

Scope of Taxable Employment Income: a case comment on FDRE

Ministry of Justice V. Tekle Garidew *et al* ♥

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Introduction

Employment income is the income that an employee receives from an office or employment.¹ The definition is wide and includes not only regular salary but also other cash payments, such as bonuses and sick-pay, most lump sum payments to employees and value of most benefits received as a result of the employment.² To be taxable as employment income, the income must derive ‘from the employment’.³

The basic definition of employment income includes any compensation related, directly or indirectly, to the employment relationship.⁴ Depending on the drafting style used and for further certainty, it may be appropriate to enumerate specific amounts including the following:⁵

♥ Federal Supreme Court of Ethiopia, Cassation Division, File No. 65330, Decided on 7 July 2011.

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¹ Gilberts, Tax and national insurance contributions (NICs) on income from Employment, p 1 [here in after Gilberts]

² Gilberts, *supra* note 1. Employment income includes normal salary, wages, bonuses, various allowances, and fringe benefits paid for employment. See National Tax Agency, Withholding Tax Guide, p 9. Under the Ethiopian income tax proclamation, income [employment income as one category of income] is defined as: “Income” shall mean every sort of economic benefit including nonrecurring gains in cash or in kind, ... See Income Tax Proclamation No. 286/2002, Negarit Gazeta, Year 8, No. 34, Article 2(10). [hereinafter Income Tax Proclamation No. 286].

³ Gilberts, *Id*

⁴ Lee Burns and Richard Krever, Individual Income Tax in Tax Law Design and Drafting vol. 2; Victor Thuronyi, ed (1998), p 16 [here in after Burns and Krever].

⁵ *Id*

- salary, wages, or other remuneration provided to the employee, including leave pay, overtime payments, bonuses, commissions, and work condition supplements, such as payments for unpleasant or dangerous working conditions;
- fringe benefits;¹
- any allowance provided by the employer for the benefit of an employee or in respect of any member of the employee's family, including a cost of living, subsistence, rent, utilities, education, entertainment, or travel allowance;
- any discharge or reimbursement by an employer of expenditure incurred by an employee other than expenditure incurred in the performance of duties of employment;
- consideration provided by an employer in respect of the employee's agreement to any conditions of employment or to any changes in the conditions of employment;
- any payment provided by an employer in respect of redundancy, any payment for loss of employment or termination of employment, and similar payments;
- any compensation received for a total or partial loss of employment income;
- retirement pensions and pension supplements;
- any consideration paid to secure a negative covenant from a past, present, or future employee; and
- gifts provided by an employer to a past, present, or prospective employee in the course of or by virtue of employment.

Almost all countries collect the income tax payable on employment income PAYE (Pay-As-You-Earn) on a current basis by withholding at source by the employer.² Under the withholding tax system³, (1) a payer of certain types of income, such as salary, interest, dividends and tax accountants' fees, (2) calculates the amount of income tax payable pursuant to

¹ *Id.*, at 21. A "fringe benefit" is any monetary or nonmonetary benefit derived from employment that does not constitute cash salary or wages. Common examples of fringe benefits are employer provided housing, the use of an employer-provided car for personal purposes, and the provision of discounted goods to employees.

² Lee Burns and Richard Krever, *Individual Income Tax in Tax Law Design and Drafting* vol. 2; Victor Thuronyi, ed (1998), p 61 [here in after Burns and Krever]. PAYE is a system for collecting tax on employment income throughout the tax year, by requiring employers to deduct tax under PAYE every time an employee is paid. See Gilberts, at 2

³ National Tax Agency, *Withholding Tax Guide*, p 3

prescribed methods at the time the income is paid, and (3) withholds the amount of income tax from the income payment and pays it to the government.

When we come to Ethiopia, what constitutes employment income is stipulated as: “Employment income shall include any payments or gains in cash or in kind received from employment by an individual, including income from former employment or otherwise or from prospective employment.”⁴ This shows that any income gained based on employment relationship is considered as employment income. Thus, as per article 10(1) of the Income Tax Proclamation, every person deriving income from employment is liable to pay tax on that income at the rate specified in Schedule A, as set out under Art 11. There are also incomes derived from employment relationship but which are exempted under various income tax laws. Art 13 of the Income Tax Proclamation provides exemptions for some income categories derived from employment.⁵ The Income Tax Regulation, too, stipulates incomes that are

⁴ Income Tax Proclamation No. 286, Article 12(1), *supra* note 2

⁵ The following categories of income shall be exempt from payment of income tax hereunder:

- (a) income from employment received by casual employees who are not regularly employed provided that they do not work for more than one (1) month for the same employer in any twelve (12) months period;
- (b) pension contribution, provident fund and all forms of retirement benefits contributed by employers in an amount that does not exceed 15% (fifteen percent) of the monthly salary of the employee;
- (c) subject to reciprocity, income from employment, received for services rendered in the exercise of their duties by:
 - (i) diplomatic and consular representatives, and
 - (ii) other persons employed in any Embassy, Legation, Consulate or Mission of a foreign state performing state affairs, who are national of that state and bearers of diplomatic passports or who are in accordance with international usage or custom normally and usually exempted from the payment of income tax.
- (d) income specifically exempted from income tax by:
 - (i) any law in Ethiopia, unless specifically amended or deleted by this Proclamation;

exempted from tax.⁶ In addition, the Ethiopian Revenue and Customs Authority Directive made exemptions on income derived from employment.⁷ Here we have exhaustive stipulation of employment incomes exempted from tax. Hence any income not mentioned under these various laws is taxable employment income.

Despite such legal frameworks as to taxable and exempted employment income, there are dispute relating to such issues. One such instance relates to resettlement fund or payment for loss of employment. A dispute appeared between the Federal Democratic Republic of Ethiopia Ministry of Justice (the applicant), on the one hand, and Tekele Garidew *et al* (respondents), on the other. The case was first entertained by the Administrative Tribunal of the

(ii) international treaty; or

(iii) an agreement made or approved by the Minister.

(e) the Council of Ministers may by regulations exempt any income recognized as such by this Proclamation for economic, administrative or social reasons.

(f) payments made to a person as compensation or a gratitude in relation to:

(i) personal injuries suffered by that person;

(ii) the death of another person.

⁶ The following categories of payments in cash or benefits in kind shall be excluded from computation of income taxable under Schedule "A":

(a) amounts paid by employers to cover the actual cost of medical treatment of employees;

(b) allowances in lieu of means of transportation granted to employees under contract of employment;

(c) hardship allowance;

(d) amounts paid to employees in reimbursement of traveling expenses incurred on duty;

(e) amounts of travelling expense paid to employees recruited from elsewhere than the place of employment on joining and completion of employment or in case of foreigners traveling expenses from or to their country, provided that such payments are made pursuant to specific provisions of the contract;

(f) allowances paid to members and secretaries of boards of public enterprises and public bodies as well as to members and secretaries of study groups set up by the Federal or Regional Government;

(g) income of persons employed for domestic duties. Council of Ministers Income Tax Regulation No. 78/2002 Negarit Gazeta, Year 8, No. 37, art 3

⁷ Ethiopian Revenue and Customs Authority income tax exemption Directive No. 21/2009, art 4

Federal Civil Service Agency⁸ and later on it reached to the Federal Supreme Court on appeal.⁹ Both the Tribunal and the Appellate Court decided that resettlement fund or payment for loss of employment is not taxable income. As a result, the case was finally taken to the Cassation Division of the Federal Supreme Court of Ethiopia which affirmed the decisions of the Tribunal and the Appellate Court. As we will be shown below, the decision of this Cassation Division is contrary to the income tax laws and its own analysis appearing in its judgment.

The Cassation Division based its judgment on Arts 2 (10), 10 (1) and 13 of the Income Tax Proclamation. While Art 2 (10) deals with definition of income, Art 10 (1) provides about taxable employment income. Art 13, on the other hand, is concerned with employment incomes that are exempted from tax. Resettlement fund or payment for loss of employment is not among those exempted.¹⁰ But the Cassation Division maintained that resettlement fund or payment for loss of employment is un-taxable and this holding appears to contradict the Division's analysis in the same case. Is the Cassation Division's ruling that resettlement fund or payment for loss of employment is un-taxable valid? What makes this Division to arrive at such a conclusion contrary to its analysis?

⁸ Federal civil service agency administrative tribunal, File No. 00944/2002 cited in Cassation Decisions of the Federal Supreme Court, File No. 65330, Vol.11, pp.369-370.

⁹ Federal Supreme Court, File No. 55990 cited in Cassation Decisions of the Federal Supreme Court, File No. 65330, Vol.11, pp.369-370.

¹⁰ Even Art 88(4) of the Federal Civil Servants' Proclamation No. 515/2007 stipulates the type of severance pay exempted from taxation. That is ... where the service of a civil servant is terminated due to death an amount equivalent to his three month's salary shall be paid to his ... which is exempted from taxation. See Federal Civil Servants' Proclamation No.515/2007, *Negarit Gazeta*, Year 13, No.15. This seems to be consistent with what is provided under Art 13(f) (ii) of the Income Tax Proclamation. But the issue under discussion is not among those stipulated either in the income tax laws or the Federal civil servants' proclamation.

This case comment set out to examine and analyze the issues in this case and to critique the position of the Cassation Division. Finally, it suggests solution that would help determine similar issues in the future. The case comment is organized as follows. Section 1 is devoted to the summary and presentation of the facts of the case and the holding of the Administrative Tribunal of the Federal Civil Service Agency and the appellate bench of the Federal Supreme Court. Section 2 deals with the judgment of the Cassation Division of the Federal Supreme Court. The final Section goes to critique the decision of the Cassation Division.

1. Facts of the Case and Holdings of the Administrative Tribunal and the Appellate Court

Tekele Gardew *et al* were employees of the Ministry of Justice of the Federal Democratic Republic of Ethiopia. The Ministry of Justice retrenched employees it thought would not qualify service and meet age requirements. Those retrenched employees were paid to resettlement fund (payment for loss of employment). The Ministry deducted income tax from the payment it made to its retrenched employees as a withholding agent of Income Tax authority.¹¹

Aggrieved by the act of the Ministry, these retrenched employees instituted suit before the Administrative Tribunal of the Federal Civil Service Agency against the Ministry.¹² The Administrative Tribunal decided that *resettlement fund* or payment for loss of employment is not subject to income tax.¹³ Being dissatisfied with this decision, the Ministry appealed against and

¹¹ An employer shall withhold tax from every "payment to an employee, unless the payment is expressly made tax-exempt by this Proclamation. Income tax proclamation, art 51(1)

¹² The Administrative Tribunal has the power to hear and decide on appeal grievances brought by civil servants relating to an illegal attachment or deduction of salary or other payments. See Art 75(3) of the Federal Civil Servants' Proclamation No. 515/2007.

¹³ *Supra* note 13

lodged its appeal before the Appellate Bench of the Federal Supreme Court. However, this appellate Court has confirmed the decision of the administrative tribunal.¹⁴

Ministry of Justice thus proceeded to the Cassation Division of the Federal Supreme Court and filed its application alleging fundamental error of law committed by the Administrative Tribunal and the Appellate Bench of the Supreme Court.

2. The Judgment of the Cassation Division of the Federal Supreme Court

The Screening Bench of the Cassation Division of the Federal Supreme Court went through the application of the Ministry and then maintained that the matter deserves reviewing by the Cassation Division. Thus respondents were ordered to present their responses on the petition of the Ministry.¹⁵

The Division framed an issue which reads: is resettlement fund or payment for loss of employment taxable or not? Then it went on to give some analysis and finally decided in favor of the respondents affirming the decisions of the Tribunal and the Appellate Court. It held that resettlement fund or payment for loss of employment is not taxable income. The Cassation Division reasoned that employment income is taxable by virtue of Arts 2 (10)

¹⁴ *Supra* note 14

¹⁵ But nothing is recorded regarding the previous history of the case, memorandum of appeal the applicant asserted and the respondent replied. In addition, the decision of the Cassation Division of the Federal Supreme Court revealed no record regarding arguments advanced by both parties during oral litigation that reflect their positions regarding the law.

and 2 (11).¹⁶ It maintained that there is no error of law committed by the Administrative Tribunal and the Appellate Court.

3. Critique

Now let's see whether the Cassation Division has properly investigated the case and appreciated the legal regime governing employment incomes that are taxable and those that are not taxable (exempted).

As highlighted above, an employee may be entitled to various kinds of payments. Various types of payments are considered as employment income if they are earned on the basis of employment relationship. As a matter of rule, all employment incomes are taxable unless exempted by law. Under the Income Tax Proclamation, income is defined as referring to “every sort of economic benefit including nonrecurring gains in cash or in kind, from whatever source derived and in whatever form paid credited or received.”¹⁷ The Proclamation further stipulates that employment income shall include “any payments or gains in cash or in kind received from employment by an individual, including income from former employment or otherwise or from prospective employment.”¹⁸ This clearly indicates that if a person gains something from employment it is subject to tax. Nevertheless the same Proclamation and other subsequent income tax laws (Income Tax Regulation and Income Tax Exemption Directive) provide exemptions for some employment incomes.¹⁹

¹⁶ Wrongly it is written as art 1(11) but the concept provided there pertains to Art 2(11)) of the income tax proclamation.

¹⁷ See Art 2 (10) of Income Tax Proclamation No.286/2002, *Federal Negarit Gazeta*, 8th Year, No. 34.

¹⁸ Art 12(1).

¹⁹ For detail information see Art 13 of the Proclamation and those other provisions under footnotes 10- 12 above. According to Art 13 of the Proclamation the following categories of income shall be exempt from payment of income tax hereunder:

When we come to the case under consideration, it is clear that respondents have got resettlement fund or payment for loss of employment. Here the question is whether this income is subject to tax or not. The Ministry argued that it is subject to tax while respondents claimed that it is not. The Cassation Division analyzed the law and the case and finally ruled as follows:

.... በቀረበው አቤቱታ መነሻነት ጉዳዩ ለሰበር ይቀርባል የተባለው ይህንኑ ነጥብ ለማግራት ስለገቢ ግብር የሚደነግገውን የገቢ ግብር አዋጅ ቁጥር 286/94 መመልከቱ ተገቢ ነው። በአዋጁ አንቀጽ 10 (1) ስር በግልፅ እንደተመለከተው ማንኛውም ሰው በመቀጠር ምክንያት በሚያገኘው ማናቸውም ገቢ ላይ የገቢ ግብር ይከፍላል በማለት ተቀምጧል። ከግብር ክፍያ ነጻ የሆኑትን አስመልክቶ በአዋጁ አንቀጽ 13 ላይ በዝርዝር ሲገልጽ አሁን የሰበር አቤቱታ የቀረበበትን ጉዳይ አይነት በግልፅ ከስራ ግብር ነፃ ስለመሆኑ አይጠቅስም። ይህ አንቀጽ ከግብር ክፍያ ነፃ የሆኑትን ከዘረዘራቸው ውስጥ ማናቸውንም አይነት የጡረታ ጥቅም፤ ወይም በተቀባዩ ሰው ላይ በደረሰ የአካል ጉዳት ካሳ ወይም በሌላ ሰው ላይ በደረሰ የሞት አደጋ የሚሰጥ የካሳ ክፍያ የሚሉት ይገኙበታል። የካሳ ክፍያ ሲባል በሕጉ ላይ በግልፅ እንደተመለከተው በደረሰ የአካል ጉዳት ወይም በደረሰ የሞት አደጋ የሚሰጥ የካሳ ክፍያ የሚመለከት እንጂ ማናቸውንም የካሳ ክፍያ ሁሉ ከግብር

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- (a) income from employment received by casual employees who are not regularly employed provided that they do not work for more than one (1) month for the same employer in any twelve (12) months period;
- (b) pension contribution, provident fund and all forms of retirement benefits contributed by employers in an amount that does not exceed 15% (fifteen percent) of the monthly salary of the employee;
- (c) subject to reciprocity, income from employment, received for services rendered in the exercise of their duties by:
- (i) diplomatic and consular representatives, and
 - (ii) other persons employed in any Embassy, Legation, Consulate or Mission of a foreign state performing state affairs, who are national of that state and bearers of diplomatic passports or who are in accordance with international usage or custom normally and usually exempted from the payment of income tax.
- (d) income specifically exempted from income tax by:
- (i) any law in Ethiopia, unless specifically amended or deleted by this Proclamation;
 - (ii) international treaty; or
 - (iii) an agreement made or approved by the Minister.
- (e) The Council of Ministers may by regulations exempt any income recognized as such by this Proclamation for economic, administrative or social reasons.
- (f) payments made to a person as compensation or a gratitude in relation to:
- (i) personal injuries suffered by that person;
 - (ii) the death of another person.

ነጻ መሆኑን የሚጠቅስ አይደለም፡፡ በመሆኑም ለተጠሪዎች ይከፈል የተባለው የመቋቋሚያ ክፍያ ግብር የሚከፈልበት ገቢ ነው ለማለት የሚያስችል የሕግ መሰረት አላገኘንም፡፡ በዚህም መሰረት በጉዳዩ ላይ በተሰጠው ውሳኔ መሰረታዊ የሆነ የሕግ ስህተት ተፈፅሟል ለማለት ስላልተቻለ የተሰጠው ውሳኔ በፍ/ብ/ሥ/ሥ/ሕ/ቁ. 348(1) መሰረት ፀንቷል፡፡

When translated into English this reads as:

In order to determine whether the disputed income is taxable or not, emphasis should be given to the Income Tax Proclamation. The Proclamation starts with stipulating about taxable employment income under Art 10(1). It then provides exempted incomes under Art 13. The income now in dispute is not clearly indicated under this provision. The provision exempted pension and compensation as provided by law for injury and death of another person. It does not exempt all types of compensation. There is no legal ground to maintain that resettlement fund or payment for loss of employment payable to respondents is taxable. There is no error of law in the judgment.²⁰

Here it is clear that the analysis and final conclusion of the Cassation Division are inconsistent. In its analysis, the Division maintained that the income in dispute is not within the list of exempted incomes. It appears that it held the income is subject to tax. This analysis is correct and reflects what is provided in the Proclamation. But the Division's conclusion deviates from this analysis and from what the Proclamation stipulates. According to the Proclamation all employment incomes are taxable except those that are exempted specifically. It is clear that the Cassation Division arrived at a wrong conclusion. This shows how the Cassation Division failed to take due care while writing its judgment. In effect it appears that it enacted a new law that grants exemption from tax.

²⁰ Author's own Translation.

It is also regrettable to see that the Appellate Bench and the Cassation Division of the Federal Supreme Court took unnecessary time to revise the decision of the Administrative tribunal but later on to confirm that same decision. Such a practice does not add any value and should be discouraged. Litigating parties should not be exposed for wastage of their time, money and energy without any good justifications.