 (1) (a).

[68] According to the Black's Law Dictionary "salary" is a fixed periodical (such as monthly, yearly) compensation paid for services rendered where the amount payable for services depending upon the time of employment and not the amount of services rendered; while "wage" (in a limited sense) refers to payment given for labor usually manual or mechanical at short stated intervals as distinguished from salary. See Black's *Law Dictionary*, 8th ed., *s. v.* "salary", "wage". In general understanding salary is considered as periodically payments and wages similar to salary except that it is paid by calculating the number of days the employee has worked. https://www.accountingtools.com/articles/what-is-the-difference-between-salary-and-wages.html> last accessed, June 5, 2019.

future employment". From past employment, for instance, the employee may receive back payment. Advance payments, may also be extended for future employment. The second category constitutes "the value of fringe benefits", which may be given in respect of a past, current, or future employment.[69] These are in kind benefits given to the employee in addition, to regular salaries and wages.[70] The benefits recognized as fringe benefits are listed and regulated in detail under Arts. 7-19 of the Regulation. The third category constitutes "an amount received by an employee on termination of employment".[71] Up on termination of the employment relationship, the employee receives different payments such as severance pay and compensation for unlawful termination.[72] It does not make a difference

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The Amharic version of Art. 12 (1) (a) of the Proclamation uses the term *"ደመወዝ"* as a direct translation of 'salary' and *"ምንዳ"* for 'wage'. The Labor Proclamation, Art. 53 defines wages, as ;

The regular payment to which the worker is entitled in return for the performance of the work that he performs under a contract of employment. And it does not include over-time pay; amount received by way of per-diems, hardship allowances, transport allowance, relocation expenses, and similar allowance payable to the worker on the occasion of travel or change of his residence; bonus; commission; other incentives paid for additional work results; and service charge received from customers.

The Labor Proclamation defines wages, not in the sense of the definition seen above (including under the Income Tax Proclamation). Its definition for "wage" represents the definition of salary seen above (the Amharic version of the provision also uses the term *ደመወዝ* for the English term wage). Thus, it is difficult to understand the distinction of the two (salary and wages) under the laws.

The rest types of payments provided under Art. 12 (1) (a) of the Proclamation (i.e., allowance, bonus, commission, gratuity) are made for some specific causes/reasons such as incentive for good work and to reimburse some of the employment-related expenses of an employee.

[69] The Proclamation, Art. 12 (1) (b).

[70] Graetz Michael J. *et al*., *Federal Income Taxation: Principles and Policies*, 6th ed., Foundation Press, 2009, p. 103. These benefits are taxed, because, they increase the ability to pay of the employee and more, not taxing these violates the principle of horizontal equity.

[71] The Proclamation, Art. 12 (1) (c).

[72] For these payments, see the Labor Proclamation, Arts. 39-45.

Related to the taxability of payments made up on termination of employment, there was a case litigated before the Federal Supreme Court Cassation Division. In that case, the employees (the respondents) were reduced from work by the employer (the applicant) due to their failure to meet service years and age requirements. Up on the reduction, the latter paid them an amount for their new start *(የመልሶ ማቋቋሚያ ክፍያ)* and also withheld employment income tax on this amount. The employees refused the tax withholding saying it is not taxable under the income tax laws. When the matter reached before the cassation bench, it decided that the payment made did not fit the expression, "income from employment" of Art. 10 (1) of the Income Tax Proclamation (the previous one) and also was not explicitly included in the exempted income sources listed under Art. 13 of the same. Therefore, there is no legal ground to tax the payment in question. See *FDRE Ministry of Justice v Tekle Garedew et al*, Federal Supreme Court Cassation Division, 2003 E.C., in *የፌደራል ጠቅላይ ፍርድቤት ሰበር ሰሚ ችሎት ውሳኔዎች፣ ቅጽ 11፣ የኢፌዲሪ ጠቅላይ ፍርድ ቤት፣ አዲስ አበባ፤* 2004፤ *ገጽ* 369-370።

It is not clear whether the term *"የመልሶ ማቋቋሚያ ክፍያ"* refers to severance payment. The Amharic interpretation of severance payment is *"የስራ ስንብት ክፍያ"* not *የመልሶ ማቋቋሚያ ክፍያ*. In any case, the important question here is, whether the matter is different under the current income tax laws. Regarding

whether the payments are made voluntarily or as a result of legal proceedings. The payments can also be made in cash or in kind since, as per Art. 2 (1) of the Proclamation the word 'amount' includes both.

Art. 12 (3) of the Proclamation adds another possible tax base for Schedule 'A'. If an employer pays the employment income tax payable by an employee, in whole or part, the amount of tax paid by the employer will be considered as employment income of the employee. The employee is getting additional income (as salary increment would do) that increases his ability to pay, hence, its taxation is appropriate.

Therefore, the tax base of Schedule 'A' incorporates a wide range of payments, both in cash and in kind. The important thing is the fulfillment of three cumulative conditions. First, the relationship should qualify as an employment relationship. For this, it should fulfill the elements of employee discussed above. It should be noted that for the purpose of Schedule 'A', our reference to decide whether there is an employment relationship or not is the income tax laws, not the labor laws. Second, the payment should be the result of this relationship. The mere fact there is an employment relationship, does not necessarily mean any income the employee has received from his/her employer is employment income. The payment should be made because of the employment relation or the employment services performed by the employee. Third, even if the payment is made as the result of an employment relationship, if it falls under exempt income, it is not considered as employment income.[73]

The characterization of employment income is not defect free. There may be overlaps with income sources derived from other forms of relationships.[74]

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this, the current Proclamation, under Art. 12 (1) (c), resolved such possibilities by explicitly taxing any amount paid as a result of redundancy (reduction from work force).

[73] The Proclamation, Art. 12 (2), states that employment income does not include exempt income. Hence, it needs to be excluded from the tax base. It is out of the scope of this paper to discuss the exempt income sources. The exemptions can be seen under Schedule 'E', specifically Art. 65 (1) (a-d, f, g, h, I, k, n, o, p) of the Proclamation. Moreover, Arts. 8 (4) of the Regulation excluded some in kind benefits from the ambit of fringe benefits hence they are not part of the employment income of the employee. There is floor exemption (the first 600 Birr), under Art. 11 of the Proclamation. The exemption also includes exemptions made under other laws. For instance, Art. 112 of the Labor Proclamation declares that cash benefits given to the worker or his beneficiaries due to employment injury are exempt from income tax.

[74] In fact, overlapping between income tax schedules is one of the disadvantages of a schedular income tax structure. See Lee Burns and Richard Krever, Individual Income Tax, p. 3. Thus, this paper is not saying that the problem is peculiar to Ethiopia. What it intends to do is; to give insights as to the

Specially, this is common in connection with payments made for the performance of specific services, which may be characterized as employment or independent contract services. As discussed above, the absence of clear criteria for the phrases "direction and control" and "substantial authority" is the main cause. It is very important to make a distinction between the two relationships since income from independent contract services is subject to Schedule 'C' not 'A'.[75] Mostly such cases of conflicts, affect employees who provide specific services either to their full-time employer or other employers or clients. This problem practically happened under the previous income tax system, where withholding agents possess substantial authority and discretion over characterization of the income.[76]

There was also a practical confusion between employment income and royalty, regarding payments made for preparation of teaching modules in Universities. The institutions treated the payments differently, mostly based on some arbitrary incidents such as the bargaining powers of the recipients, and willingness of the withholding agents to listen to the arguments and persuasions of the recipients.[77] For the case raised, the author believes that the employment contract can be used as a way out. Accordingly, if teaching material preparation is one of the obligations of the teachers assumed under the employment contract, the income thereof can be considered as employment income. However, if the materials are prepared based on a

possible conflicts, to explore the practice that can fill the gaps and to forward recommendations to avoid (at least) serious overlaps.

[75] The Proclamation, Art. 2 (2) (a), in defining the term "business" it includes professional and vocational activity, but excludes services of an employee. It means the income of an independent contractor is a subject matter of Schedule 'C'.

[76] Taddese Lencho, *The Ethiopian Income Tax System: Policy, Design and Practice*, PhD Thesis, Department of Interdisciplinary Studies, Graduate School of the University of Alabama, 2014, (Unpublished), pp. 297-311. [Here in after, Taddese, *the Ethiopian Income Tax System*]. Despite the law stipulated "direction and control" as a key test of employment relationship, the Authorities, including the then Ethiopian Revenue and Customs Authority (now the Ministry of Revenue), disregarded this requirement and instead provided for easy-to-apply factors like whether a person is a full-time or part-time employee; whether a person possesses a Tax Identification Number (TIN) or not; or whether a person possesses a business license as a professional. However, none of these factors are determinative of whether an individual is an employee or independent contractor. Unless, the enforcement organs come up with clear factor tests, the problem will remain the same under the current income tax system too.

[77] *Id*, pp. 312-314. The tax liability between the two income sources is very different; while high progressive tax is imposed on employment income, a flat 5% tax rate is imposed on royalty. See the Proclamation, Arts. 11 and 54. Thus, the taxpayers may insist for the income to be taxed as royalty (to pay a lesser amount of tax) while the tax authorities may be inclined to consider it as employment income (to derive more revenue).

separate contract (apart from the employment contract) concluded between the institution/employer and the teacher/employee, the payment made can be considered as royalty. In any case, rather than using inconsistent and arbitrary factors, it is better to have a guideline, which constitutes such objective parameters.

Possible overlap may also happen between employment income and dividends, with respect to payments made to members of BODs of a share company. Some companies have provisions for the payment of a percentage of the profits of a company to directors as an incentive and compensation for the latter's services.[78] While some considered this as employment income, others have argued to characterize it as dividends since the payment is made from the profits of the company.[79] As discussed above, directors are considered as employees. Based on this, it may be argued that the benefits given to members of BODs by the company are employment income. However, this conclusion may be contested invoking they do not qualify the direction and control requirement of an employee. The "director" mentioned under Art. 2 (7) of the Proclamation, may be referring to an employee manager (but not a member of BODs), since it is common to call such personnel a director.[80] If so, an incentive and compensation made to them may be considered as dividend, if "in substance" it amounts as a distribution of profits.[81] Above, it is mentioned that for instance in South Africa, directors who do not participate in the day-to-day management of a company are not considered as employees.[82] In effect, the incentives they are provided with by the company will not be considered as employment income. In Ethiopia too, members of BODs are not entrusted to run the day to day activities of the company, where, this task is left to the general manager,

[78] For instance, such possibilities are indicated under Art. 353 of the Commercial Code of the Empire of Ethiopia, 1966, *Negarit Gazzeta*, Extraordinary Issue, Proc. No. 166, 19th year, No. 3. [Here in after, the Commercial Code].

[79] Taddese, *the Ethiopian Income Tax System*, p. 317.

[80] See the Tax Administration Proclamation, Art. 2 (19) (b). This provision considers director of a company as a manager.

[81] The Proclamation, Art. 2 (6) (c) lists transactions which are considered as dividends, to the extent they in substance amount to 'distribution of profits. In fact, even if this way of constructing the provisions may mitigate the possible conflict, the issue remains intact, regarding payments made to members of BODs as incentive or compensation, which *in substance* does not amount to distribution of profits.

[82] Linda and Rudienel, 'Non-Executives Directors: Employees or Independent Contractor for Tax Purposes?' pp. 401-420.

who is considered as employee of the company by the Commercial Code.[83] Yet, the income tax laws consider directors as employees.

Art. 2 (17) of the Proclamation defines management fee as; "an amount as consideration for the rendering of any managerial or administrative service, but *does not include employment income*" (emphasis added). From this definition, we can see that management fee is for managerial or administrative services. However, what constitutes managerial or administrative services? It may be taken as it is referring to services of a manager.[84] As noted above, managers are considered as employees. These may create characterization confusions (at the least), between employee and manager or employment income and management fee which is taxable under Schedule 'D'.[85] The Proclamation has no parameters that can differentiate between employment services and managerial or administrative services (though doing so may be a task for the delegated organs). However, the concerns can be mitigated by understanding that when the manager is an employee manager the payment made to him will be employment income, while, when the individual gives the managerial services through independent contract (not as an employee), it is management fee. Similar concern can also arise between employment income and technical fee, which is defined as; "a fee for technical, professional, or consultancy services, including a fee for the provision of services of technical or other personnel."[86] Thus, technical fee is for technical, professional, or consultancy services. However, the Proclamation, has failed to have an indication of what these services constitute and how they are distinct from employment services. Besides, even though the definition intends to define the term "technical", it includes professional and consultancy services without any qualification as to what kind of professional or consultancy services are technical. This in effect may leads to inclusion of services which are not technical in nature. Once again, this concern may be addressed in that

[83] See the Commercial Code, Arts. 348, 362 and 363.

[84] The Tax Administration Proclamation, Art. 2 (19) reads as follows;

"Manager" means: for a partnership, a partner or general manager of the partnership, or a person acting or purporting to act in that capacity; for a company, the chief executive officer, a director, general manager, or other similar officer of the company, or a person acting or purporting to act in that capacity; and for any other body, the general manager or other similar officer of the body, or a person acting or purporting to act in that capacity.

[85] The Proclamation, Art. 51.

[86] *Id*, Art. 2 (23).

when the services are provided based on a contract of employment concluded between the service provider and the receiver, the payment made there will be employment income and when the services are delivered through other ways like as an independent contract, it is technical fee.

2. Schedule 'B': Income from Rental of Buildings

2.1. Taxable Units of Schedule 'B'

Schedule 'B' is designed to tax income from rental of buildings.[87] Art. 13 (1) of the Proclamation states that "Rental income tax shall be imposed… on *a person* renting out a building or buildings …" (emphasis added). The provision uses the word 'a person', which is inclusive of both natural and legal person.[88] Thus, both an individual and a body (that generate income from renting out a building), is a taxable unit of Schedule 'B'. This person can be the owner or the sub lesser of a building being rented out.[89] In case of sub lease there are two taxpayers for the same building. The owner of the building has to pay tax on the income received from the lessee and at the same time the lessee has to pay tax on the income received from the sub-lessee. The taxpayer can also be a resident or non-resident. If the owner or sub-lesser is a resident of Ethiopia, it is expected to pay income tax on its Ethiopian and foreign source rental income; while, a non-resident will be a taxable unit of the Schedule if it received Ethiopian source rental income. The rental income will be considered as an Ethiopian source income, if it is derived from the lease of buildings located in Ethiopia.[90] Contrary readings, foreign rental income will be income derived from lease of buildings located outside Ethiopia.[91]

However, it does not mean, all persons who derive income from rental of a building are taxable units of Schedule 'B'. There are exceptions. The first exception is casual rental of buildings. According to Art. 13 (3) of the Proclamation, Schedule 'B' is not applicable to rental income subject to tax under Art. 58 (which is found under Schedule 'D'). The latter taxes a person

[87] The Proclamation, Arts. 13 - 17 and the Regulation, Arts. 21 - 26 are dedicated to govern Schedule 'B'.

[88] The Tax Administration Proclamation, Art. 2 (26) defines, 'person' as "an individual, body, government, local government, or international organization."

[89] The Proclamation, Art. 16; recognizes sub-lease.

[90] *Id*, Art. 6 (4) (b) (1).

[91] If a resident taxpayer has paid tax to the other jurisdictions on its foreign rental income; it can claim a tax credit under Art. 25 of the Regulation.

who derives income from the casual rental of assets, including buildings. Previously, due to the absence of an explanation as to what it meant by "casual", the characterization conflict between Schedule 'B' and Schedule 'D' was intense.[92] The current system tries to address this concern. Art. 50 of the Regulation reads; "… income derived from casual rental of asset means gross income derived by a person who is *not engaged in the regular business of rental of movable or immovable asset"* (emphasis added). The contrary reading of this provision (together with Art. 13 (3) of the Proclamation), gives us a message that it is only the rental of buildings made on a regular basis that is subject to Schedule 'B'. Though, the attempt may be found appreciable, it is difficult to say the problem is totally avoided. The expression "not engaged in the regular business of rental" is a kind of circular definition for the term 'casual'. If only regular rental of buildings is subject to Schedule 'B'; how can the enforcement organs determine "regularity" or what is our test of regularity? Is it based on the period of the rent (the length and/or frequency of the rent); or the identity of the lesser (whether the person engaged in the rental activity is a business person or not); or the purpose for which the building is rented out (whether it is rented for commerce, residence, or office)? There is no clear answer in the provisions. Even more, it seems that the two versions of Art. 50 of the Regulation send different meanings. The Amharic version reads *"... በንግድ ስራ ላይ በመደበኛነት ያልተሰማራ ሰው ..."* Here, the important thing seems whether or not the person engaged in the rental activity is a business person. On the other hand, the English version seems interested in the period or frequency of the rental activity. It reads "…a person who is not engaged in the regular business of rental…" So, still there is a potential for overlaps or confusions between Schedule 'B' and Schedule 'D' which may also cause administrative difficulties or inconsistent treatments. It is better if either the Ministry of Revenue or Ministry of Finance develops a guideline, in this regard (taking in to account the factors mentioned above).

Another exception is provided under Art. 22 of the Regulation which reads "Income derived from the lease of a business, *including* goods, equipment, and *buildings* that are part of the normal operation of a business, shall be taxable under Schedule 'C' of the Proclamation" (emphasis added). This

[92] The previous Income Tax Proclamation, Art. 35, was dedicated to tax casual rental of property, including a building.

refers to buildings and other assets which are part of the business and handed over to the lessee (business owner) since they cannot be separated from the business. For instance, persons whose business involves rental of buildings as a matter of course such as hotels and hostels can fall under this exception; hence, they are not tax payers of Schedule 'B'. Such business persons will be taxable units of Schedule 'C' for the whole of their operations, which commonly are catering, rental of rooms, and entertainment. The rental part of their activities is fully integrated into their other businesses, which are taxable under Schedule 'C'. The author believes that doing so is appropriate since in the undertakings mentioned above (e.g., hotels and hostels); rental of rooms (which are buildings) is part and parcel of their business. For instance, it is hard to consider a certain business as a hotel business if it does not provide such services. At this juncture, it is important to make a distinction between the leases of buildings dealt under Art. 22 of the Regulation and lease of business premises (buildings destined for conducting business). For instance, if one operates a hotel business in his own building, it will be subject to tax under Schedule 'C' for the rental income derived from rental of (bed) rooms. However, if the hotel business is being operated in a leased building, the lesser of the premise (a building where the hotel business is being conducted), is a taxpayer of Schedule 'B'; while the owner of the hotel business will pay tax under Schedule 'C' for the rental income derived from rental of (bed) rooms.

There are businesses, which engage in rental of buildings, however, without integrating it with their other businesses. For instance, certain commercial banks engage in activities of building and then rented out what they build. In such case, for the rental part, are the banks taxable units of Schedule 'B' or wholly taxable under Schedule 'C' (like hotels)? The former seems the position of the Proclamation. Here, the rental activity is not integrated to their main business or the rental activity is not part of their normal business operation (which is delivering banking services). Therefore, for the rental part, the banks will be taxable units of Schedule 'B' while for their main business activity (banking services); they are taxable under Schedule 'C'. What about real estate businesses engaging in both sale and rental of buildings? Rental of buildings by real estate businesses seems not to fall under the expression '*part of the normal operation of a business*'. Rental of buildings itself is the normal operation of real estate businesses; hence, it is

inappropriate to take it as an intrinsic element or part and parcel of the sale part. Therefore, they should be separately taxed for the two; for the rental part under Schedule 'B' and for the sale part, it is obvious that Schedule 'B' is not applicable.

There are also businesses, such as pensions and guest houses, which primarily (if not solely) established for delivering services of rental of buildings. Such entities should be fully taxable under Schedule 'B' since they have no other businesses which the rental activity is subsidiary to it (i.e., not fall under the expression "part of the normal operation of business" of Art. 22 of the Regulation). Besides, the rental of buildings is excluded from Schedule 'C' despite the fact that the rental activity is being done regularly and for profit by persons who are conventionally considered as business persons, such as real estate companies (i.e., at least for the purpose of income tax, the activity is not considered as a business).[93]

The above discussion tells us that the mere fact a person engages in rental of buildings, does not necessarily make it a taxable unit of Schedule 'B'. It is only after soliciting the above exceptions that we can identify the tax payers of the Schedule. After going through this process, entities which can be considered as the taxable units of Schedule 'B' are: Real estates' engaged in rental of buildings; real estates' engaged in both rental and sale of buildings, for the rental part; non-real estate business persons engaged in rental of buildings; non-real estate business persons engaged in both rental of buildings and other businesses, for the rental part; and non-business legal[94] and natural persons engaged in rental of buildings (residential houses, apartments, bed rooms and condominiums).

2.2. Tax Bases of Schedule 'B'

Art. 13 (1) of the Proclamation states that, "Rental income tax shall be imposed… on a person *renting out a building or buildings* who has taxable *rental income* for the year" (emphasis added). From this, it is possible to capture that the tax base of Schedule 'B' is "rental income" derived from the lease of a building or buildings. Thus, the rental of equipment, movables,

[93] The Proclamation, Art. 2 (2) (a), while defining "business" it explicitly excludes the rental of buildings.

[94] For instance, it is common to see religious organizations rent out buildings under their ownership. In fact, the rental income they derive from such activities can fall under the exemption made by Art. 65 (1) (m) of the Proclamation.

immovable assets other than buildings, intangible properties, and businesses are not the concern of this Schedule.

Though, the terms "building" and "rent" are important to determine the scope of Schedule 'B', the Proclamation has no definition for the two terms.[95] Yet, it has to be noted that the tax base of the Schedule is not a building, but when it is rented out (i.e., the income derived from the rent). If rental income is the base of the Schedule, it is imperative to identify what it is. Art. 15 of the Proclamation, most importantly sub-article two, lists income categories which are considered as rental income, as follows. First, "all amounts derived by the taxpayer during the year *under the lease agreement*, including any lease premium or similar amount" (emphasis added).[96] This is broad enough to include various types of payments, both cash and in kind. The important thing is whether the payment in question is made as per the lease agreement or not. Second, "all payments made by the lessee during the year on behalf of the lesser according to the lease agreement."[97] For instance, if the lessee has paid a debt of his lesser to the creditor of the latter in exchange of the rent, the amount of the debt paid by the lessee will be considered as rental income for the lesser. But this is only as long as the payment is made according to the lease agreement. Third, "the amount of any bond, security, or similar amount that, during the year, the taxpayer is entitled to retain as a result of damage to the building and that has not been used by the taxpayer in repairing the damage to the building."[98] Here, the payments are made with a view to fix the damage of the building. But, since the amount is not used for that purpose, it is considered as rental income and subject to tax. Fourth, "the value of any renovation or improvement made under the lease agreement to the building when the cost was borne by the lessee in addition to the rent payable to the taxpayer."[99] If the lessee covers these costs in exchange for the rent payments (as set-off), the lesser is not taxed (to the extent of the costs incurred). The value of such

[95] For instance, what structures qualify as a building? Of course, the definition for "building" may not necessarily be provided under tax statutes, but other relevant laws. For instance, The Ethiopian Building Proclamation No. 624/2009, Federal *Negarit Gazeta*, 15th year, No. 31, Art. 2 (2) defined 'building' as "a permanent or temporary construction used for the purpose of dwelling, office, factory or for any other purpose." This definition may be used to understand the term 'building', for the purpose of the Income Tax Proclamation too.

[96] The Proclamation, Art. 15 (2) (a).

[97] *Id*, Art. 15 (2) (b).

[98] *Id*, Art. 15 (2) (c).

[99] *Id*, Art. 15 (2) (d).

renovation or improvement is treated as taxable income to the lesser, if the lessee incurs these costs in addition to paying the rents due. This is because; the lessee saved the lesser from costs it would have incurred for maintenance of the building (it increased the lesser' ability to pay).

Art. 15 (3) of the Proclamation also adds another possible tax base of Schedule 'B', which is, "any amount attributable to the 'lease of the furniture or equipment'". That is, if the taxpayer leases a furnished building (such as a building with household items), and if the lessee is required to pay additional payments for the items. Finally, as stated above, sub-lease is also subjected to Schedule 'B', hence, the rental income received by the sub-lesser is a tax base of the Schedule.[100] In this regard, Art. 16 (2) of the Proclamation noted that if the lessee failed to pay the tax, the owner of the building will be liable for the rental income tax payable by the lessee, as long as the owner allows a lessee to sub-lease the building. Thus, the owner is considered as a guarantor of the lessee (a guarantor by law).

Based on the preceding paragraphs, it is possible to conclude that 'rental income' subject to Schedule 'B' covers a wide range of payments and benefits, derived in cash or in kind,[101] as long as it is related with the lease agreement or the lease of the building. The list under Art. 15 (2) is also not exhaustive, since, the introductory statement of the provision uses the expression "… include the following".[102] However, it is not all those income

[100] *Id*, Art. 16 (1); the rental income of a sub-lesser will be, " … the difference between the total rental income received by the sub-lesser during the year and the total rental income paid to the lesser of the building plus other expenses to the extent necessarily incurred by the sub lesser to generate the income."

[101] *Id*, Art. 15 (2) uses the word "amount" which includes in kind payments, as per Art. 2 (1) of the same.

[102] For instance, in one case, the Federal Supreme Court Cassation Division ordered a payment for 'lost rental income'. In that particular case, after the expiry of the lease period and a court order to evacuate the building and handed it over to the lesser, the lessee failed to comply immediately. It was after 172 days that the lessee finally evacuated the building. While the lesser requested payment of rental income for the 172 days, the lessee refused invoking the former (the lesser) failed to take delivery of the building in due time. However, the real reason was that the lessee was renovating the building, which was one of the obligations imposed on the lessee by the lease contract. When the matter reached before the Cassation Bench, the court ruled that the lessee was expected to meet his duty to renovate, not after the expiry of the lease period, but before. Therefore, the lesser has a right to be paid with the lost rental income for the 172 days. According to the decision of the court, the amount can be calculated based on the agreed amount of rent between the parties (if any); failed this based on the rental rates/tariffs fixed by the municipalities and finally, in the absence of all these, based on the market price of the place where the building is found. See *Universal Metals and Minerals PLC v Besfat Trading PLC*, Federal Supreme Court Cassation Division, 2008 E.C., in *የፌደራል ጠቅላይ ፍርድቤት ሰበር ሰሚ ችሎት ውሳኔዎች፣ ቅጽ* 19፤ *የኢፌዴሪ ጠቅላይ ፍርድ ቤት፣ አዲስ አበባ፣* 2008፤ *ገጽ* 372-377።

sources considered as rental income are the taxable income of Schedule 'B'. As per Art. 15 (1) of the Proclamation, taxable rental income can be known after reduction of the allowed deductions. Thus, we need to identify all the allowed deductions and make the deductions accordingly, before tax is imposed on (gross) rental income.[103] In addition, Art. 15 (4) of the Proclamation states that exempt income is not considered as rental income. Therefore, there is a need to identify the income exempted from taxation under the Schedule and then exclude it from making the tax base of the Schedule.[104]

Above, it has been pointed out that not all persons that derived income from rental of buildings are taxable units of Schedule 'B'. It follows; the income derived by these persons (the exceptions) is not the tax base of the Schedule. Accordingly, income from casual rental of buildings is not part of a tax base of Schedule 'B', but Schedule 'D'.[105] It is only the income derived from buildings rented out on a regular basis subject to Schedule 'B'. However, as discussed in the preceding sub section, there is lack of clarity as to how to determine 'regularity' or what it meant by 'casual/regular'. Income derived from the lease of buildings that are part of the normal operation of a business is also not taxable under Schedule 'B' but Schedule 'C' per Art. 22 of the Regulation. However, the expression "…that are part of the normal operation of a business…" is not clarified. What does it mean by 'normal operation'? The title of Art. 22 of the Regulation is "lease of business assets". So, the expression may be understood as it is referring to business assets. Art. 2 (3) of the Proclamation, defines business asset as, "an asset

So, the tax authorities should also consider such scenarios to impose tax under Schedule 'B' on lost rental income recovered by the lesser (up on agreement or as a result of court proceedings).

[103] It is not the scope of this paper to deal with the deductions. But to say few words, Schedule 'B' has two types of deductions. The first one is, standard deduction, which is an outright deduction of certain types and amounts of expenses listed under the Proclamation and it is applicable for those who do not maintain books of account. This refers to category 'C' taxpayers of Schedule 'B'. The second is, actual deduction, which requires actual proof of the expenses incurred and it is applicable for those who maintain books of account. These are taxpayers of category 'A' and 'B'. For the details, see the Proclamation, Art. 15 (5) – (7) and the Regulation, Arts. 23- 25.

[104] For this, we should consult Schedule 'E' and sort out the applicable exemptions. There is also a floor exemption for individual taxpayers - the first 7, 200 birr under Art. 14 (2) of the Proclamation.

The difference between exemption and deductions is that when the income is exempted, the Proclamation does not considers it as part of the tax base of a schedule (not considered as rental income or employment income or business income) from the very beginning. But, when it is deduction, it means the amount is considered or recognized as part of the tax base of the concerned schedule (it is part of the gross income of the taxpayer).

[105] The Proclamation, Art. 58.

held or used in the conduct of a business wholly or partly to derive business income." Thus, buildings held for business (including business premises), are considered as business assets. If this building has become part of the normal operation of the business (as explained under the preceding sub section), the income derived from lease of such buildings is not subject to Schedule 'B'. Therefore, it necessitates a cautious understanding of the provisions for the sake of avoiding potential overlaps.

The exclusions also include the other exceptions mentioned above. For instance, for types of businesses which engage in rental of buildings as part of their business activities, where the rental activity is fully integrated into their other businesses, the income they derived from the rental activity is not part of the tax base of Schedule 'B'. However, for other types of businesses which engage in the rental of buildings, yet, their rental activity is not fully integrated with their other businesses, the income from the rental part is considered as a tax base for Schedule 'B', while they are subject to Schedule 'C' for the income from their main business. These types of businesses are required to keep their rental activities separately from their Schedule 'C' activities for purposes of tax reporting and filing.[106] The proportion of rental activity vis-à-vis business activity is irrelevant for purposes of income taxation. This leads to the splitting of income as well as expenses of real estate businesses that are involved in both sale and rental of real estate.[107] It goes the same for those non-real estate business enterprises and sole proprietors engaged in rental of buildings along with their main line of business.[108] The system not only obliges taxpayers to split their income but

[106] *Id*, Art. 82. This provision separately dealt with book keeping requirements for taxpayers of Schedule 'C' (from sub article one to sub article three) and taxpayers of Schedule 'B' (under sub article four).

[107] Taddese, *the Ethiopian Income Tax System*, p. 349.

[108] *Ibid*. This may open a door for tax planning. The differences in tax liabilities as a result of the artificial split of income from rental of buildings and income from business activities may lead to real differences in tax liabilities among natural persons, largely because of the progressive income tax rate structure applicable to them. Even if the income brackets and the tax rate structures are similar for individual taxpayers of Schedule 'B' and 'C', the permitted deductions are different under the two Schedules. Schedule 'C' has more extensive deductions than Schedule 'B'. Thus, to get more deductions, taxpayers may shift their income to Schedule 'C' while it is supposed to be taxed under Schedule 'B'. In fact, the requirement to have separate books of account may mitigate this concern. Yet, they still have a chance to evade this duty, especially in our underdeveloped system of tax administration. As a solution, it may be proposed to consider the proportion of rental activity vis-à-vis business activity and tax the whole income under either of the Schedules (i.e., if the rental activity is substantial than the other businesses of the taxpayer, tax the whole amount under Schedule 'B' and if vice versa tax the whole amount under Schedule 'C'). Making the separate book keeping requirements more stringent can also be considered. It has to be also noted that body taxpayers too can avail

also jurisdictions to which payments are to be made. Because, under the current fiscal federalism arrangement of Ethiopia, companies that are engaged in the rental of buildings along with their main line of business are required to file their income tax under Schedule 'B' to the Regional Governments in which the building is located, and their income from their core or other business to the Federal Government.[109] Once again, the proportion of the rental income vis-à-vis their other income (i.e., business income) is not taken into consideration.

2.3. The Relevance of Schedule 'B' as a Separate Schedule

Even if Schedule 'B' on its face, seems to include all income from the lease of buildings (the Schedule is titled as "Income from Rental of Buildings"), this is not the case, because of the number of exclusions discussed above. The exclusions somehow complicated the task of characterizing the taxable units and tax bases of Schedule 'B'. This in fact has been one of the reasons to question the separate treatment of the Schedule.[110] In this regard, some favored to maintain the Schedule for the sake of protecting government revenue generated from the real estate business which is comparatively profitable and relatively passive, compared to Schedule 'C' activities which are more prone to losses.[111] The recognition of loss-carry forward privileges for taxpayers of Schedule 'C' not Schedule 'B', was also used to support the fact that this is the policy of the government. However, this can no more serve as a supportive reason to maintain the Schedule. Currently loss carry forward is allowed to Schedule 'B' tax payers too.[112] Besides, it is wrong to assume that the real estate rental business is not prone to loss. Others

themselves to this tax planning scheme. But, the fact that they are charged with 30% flat tax rate under both Schedules may lessen their motivation to do so.

[109] As per Art. 97 (6) of the FDRE Constitution, Regional governments have a power to levy and collect taxes on income derived from private houses and other properties within the State. "Private houses" include buildings owned by companies. However, Art. 98 of the Constitution, makes the profits of companies a shared [concurrent] power of taxation. The phrase "profits of companies" seems referring to their main business, not their rental activity (which is in fact excluded from being business under the Proclamation - Art. 2 (2)). The tax under Art. 98 of the Constitution is being collected by the Federal Government, hence, the taxpayers shall made their income tax declaration accordingly.

[110] Most of the above exclusions (under the current income tax laws) were also made under the previous income tax system. Hence, the views reflected then can be found relevant for the current system too. Regarding those views, see Taddese, *the Ethiopian Income Tax System*, pp. 362 – 367.

[111] *Ibid*. The real estate business (the rental part) is related with Schedule 'B' because, as seen above, the Proclamation excluded rental of buildings from the domain of business (in effect from Schedule 'C' or business income tax), though the activity could have been considered as business.

[112] The Regulation, Art. 24 (2).

(including Taddese Lencho (PhD), one of the Ethiopian tax law scholars) argued that the separate treatment of rental of buildings is not a product of serious policy deliberation rather, a mere accident of history.[113] Accepting this view would mean, the existing Schedule 'B' is also a simple continuation of this historical incident. However, seeing that each schedule adopts its own rules of tax calculation, deduction, tax accounting, and has its own characterization of taxpayer and tax base, it seems difficult to conclude that the separate treatment of Schedule 'B' is done by accident.

The exclusions made under the Schedule and the possibilities to categorize the remaining income sources of the Schedule to the other income tax schedules may also be raised as a reason to contest the separate treatment of Schedule 'B'. For instance, those real estate businesses engaging in a regular rental of buildings could have subjected to Schedule 'C' (by considering the activity as business). The same may also be considered for non-real estate businesses regularly engaged in rental of buildings (such as pensions and guest houses) and those which besides their main business engage in the rental of buildings. Once the Schedule is emptied of rental of buildings in "commercial settings", what is left is informal rental of buildings and lease of residential building by private individual homeowners. We may not need a separate Schedule just to capture these.[114] For instance, it can be conceived to include these under Art. 58 of the Proclamation, as casual rental of assets. Of course, Art 63 of the Proclamation can also be the other possible way-out. The author believes that the nature of the entity engaging in the rental activity and the frequency/length of the lease may be taken in to account in categorizing the current tax bases of Schedule 'B' to the other Schedules. For instance, if rental of buildings is not the main undertaking of the entity, this can be subjected to Schedule 'D' (Art. 58) and if rental of buildings is the primary business of the entity or engages in the activity on regular basis, this can be subject to Schedule 'C', like any other business.

However, it has to be noted that strike off Schedule 'B' might not be an easy endeavor. To begin with, rental incomes have many characteristics, which differentiated them from business income; hence, it may be difficult to

[113] Taddese, *the Ethiopian Income Tax System*, pp. 365. Since 1949, rental income tax is subject to a separate schedule, despite the difference in its scope from regime to regime. See also; Taddese Lencho, 'Towards Legislative History of Modern Taxes in Ethiopia', *Journal of Ethiopian Law*, 2012, Vol. 25, No. 2, pp. 121-122.

[114] *Id*, p. 543.

merge the two as easily as discussed above. In addition, the fact that the current Proclamation, by explicitly excluded rental of buildings from Schedule 'C',[115] broadened the tax base of Schedule 'B'. The previous Income Tax Proclamation defined business as "any industrial, commercial, professional or vocational activity or any other activity recognized as trade by the Commercial Code of Ethiopia and *carried on by any person for profit* (emphasis added).[116] It means if for instance the rental of the building was done for profit it was considered as a business and subject to Schedule 'C'. However, the current Proclamation, clearly affirmed that rental of buildings are not subject to Schedule 'C', despite the activity being undertaken for profit and for that matter even if it is done by companies (which considered as always commercial).[117] This widening of the scope of Schedule 'B' can be forwarded as a strong reason to support the separate treatment of the Schedule. It may be taken as that the government still believes that the rental of buildings (which includes the real estate business, pensions, guest houses and rental activity by big businesses such as commercial banks) is not prone to business loss as such like other businesses subject to Schedule 'C'. By separately taxing income from rental of buildings, the government deny taxpayers of Schedule 'C' a chance to transfer the losses they suffered under Schedule 'C' business activities (which compared to rental of buildings are considered as more prone to losses) to their rental income. This way, the government is protecting its revenue.

The other main difficulty is that; as stated above, under the current fiscal arrangement of Ethiopia, taxation of rental of buildings falls under both the federal and regional power of taxation.[118] So, there is a need to strike an agreement between the federal government and the regional governments. Either the regional governments should allow the federal government to tax all rentals of buildings or the federal government has to give up part of its power to tax rental of buildings under its jurisdiction. This is not expected to be easy and also needs constitutional amendment.

In general, weighting the difficulties that may happen because of the separate treatment of Schedule 'B' against the complexities involved to

[115] The Proclamation, Art. 2 (2) (a).
[116] The previous Income Tax Proclamation, Art. 2 (6).
[117] The Proclamation, Art. 2 (2) (c).
[118] The FDRE Constitution, Arts.96 (6) and 97 (6).

demise the Schedule (including constitutional amendment which cannot be secured easily), maintaining the Schedule sounds the better thing to do. The broadening of the tax base of the Schedule under the current income tax laws can be taken as the manifestation of the government's policy towards the separate treatment of Schedule 'B' (it is no more a simple continuation of historical incident).

Concluding Remarks

This paper has examined the characterization of taxable units and tax bases under the Income Tax Schedules 'A' and 'B' of Proclamation No. 979/2016. The discussion in this regard shows that the current income tax system has emerged with new developments. Among these; the Proclamation incorporates definitional provisions dedicated to explain the taxable units and tax bases of the schedules. In the absence of these, it has provisions with a clear list of income categories subject to each schedule.

However, it is also found that still there are problems. To begin with, there are potential characterization conflicts and overlaps among the Schedules. Of course, characterization overlaps is common in schedular income tax systems. But, if the overlaps are serious or create administrative difficulties or open a door for tax avoidance schemes, the problem should not be ignored. Consulting the jurisprudence and some international practices, this paper tried to indicate the way out from such problems. To avoid some of the overlaps, re-organization of the taxable units and tax bases of the Schedules could be forwarded as a solution. However, since re-organization is a hectic process which demands the amendment of the income tax regime, solving the problems through other ways may be found preferable. Issuing directives and advance rulings should be considered, in this regard.

There is also clarity problem in some of the provisions. This in turn has a potential to pose enforcement or administrative difficulties. To avoid this from happening, the author, once again, recommends for the Ministry of Revenue and the Ministry of Finance to enact directives or guidelines which supplement or elaborate the concerned provisions. Concerns related to the separate treatment of Schedule 'B' are also raised. For this, the paper tried to indicate the concerns involved so that the relevant organ may come across with the issues and consider appropriate measures.