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**DISSERTATION TITTLE: Revisiting Ethiopian Income Tax law
on Tax Evasion and Avoidance: Special emphasis on Share
Companies**

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Revisiting Ethiopian income taxation law of companies:

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DECLARATION

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

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Preface

The one that should have to be in the problem is the one that is included in the spectrum of being good to those around him that the person goes in the way that will ultimately contribute to the on that enhance to the best of the person that will entitled to those that are in the way that enhance in the way to those that are included in the way that should have to be in the way that are included by the way of including those that are included in the way that should have to be in the way that are include in the way that are include in the way the most important person in that are the most important person that should have to be include in the way that are included in the way that are important for the likelihood of the country in the way that are in the way that are included in the way that should have to be in the way that should have to be in the way that will include in the way that has importance towards the achievement of the country with help of the country that can include in the way that are include in the way for greater enforcement of the people in the way that can include in the way that can be in the way that could have included in the way that has greater for the best of the best in the way that has been in the way that can include in the way that are included in the way that can used to the best of the best.

The Researcher, ASSOCIATE PROFESSOR DR. Mustefa Ali MOHAMMED.

Abbreviations

FDRE **Federal Democratic Republic of Ethiopia**

Art **article**

Arts **articles**

Bus. **Business**

CIV.C **Civil Code**

COM.C **Commercial Code**

Corp. **Corporation**

SC **share company**

Proc. **Proclamation**

CEO **Chief executive officer**

Abstract

Tax evasion and avoidance is a problem of any system of tax administration. Unless different devices of controlling this problem put in place it would have the effect of undermining various interests, being generating enough revenue by the government taking prominence. Ethiopia taxation system, as any other taxation system, suffers from the problem of tax evasion and avoidance that it calls for a certain means of controlling this practice of tax evasion and avoidance by taxpayers.

The first device of controlling the tax evasion practices of taxpayer is through disclosure requirement. This disclosure requirement has two purposes. These are divulging or publicizing the tax evasion act of taxpayer, along with audit report, to public at large and putting into light the business transaction the businesses come to engaged in. In light of that the Ethiopian income tax requires the publication of the tax evasion act of taxpayer, but not requires the publication of audit report.

Further the formality requirement as provided in the general contract law, which meant to achieve the aim of putting the business transaction into light, is not the one which fully achieves the aim of leaving behind adequate level of audit trial as the formality requirement is limited to immovable and special movables. The civil liability provided under the income tax proclamation, the other device of controlling tax evasion practices of taxpayer, is not the one that creates high risk to taxpayer on the event of being found in the act of evading tax. Thus the taxpayer disposition to tax evasion is higher.

Further the civil liability is not in line with deterrence and compensatory elements of effective and efficient system of tax administration. As far as the criminal liability is concerned, the income tax proclamation fails to extend some special power, like entering business premise without search warrant, as some jurisdiction did, to public prosecutor that would have make easy to fulfill their burden of proving beyond reasonable doubt.

The rule on deduction of loan from bank as expense and prohibition of such deduction to the dividend used to increase the capital of the company seem to encourage tax avoidance practices by the taxpayers. As a part of controlling the tax evasion practices of taxpayer, flat rate of taxing the income of share companies and the condition around appeal right of taxpayer are fall short of fairness and equity principles which underlie any system of tax administration. Thus they could be one reason for widespread practices of tax evasion by taxpayer as overwhelming empirical research found out.

CHAPTER ONE

1. Introduction

The Ethiopian tax system has not been blessed with excellent organization of many modern laws of Ethiopia.¹ Such scenario, obviously, make it harder to levy and collect enough revenues towards development Ethiopia aiming to attain years ago.

Within these broader spectrum that taxation of companies are exercised. Added to the unique complexity involved in the taxation of companies relative to that of taxing individual traders, it will not be an easy task for the authorities to collect tax from the companies in Ethiopia and foreign companies having their income source in Ethiopia. This is, actually, why Ethiopian tax system subjected for series of amendment to the tax legislation, especially the income tax legislation.

Tax administrations face a formidable number of challenges in every country. In many developing countries tax administration reform are needed simply to achieve macro-economic stability.² Ethiopia is not exception to the challenge faced by other developing countries that there are multifarious challenges persist to exist in the enforcement endeavor of the tax authority.³

Business organizations, especially companies, are much difficult for taxation purpose. This seems actually stem out of the varieties of the tax to be imposed and the complexity and the frequency of the business transactions, which in turn has taxation implication, to be entered by the concerned business organization. The professional personnel involved in the business organization can also matter. Since, they are the one who well aware of the gaps and

¹ See Neil Brooks, Tax Conference, Key Issues in Income Tax: Challenges of Tax Administration and Compliance, Asian Development Bank, Saturday, 8 September 2001, at 6.

³ On the top of that, Ethiopia is experiencing proliferation of business organization throughout the country, which will in turn have the effect of heightening the challenges Ethiopia faced in the enforcement of stage of tax legislations as this have the effect of increasing the type of tax to be paid and the number of the tax payer who expected to pay certain sum of money as payment of tax due.

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inefficiencies in the tax legislations that they could readily manipulate such weakness to their advantage and other stake holder in the business organization.

These circumstances make this business organization fertile place for tax evasion and avoidance. Unless different mechanisms put in place to minimize, if not to avoid all in all, it will end up in exerting greater pressure on the capacity of the country to generate enough revenues and spend it to different economic growth path the country involving into.

But blind move towards the tackling of tax evasion and avoidance strategy of companies can potentially end up in distorting the business environment these business organizations operate in. So that, any move towards tax evasion strategy of companies needs to be maintain the balance between tackling the problem of tax evasion and avoidance and remain neutral on the business decision to be made by the concerned firms.

1.1 Background

As Ethiopian history of taxation of companies reveals, the inception of which rooted in the decree No.19/1956, corporate bodies were taxed separately. Accordingly, corporate bodies are subjected to 15% of their taxable income while the unincorporated one subjected to separate tax rate. The subsequently enacted laws also follow the same trend of taxing these corporate bodies, but with increasing rate of their taxable income. Proclamation No.173/1961 provides tax rate of 16% of their taxable income.

While proclamation No.255/1967 provides tax rate of 20% of the taxable income of the corporate bodies. Further, proclamation No.155/78 provides the most exaggerated income tax rate of taxing corporate bodies. It fixes 50% of the corporate body's taxable income to be collected as income tax. The current income tax proclamation No.286/2002 provides tax rate of 30% of taxing the taxable income of the corporations.

The commercial code of Ethiopia which provides the country with modern law to guide and regulate the then emerging market in efficient and organized manner as compared to the scattered and traditional way of guiding and regulating the business that was operating across the

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country. Every market is not self-sufficient to run by itself, at least with regard to matters which can intervene in the normal economic decision of different participant in certain market.

Indeed that does not mean that the laws to be enacted can intervene into the normal economic decision of individuals which guided by the invisible hand of the demand and supply, rather it will regulate actions which can intervene into free economic decision of individuals in certain market. Which the market itself has no mechanism of preventing such possibility of manipulation of the market by the different actors.

Having such in mind, the commercial code of Ethiopia, hereby the code, laid down rules to regulate the different aspects of businesses in the country. Accordingly, the code recognizes two ways of doing business. The first is through individual business venture. In such a case, individual trader will be the proper subject which purports to be regulated that the complexity is minimal. The second one is through formation of business organization. As the interest of the market growing, new way of doing business becomes necessary to satisfy the interests growing. So that the interest of the market will only be satisfied easily and effectively if the new legally developed entity succeed to generate enough capital for the business venture they intend to embark on. And which will ultimately let these entities to make goods available to ultimate consumers, which they cannot make it happen by the traditional way of doing business via individual trader.

The code recognizes six form of business organization, namely, ordinary partnership, joint venture, general partnership, limited partnership, private limited company and Share Company. In light of the research purpose, the writer will only limited to discussion of the last form of business organization. The code considers Share Company always as commercial business organization regardless of their purpose and to be formed in writing.⁴ The formation should also be publicized and so that third parties will take cognizant of the coming into being of this entity which will, in turn, bestow the firm with legal personality which let this legal entity to get engaged with third parties in different business transaction in different capacity and level.⁵

⁴ See art.10 (2) and 214 of the 1960 COMMERCIALCODEOFETHIOPIA.

⁵ See Id, art.223.

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As was the case in the other developing countries tax administration, Ethiopian tax administration facing real challenge in its effort to levy and collect tax due by these companies and their respective shareholders. Apart from engaging into reforming of the tax legislation here and then, the tax administration did not try to develop new way of looking into the challenge it is facing.

The behaviors of corporations are highly influenced by the institution and the legislation in force. The laws need to be seen together and concerted effort need to be made towards the minimization of tax evasion practices of this corporation. Together with the move of Ethiopia to join WTO, the scenario will get worse. It is inevitable that multinational corporation flow down to Ethiopia by using the fertile environment to be established in the Ethiopia market on the realization of joining WTO.

As these multinational corporations brought with them unique way of income tax evasion and avoiding that the challenge faced by the administration can possibly increase in exceptional pattern. Which means the authority would find it difficult and complex to identify tax evasion and avoidance strategy of these corporations which, in turn, intensify the income tax evasion and avoidance of practice of these corporations.

1.2 Statement of the problem

Administration of tax is one of the painstaking and challenging tasks. This is because in the course of administering the tax legislations there are competing interests that calls for equal recognition. Thus the success in the administration of tax lies on the way these interests reconciled. Otherwise there are drawbacks, like tax evasion and avoidance, to happen for failure to come up with tax administrations that cater equally and appropriately for the interests of stakeholders in tax administration. Tackling tax evasion and avoidance is vital, if the government is to support honest taxpayer and uphold rule of law.⁶

In the meanwhile there are two important interests, among others, in tax administration which are the interest of the public at large, represented by the government, and the interest of the taxpayers. The interest of the government is to generate maximum revenue by strict enforcement

⁶ Mark Serwota, General secretary, pcs-the public and commercial services union, London, September 2014, at 3.

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of the tax legislations. While the taxpayer wants the tax legislations and their administration to uphold basic principles of taxation that limit the power of the government in the course of collecting the tax due and protecting the right of taxpayers in equal pattern.

The interest of government compromised by the tax evasion and avoidance practices of taxpayers. While the interests of the taxpayers compromised by the move of the government to tackle tax evasion and avoidance, different rules in the tax legislation, like flat rate of taxing share company, and different legal loopholes and lacunae which open opportunity to tax evader or avoider which in turn put pressure on the honest taxpayers.

So we need to develop certain device whereby the interest of government and taxpayer remain intact. Or mechanism of creating fair play for the government and taxpayers in the course of administering tax legislations. The first device or mechanism is the disclosure requirement on the share companies whereby the information about non-compliance of taxpayer will be divulged to the general public and the transparency in the day to day activity of business would insure. Thus various opportunities for audit trail will created.

The second is measure to be taken on the event of tax evasion and avoidance by the share companies. As far as civil liability is concerned, the measure to be taken should be compensatory, deterrent, simple, integrity, fair and continuous. The criminal liability should also insure the purpose of deterring future violations and punishing the evader. The third one is removing out rules that encourage tax avoidance either directly or indirectly. Otherwise the share companies can readily manipulate it to their advantage against the government. These three devices help to protect the interest of the tax authority.

The other is a mechanism or devices to protect the interest of the taxpayers either generally or as part of them. This device is to make rules that arbitrary inflict damage to taxpayer to be moderate or removing them all in all. These rules can be a source of tax evasion and avoidance as some empirical evidences suggests.

Coming to Ethiopia context, these all things are quite obscure. There is a need to shade light on the context of the above discussion which is all about of creating fair play in the administration system of Ethiopia. Starting from the disclosure requirement, it seems that there is limited

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recognition of this disclosure requirement in terms of form and content as far as the income tax proclamation is concerned.

Secondly, it seem that Ethiopian income tax proclamation provide for civil liability, but it is not in line with the two criteria, i.e. compensatory and deterrent , of effective and efficient system of civil penalty. It also not the one that constitute a risk to taxpayers. Thus it calls for in depth evaluation of the income tax proclamation. As far as tax avoidance is concerned, there are rules which seem to encourage tax avoidance practices of share companies, let alone designing the law to fight against it. The last, but not the least, is that there are rules which seem to inflict unnecessary pressure on the part or general taxpayer which in turn escalate tax evasion practices of taxpayers. These are flat rate of taxing the income of the share companies and the appeal right of the taxpayers. In line with that the followings are the research question to be answered in this research,

- What is the role of the disclosure obligation of companies in the fight against tax evasion and avoidance?
- Are the civil penalties provided by the income tax proclamation the one that constitute risk to taxpayer and in line with deterrent and compensatory element of effective and efficient of optimal civil penalty system?
- What are the implications of the rules on income taxation on deduction of loan from banks and dividend used to increase the capital of the share company?
- How fair is the circumstances around the condition for exercising of appeal right of taxpayers and flat rate of taxing the income of share companies?

1.3 Scope of the study

The study is limited in analyzing income taxation of share company's laws. Which means the taxation of the other five kinds of business organizations, including private limited company falls out of the realm of this research. For that matter, income tax proclamations, including their respective regulations and directives are the proper focus of this research. So every tax proclamations will not be the subject of the research. Concerns with regard to transfer of price

and other matters in corporate income taxation which capable of being one research theme are intentionally left untouched.

1.4 Objective of the study

The research generally intends to evaluate the mechanism of controlling the tax avoidance and evasion practices of taxpayers. Accordingly the different rules in the income tax proclamation will be evaluated based on their significance in the fight against tax evasion and avoidance practices of taxpayers. Based on that the followings are the general objectives:

- ❖ To evaluate the role of disclosure requirement in the fight against income tax evasion practice of share companies.
- ❖ To evaluate aggressive income tax rules effect on the enforcement of tax laws as it may become a fuel for tax evasion activity by companies.
- ❖ To evaluate that the civil penalties provided by the income tax proclamation in light of effective and efficient system of optimal civil penalty.
- ❖ To evaluate the role of rules on deduction loan from banks and non-deduction of dividend used to increase the capital of the share companies on the tax avoidance activity of the same.

1.5 Research Methodology

Both primary and secondary data will be used for the furtherance of the purpose of the research at hand. The primary data includes the income tax proclamations, regulations and directives which have relevance to undertake the study. These laws will be analyzed in detail and so that their impact towards income tax evasion and avoidance of share companies will properly examined which, in turn, provide us with better understanding of the correct course of action that need to be followed as far as income taxation of share companies in Ethiopia are concerned.

Secondary data will also be used for the same purpose why the primary data is used. Both national and foreign text book will be consulted for the achievement of the objectives this research set. Furthermore, interview whenever necessary will be used to secure necessary data.

1.6 Significance of the study

As the research try to develop new way of approaching taxation of companies in Ethiopia, it will deal with different problems, tax evasion and avoidance being the first, in the old approach of taxing companies. As Ethiopia experiencing proliferation of companies in different parts of the country, efficiency and effectiveness of the income tax laws to deal with tax evasion and avoidance of share companies need to be tasted and made to be consistent in line with the result of that kind of tests. So that the research will serve as a one source for potential measures to be taken either by the tax authority or by the concerned law making organ with regard to how to tackle tax evasion and avoidance by the share companies in Ethiopia. It also serves as one material source either for academic or other extra academics endeavors.

1.7 Limitation of the study

The first problem to undertake this study is with regard to literature on the subject matter the research deal with. There is no well develop jurisprudence on the law of income taxation of share company in Ethiopia which, in turn, make the study difficult to undertake comprehensive look at the different aspects of the subject matter at hand. Besides, the researcher potentially will experience time and cost constraints. These problems will limit the ability of the writer to get access of bulk of data's that would have made it easy to identify the problems with regard to income taxation of companies and would give it with proper treatment it deserve for.

This will in turn have impact on the collection of required data for this study. Despite the materialization of such challenges, effort will be exerted to the maximum possible to reduce their effect on the study at hand.

1.8 Literature review

There is no written material on the income taxation of share companies in Ethiopia. Thus the study will suffer from lack of literatures which would have boosted the different perspectives the study use towards the subject matter being under consideration. The only study in this area is the research done for LL.M PROGRAMME IN BUSINESS LAW in Addis Ababa University which titled as corporate taxation in Ethiopia.

But, apart from being too general in terms of coverage of the type of tax and concepts to deal with, it wholly remain to be descriptive of how taxation of companies are exercised while ignoring to deal with the implications of the rules on the tax evasion and avoidance of companies in Ethiopia. Apart from citing the problem of tax evasion and avoidance practices by the companies in his statement of problem, and failing to show certain way of dealing with tax evasion and avoidance strategy of the companies in Ethiopia.

The research here I am dealing with deviate from its predecessor in the following matters. This research tries to evaluate the nexus of rules on disclosure requirement and the tax evasion and avoiding act of companies in Ethiopia. It also looks into the consequences, i.e. civil and criminal liability, to follow the act of tax evasion as it is provided under the income tax proclamation.

Further it look into rules on the appeal right of taxpayers and flat rate of taxing the income of share companies and examine their effects on the tax evasion and avoiding strategy of companies. Moreover it examines the effect of deduction on capital financing and loan from banks on tax avoidance of share companies. These things and other made my research stand apart and independent of the cited research.

1.9 Organization of the study

This research has four chapters, the first chapter being introduction of the research and the second chapter deals with taxation evasion and avoidance in corporate taxation. Under this chapter I will first deal with tax evasion and avoidance in general. Further I will deal with tax evasion versus avoidance, theory of compliance, disclosure requirement and compliance, consequence of tax evasion on the companies and the nexus of aggressive taxation rules and tax evasion and avoidance will be discussed.

The third chapter will deal with Ethiopian income tax law on tax evasion and avoidance by share companies. Under this chapter, Disclosure requirement, consequence of tax evasion, which contains criminal and civil liability under it, tax avoidance and aggressive taxation behaviors, will be discussed in detail. Under the topic of aggressive taxation behavior, corporate tax rate and tax assessment and appeal will explore in greater depth. Fourth chapter will be conclusion and recommendation

CHAPTER TWO

2. Income tax in corporate taxation

2.1 Tax evasion and avoidance in general

Ensuring that taxes are collected from those who owed them has always been an elusive challenge for tax departments.⁷ In 2008, a US senate subcommittee issued a report highlighting that banks located in tax havens cost US taxpayers some USD 100 billion a year in lost revenue. This leakage occurred despite solid US laws, institutions and other mechanisms to help control tax evasion.⁸ If such capital flight is occurring with regulatory frameworks commonly perceived as sound, one can imagine how many more opportunities exist for evasive practices in countries with weak regulatory and legal environments.

Developing countries lose vital revenue through tax evasion and the siphoning of money to tax havens.⁹ According to the World Bank, illicit flows of cash from developing countries amount to between USD 500 - 800 billion a year. These are funds that could otherwise have been used to fund development priorities.¹⁰

For Africa, tax evasion is more than just a contributor to the current economic crisis – it is one of the main impediments to expanding the tax base and mobilizing domestic resources.¹¹ In any country around this globe, business organization managed to avoid the substantial impact meant to be realized by the tax system of the concerned country. They manipulate the tax system in so many fashions. Some have already succeeded to retain sufficient political influence to remain out of the reach of the scope of application of the legislation.¹²

So many giant multinational corporations are powerful enough to manage stay out of the scope of application of legislation in much disguised and unique way. The legislators want these giant

⁷ See Brooks, *supra* note 2, at 6.

⁸ *Id.*

⁹ Developing countries are not providing there citizens with adequate level of different social services. This mainly because the governments in developing countries are not generating enough revenue via taxation, especially from those who take the lion share of the tax due. *Id.*

¹⁰ *Id.*

¹¹ *Id.*, at 11.

¹² Richard M. Bird, *Is it really so hard to tax the hard to tax? The context and role of presumptive tax*, University of Toronto, Prepared for a Conference on The Hard to Tax Sector, December 2003, at 5.

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companies to be there in their side. This is because these corporation has the potential of initiating different problems to this legislator even to the extent of not be elected again as legislator again, besides the different plot they would engaged in to give no effect to the legislation.

This is actually the normal way of evading tax by all taxpayer. This in fact can be get controlled by strict assessment of the information coming from the taxpayer. This in turn will have implication on the administration as it is difficulty to do such assessment.

And finally, the taxpayers are not willing to pay their taxes. ¹³This is actually the more obvious way of evading the payment of tax. For that matter it will be up to the concerned authority to identify such avoidance of payment of tax and resort to take the measures indicated under the appropriate law. Mostly the measures include civil and criminal liability.¹⁴

Most of the strategies to avoid the effect of taxation can be handled to some extent. Transparency and open debate have the potential of reducing down the influence of the lobbyists.¹⁵ Since these lobbyists perform their work of convincing the politician behind the veil, it is not an easy task to identify when and how they succeeded to set the law in the way it let them remain unaffected. So that transparency and open debate would have the effect of uncovering the conspiracy of these lobbyists at the back.¹⁶

Skillful drafting and tight administration hold important place in the struggle against tax evasion in the event of tax planning and avoidance. Tighten follow up of observance and strong commitment to enforcement is best strategy to deal with non- payers.¹⁷

¹³ Id.

¹⁴ From civil liability, punitive monetary payment and other related payment of money are the prominent and most practiced form for non-observance of the tax rules while the criminal liability resulted for imprisonment as any other criminals violating the general criminal law. The measures to be taken either in the form of civil or criminal punishment need to be the one which have the potential of deterring future violation.

¹⁵ See Supra note at 14.

¹⁶ Since it subject the laws for scrutiny by the wider public. Besides, the existence of transparency and open debate gives an opportunity for the public at large to become aware of every justification behind the adoption of the tax laws in certain pattern. That will give bad experience for officials in their effort to provide adequate justification for the rules adopted by mere influence of the lobbyist.

¹⁷ See Supra note at 14.

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As the tax administration become loose and disorganized, it will obviously become vulnerable for tax evasion.¹⁸

2.2 Tax evasion versus tax avoidance

Every human being no matter how honest and how law abiding he is, he always try to take the maximum out of the given situation and mould rules and regulation which suit them.¹⁹ Tax evasion is illegal and is not undertaken by criminals but also by some firms and many individual. It is costing vast sums in lost taxes and it generates unfair competition for the compliant firms.²⁰

Tax evaders are the one who choose to hide their income and wealth to evade tax, claim relief to which they are not entitled and subvert the tax system to make money for themselves. They are criminals and, like other fraudsters, they are dishonest and motivated by greed.²¹ Generally tax exemptions are provided for several situation. A taxpayer can mould the situation to take the benefit of these exemptions or lesser liability. Sometimes even due to improper drafting and ambiguity in the provision taxpayer escapes his liability.²²

Tax evasion is the general term for effort by individuals, firms, trust and other entities to evade taxes by illegal means. Tax evasion usually entails taxpayers deliberately misrepresenting or conceal the true state of their income to the tax authority to reduce their tax liability.²³ Tax evasion is the crime of not declaring income to a tax authority that has the right to know about it and the crime of claiming expenses should not be claimed for that purpose.²⁴

¹⁸ The tax administration need to be the one that take full cognizance of the tax evasion strategy of the tax payers. The tax payers are known for their skill of coming up with new way of evading tax having taken into account of the working of the tax administration, i.e. the identification process need to be vigilant of looking into these legal gap and resort to appropriate legal measure to fill these legal gap.

¹⁹ Priyesh Sharma and Siddharth Dang, Myth and reality of imbricating concepts of tax avoidance and evasion, Hidaytullah national law university (HNLU), Raipur, India, accepted 6 may, 2011, at 46, available at [www.academicjournal.org/jat.\(accessed](http://www.academicjournal.org/jat.(accessed) at 03\03\2016)

²⁰ ETUC resolution on tackling tax evasion, avoidance and tax heavens, adopted at the ETUC executive committee on 10-11 march 15, at 1, available at <https://www.etuc.org/.....\en-resolution>. (accessed at 11\4\2016)

²¹ Speech by keir stamer QC, director of public prosecutor, available at WWW.cps.gov-uk)\prosecution tax.....(Accessed at 23 january 2013)

²² Richard Murphy, The tax gap, tax evasion in 2014- and what can be done about it, tax research UK for the public and commercial service union, 2014, at 40

²³ [http://investopedia, com/terms+l tax evasion.asp](http://investopedia.com/terms+l+tax+evasion.asp) 2010.

²⁴ See Stamer, Supra note at 23,at 17.

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Tax evasion can occur as an isolated incident within activities that are-in other aspect-legal. Or tax evasion occur in the informal economy where the whole activity takes in an informal manner—this means the business is not only evading tax payment but it also not registered as formal enterprise at all.²⁵

Tax evasion can occur in a number of ways; deliberately omitting or under-reporting income, keeping two sets of book, or engaging in fraudulent accounting activities, claiming false or overstated deduction on return, overstating charitable deduction or misrepresenting travel costs and claiming personal expenses as business expenses.²⁶

Coming to tax avoidance, it comprises activities which exploit loopholes in the tax system but run counter to the purpose of the law.²⁷ There will always be some room for choices which firms may exploit to reduce their tax burden. Using this would be classified as tax avoidance.²⁸ Taxpayers may create device to arrange his commercial affairs to minimize his liability and its acceptance is based on operation of law.²⁹ There are different ways by which a taxpayer escapes his tax liability. But there is a thin line difference between escaping tax liability and overcoming tax burden.³⁰

Tax avoidance refers to those cases where the taxpayer has apparently circumvented the law, without giving rise to a critical offence by the use of a scheme, arrangement or devise often of a complex nature whose sole purpose is to defer, reduce or completely avoid the taxable under the law.³¹

Tax avoidance concerns arrangement that reduce tax liability in a manner contrary to the intention of parliament.³² Tax avoidance is commonly undertaken by large business and high net worth individuals who employ an army of accountant and lawyers to find loopholes in the law

²⁵ GIZ sector programme public finance, administrative reform, addressing tax evasion and avoidance in developing countries, 22 December 2010, at 9, available at www.giz.de/public-finance. (Accessed at 11\4\2016)

²⁶ Miller Berstein, Tax evasion and avoidance and impact on your business, at 3, available at millerberstein.com/...../tax evasion and avoidance. (accessed at 21\3\2016)

²⁷ Id

²⁸ Clements Fuest and Nadine Riedel, Tax evasion, tax avoidance and tax expenditure in developing countries; A review of the existing literature, Oxford University center for business taxation, June 19th, 2009, at 5..

²⁹ Id.

³⁰ See Sharma and Dang, Supra note at 21, at 40.

³¹ <http://en.wikipedia.org/wiki/tax-avoidance-and-tax-evasion> 2010.

³² Denis Healey, Tax avoidance or tax evasion? Symposia meltensia number 10(2015), at 218.

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and regulation of a country to make sure that they do not pay tax whilst claiming that they were not breaking any law, anywhere, whilst achieving that objective.³³

Tax avoidance refers to types of transaction that result in manner or circumstance contrary to the purpose and policy of the relevant revenue provisions.³⁴ It covers instances where legislative intention and policy miscarried and failed to anticipate and reach transaction under consideration.³⁵ Tax avoidance has been described by reference to a certain observable criteria and functional characteristics, which include whether the transaction was artificial or contrived,³⁶ whether the transaction sought to exploit statutory loopholes or weakness,³⁷ the extent to which the transaction was influenced or actuated by the prescribed taxation purpose,³⁸ and whether the transaction lacks economic reality.³⁹

Tax evasion and avoidance are both phenomena that are probably as old as taxation itself. Whenever and wherever an authority decides to levy tax, individuals and firms try to avoid paying them.⁴⁰ The difference between tax avoidance and evasion was first noted in the UK in 1990 in the case of Bullivant vs AG where it was stated that the word 'evade' is ambiguous⁴¹

There is thin line of demarcation between tax avoidance and evasion; though both result in avoidance of tax. The distinction between the two lies in the legality of transaction.⁴² The difference between tax avoidance and evasion is the thickness of a prison wall.⁴³ From an economic point view, legal consideration apart, tax avoidance and tax evasion have similar effect, namely reduction of revenue yield, and based on the same desire to reduce the tax

³³ See Murphy, supra note at 24, at 17.

³⁴ Id.

³⁵ See Healey, Supra note at 34, at 220.

³⁶ N.orow, General anti-avoidance rules; comparative analysis (Bristol, 2010), at 67.

³⁷ G.S.A Wheatcraft,"The attitude of the legislature and courts to tax avoidance: modern tax review (1955), at 7.

³⁸ Y. Gbrich, A.J. brad brook, k.pose, revenue law cases and materials (Sydney 1990), at 54.

³⁹ Radcliffe commission, royal commission on the taxation of profit and income final report (1955), at 9.

⁴⁰ See Murphy, supra note at 24, at 8.

⁴¹ See Sharma and Dang, Supra note at 21, at 218.

⁴² See Bird, Supra note at 14, at 42.

⁴³ Id, at 40.

burden.⁴⁴ Both evasion and avoidance impose cost on the rest of us (higher tax rate to raise the same revenue, larger deficit, and less funding of public services.⁴⁵

2.4 Aggressive taxation rules and income taxation

Here aggressive taxation rules used in the sense that these taxation rules are not in line with fair and equitable principles of optimal tax system. Mahabharata successfully expresses this concern in saying that “the ruler should act like a bee which collects honey without causing pain to the plant”. Accordingly the tax laws and regulations needs to be limited by the fair and equitable principle while collecting the tax due from the taxpayers. Otherwise it will result in causing unnecessary damage to the general or to the part of tax payers.

In the meanwhile underground economy persists to be practiced because of government taxes and regulation. It seems that the more taxes and regulation, other things being equal, are the fuel for the larger the underground economy.⁴⁶ One strand of literature proposes that firms operate in the underground economy due to, among others, over regulation of tax payers.⁴⁷

Guttman(1977) mention that underground economy is a product of government regulation and policies and suggest revisiting them in order to not motivate unreported activities.⁴⁸ The regulation of taxpayer needs to be limited by what is fair and equitable. Thus the taxpayers start to perceive the taxation system as fair and equitable.

According to Everest-Philipps (2008) the perceived fairness of a taxation system has greater contribution for better compliance practice of tax payers.⁴⁹ Empirical evidences indicated that formal economic model of tax behavior lack conclusive evidence. In addition to economic

⁴⁴ Erich Kirchler, Boris Maciejovsky and Friedrich Schneider, everyday representation of tax avoidance, evasion, and tax flight; do legal differences matter? April, 2001, at 1, available at www.econ.jku.at/.....\kleven-jep.(accessed at 21\3\2016).

⁴⁵ Eric Toder, Focus on the tax “avoidance” gaps, 2009, at 95.

⁴⁶ Id.

⁴⁷See Berstein, Supra note at 28,at 41. See also Friedman et al 2000

⁴⁸ Mohsen Mehrara and Yazdan Gurdazi Farahani, The study of the effect of tax evasion and tax revenue on economic stabilities in OECD countries, world scientific news, Faculty of Economics, University of Tehran, at 44, available at www.worldscientificnews.com/.....\WSN-3.(accessed at 12\4\2016).

⁴⁹ See Berstein , Supra note at 28, at 44.

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determinants of tax decision, psychological factor, such as perceived fairness, were found to be important in describing and understanding tax behavior.⁵⁰

Further more substantial body of literature confirms the importance of psychological factors on the decision outcomes with respect to tax evasion, like perceived fairness and justice of the overall taxation system.⁵¹

Pommerhe et al (1994) conducted study in order to recognize the determinant of tax evasion. Result indicated that as the sentiment of grievance increased in absolute terms, the level of tax evasion increased and the level of tax moral decreased. The less the taxation rules become fair and equitable, the more grievance to be ensued from the taxpayers and which in turn led to greater tax evasion unless measure taken by the authorities.

Both substantive and procedural laws should be directed toward improving taxpayer compliance. It is generally agreed that improving taxpayer compliance has many aspect to it, among which making tax law fair and equitable takes the prominence.⁵² The perceived inequity is important obstacles to tax payer compliance practices.⁵³ Eriksen and Fallan (1996), when the perceived fairness in taxation increased the attitude towards other people's tax evasion become stricter.

A number of theories of human behavior, as the above cited empirical evidences suggests, indicated that reducing the inequities in the tax system might increase compliance. For example, "equity theory" in psychology suggests that people are more likely to comply with rules if they perceive the system which determines the rules to be equitable.

Even tax payers are the one who will be used as one source of influence for greater enforcement of the tax rules as Eriksen and Fallan found out. This is because the one who may be seen in the

⁵⁰ See Mehrara and Farahani, *Supra* note at 61,at 5.

⁵¹ See Kirchler, *Supra* note at 46, At 3. See also Domsten, 1987; Kircher,1997; Spicer and Beckler, 1980 and Ludster,1976.

⁵² Richard K.Gordon, *Law of tax administration and procedure*. Cited in *Tax law design and drafting* (volume 1; international monetary fund;1996; Victor Thuronyi.ed, at 17.

⁵³ Carlos Silvani and Katherine Baer, *Designing a tax administration reform strategy; experience and guideline*, international monetary fund, fiscal affairs department, March 1997, at 44.

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practice evading payment of taxes, though not identified by the tax authority, will be assumed as doing something immoral.⁵⁴

The theory argues that if the general public thinks inequities in exchange relationships exist they will adjust their inputs to the exchange to attempt to achieve a more just exchange.⁵⁵

If the tax system is viewed by taxpayers as an exchange relationship, equity theory would suggest that tax evasion should become less practiced and minimal if the tax system is perceived as becoming more equitable.⁵⁶

In general, aggressive taxation rules are rules that do not have moral persuasion power over the tax payers. Tax payers expect the tax rules and principles to take into account of the situations prevail around which affect them either directly or indirectly the ability of the tax payer to comply with these tax rules and principles.⁵⁷

2.5 Publication and formality requirement

Disclosure requirement here used into two sense or meaning. The first meaning is that of declaring to the general public about the tax evasion, including the result of audit effort of tax authority, practices of taxpayers. The other meaning is that of making the activities of business more transparent by putting certain formalities for the business transactions to be concluded by the businesses whereby the auditing effort of tax authority becomes more fruitful as several opportunities for audit trial created.

⁵⁴ If the general public, which constitute the tax payer, accept the tax rules as equitable more likely they will cooperate with the enforcement organs by exposing the tax evasion practice of tax payer. Which is possibly detect by their capacity, for example, notifying the authority that receipt is not being issued for certain transaction the tax payer obliged by the concerned tax legislation to provide.

⁵⁵ See Bird, Supra note at 16.

⁵⁶ Id.

⁵⁷ This means is that these tax rules need to remain within the boundary of what is called fair and equity. Indeed it will not be an easy task to come up with the criteria or standard that made a certain tax rules fair. What possibly be done is, rather than trying to come up with precise definition of fair and equity, to look around the circumstances of the two equally competing parties, i.e. the government and tax payers in general, and exerting an effort to reach at a point where fairness and equity dictates.

Here still there is no such specific standard to be applied; rather relative consideration of the different concerns of the government and the tax payer in light of what will be fair and equity

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In the meanwhile publicizing the result of past enforcement actions carried out by the tax administration has often to be more effective than announcement of future action.⁵⁸ Publicizing the tax evasion practices of taxpayer have a role of indicating the fact that there is a certain consequence to follow the act of evading the payment of tax due. In one way, this action is threatening those taxpayers who engage in tax evasion practice that there are certain consequences to follow the act evading the tax due. It also insures that these consequences of evading tax indicated in the tax legislation are not without merit. In other way, it ruin down the business reputation of the businesses which engaged in the tax evasion practices.

Further it also increases the knowledge of the general public about tax evasion and avoidance. According to Kircher and Maciejousky(2001) associate little knowledge with low compliance. Accordingly this effort of publicizing the tax evasion practice of taxpayer will contribute its part for the increment of taxpayer knowledge and, in turn, better compliance by the taxpayers. Most studies have found that public disclosure of non-compliance act as an additional penalty mechanism.⁵⁹

Moreover, publicizing tax evasion conviction in the media work as an alternative non-financial type of penalty.⁶⁰ In other words, publicizing conviction for tax evasion has a role of insuring better compliance.

Not only conviction of taxpayer for the involvement in tax evasion, but disclosing audit information also have role in insuring better compliance.⁶¹ The disclosure of this audit information serves the purpose of letting the taxpayers know the result of auditing effort of the tax authority.

This in turn has two roles. One is feeding up the general public about the fact that tax authority is doing its best to insure proper enforcement of tax legislations. Secondly, it serves as a threat to the business that they would also be subjected to this kind of audit and face criminal and civil

⁵⁸ See Gordon, Supra note at 65, at 27.

⁵⁹ James Alm, Department of economics, Tulane University, New Orleans, LA, at 20.

⁶⁰ Muhammad Muazel Mugal and Muhammed Akram, reasons of tax evasion and tax avoidance ; reflections from Pakistan, Hailey college of commerce, University of Punjab, journal of economics and behavioral studies, vol. 4,no.4 , April 2012. At 221, available at [www.infrnd.org/.....\j4\(4\)5.pdf](http://www.infrnd.org/.....\j4(4)5.pdf).(accessed at 15\5\2016)

⁶¹ See Alm, Supra note at 72.

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liability. This means is that this audit effort has the potential of deterring future violation. As it gives us with the detail information of auditing process, it has greater potential of deterring future violation from the mere information of conviction of taxpayers for their tax evasion act.

Public campaign, as a part of disclosure requirement, has also greater contribution for the effort of minimizing the tax evasion practices of tax payers as some research suggests.⁶²

The other aspect of disclosure requirement is that of putting the business transaction to light via the formality requirement for these business transactions. Various empirical studies have found out the significant deterrent effect of higher audit rate leads to a more compliance with tax legislations.⁶³

Further Alligham and Sandmo(1972), via behavioral modeling, found out that individuals will deterred from evading by fixed probability of audit by the tax authority. This auditing effort is meaningless unless certain mechanism put in place to insure that adequate audit trail let to happen by the formality requirement to be provided by the general private law.

Increasing the visibility of economic transactions subject to tax is a key for effective enforcement. One way this might be done is by increasing the degree of formality required to be fulfilled to get legal recognition under the general law whenever economic transactions occurs. If the general private law requires that economic transactions to be conducted formally they should have to fulfill certain level of formality requirement and so they will leave an audit trail behind.

For example, in laws relating to companies, transfer of property, sale of goods and services, and financial transactions, to what extent is their requirements for written contracts, registration of loans, mortgages, sales of property, use of invoices, transportation documents and books of accounts to record business transactions, payments through drafts, checks, credit cards and electronic transfers? Also, to increase the probability of an audit trail, large cash bills might be taken out of circulation.

⁶² See Mugal and Akram, Supra note at 73.

⁶³ See Alm, Supra note at 72, at 18.

2.6 Civil and criminal sanction

Without doubt, taxation is one of the most powerful motivational forces in corporate life.⁶⁴ Tax consequences are important determinants of capital structure, dividend payments and the arrangement of groups of companies, amongst many other things.⁶⁵

Proper mixture of imposing punishment with a plausible taxation structure, tax evasion can be decreased to very low level.⁶⁶ Penalty promotes compliance.⁶⁷ A good system of sanction and penalties also an indispensable tool for enforcing compliance.⁶⁸

As part of the assessment of the tax administration, the effectiveness of the sanctions and penalty systems in encouraging taxpayers to voluntarily comply with their tax obligations should be evaluated.⁶⁹ There is a considerable discussion in the economic literature of the role of sanctions and penalties in creating incentives for individuals to engage or not in tax evasion act.⁷⁰

The important aspect of improving compliance is the provision of effective sanction for failure to comply.⁷¹ Most studies have found that compliance increase but only with slight with increase in the fine rate on unpaid taxes.⁷² Behavioral modeling started with Allingham and Sadmo (1972) in which individuals are deterred from evasion by the proportional penalty to be applied over and above the payment of the true liability.⁷³ Increase legal penalty result in decreasing tax evasion.⁷⁴

The size and nature of penalties that are incurred after evasion has been detected is directly linked to the level of tax compliance.⁷⁵ Srinivasan(1973) introduced simenal theoretical model and conduct study while it exploring the determinant of tax evasion. In this study, he

⁶⁴ Dave Hartnett, Taxation, Accounting and Transparency: The Missing Trinity of Corporate Life, at 101.

⁶⁵ Id

⁶⁶ See Mehrara and Farani, Supra note at 61.

⁶⁷ Michael Doran, Tax penalties and tax compliance, Georgetown University law center, 2009, at 44, available at scholarship law Georgetown.edu\...\ (accessed at 24\5\2016).

⁶⁸ See Mehrara and Farani, Supra note at 61, at 25.

⁶⁹ See Hartnet, Supra note at 77.

⁷⁰ Id.

⁷¹ See Gordon Supra note, at 65, at 17.

⁷² See Alm, Supra note at 72, at 18.

⁷³ Salvador Balle, Lucia Mangiavacchi, Luca Piccolo and Amedo spadaro, Tax evasion and optimal non-linear labor income taxation, working paper series, society for the study of economic inequality, August 2015, at 2, available at www.ecineq.org/\.....\ECINEQ2015-373 pdf. (accessed at 12\3\2016).

⁷⁴ Miller Berstein, Tax evasion and avoidance and the impact on your business, at 5.

⁷⁵ See GIZ , Supra note at 27, at 18. See also Fishlow and friedman,1994

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explained that the behavior of tax evasion was based on the risk aversion, and the penalty imposed.⁷⁶

Taxpayers comply with their tax obligation to avoid legal sanction whenever those sanctions are expected to be more costly than compliance.⁷⁷ For example economics-of-crime approach concludes that an individual pays taxes only because of economic consequences of detection and punishment.⁷⁸

In order to be effective in encouraging compliance with the tax collection process, a system of civil penalties should have a number of characteristics.⁷⁹

(1) Simplicity. The civil penalty system should be as simple and understandable as possible so that it is comprehensible to the taxpayer and administrable by the tax department.⁸⁰ In most tax systems, civil penalties have been enacted or modifies on an ad hoc basis without full consideration given to the overall civil penalty structure. This has resulted in extremely complex systems of tax penalties.⁸¹

(2) Integration. Taxpayers should not be faced with the imposition of multiple penalties for same transgression of the rules, nor there noncompliant behavior for which there are no penalties.⁸²

(3) Deterrence. The principal goal of sanction is based on the simple premise-the threat of punishment deters unwanted behaviors.⁸³ One widely held view of compliant tax behavior is that taxpayers rationally weigh the economic costs and benefits of tax compliance.⁸⁴

Under this view, the major purpose of civil penalties, when taken in conjunction with the chance of being caught, is to increase the cost of noncompliance to the point at which these costs outweigh the benefits of noncompliance.⁸⁵ Clearly, then, penalties should be severe enough to

⁷⁶ See Mugal and Akram, *Supra* note, at 73, at 218.

⁷⁷ See Doran, *Supra* note at 80, at 112.

⁷⁸ See Alm, *Supra* note, at 72, at 8.

⁷⁹ See Hartnet, *Supra* note at 77.

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² *Id.*

⁸³ See Gordon, *Supra* note at 65, at 23.

⁸⁴ See Hartnet, *Supra* note at 77, at 31.

⁸⁵ *Id.*

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provide incentives for taxpayers to comply with the tax law. Also, they should be severe enough to reassure the compliant taxpayer that there are adverse consequences for those who do not comply.

(4) Fairness. To be morally acceptable, penalties must be seen as just punishment for transgressions against societal standards.⁸⁶ Unlike deterrence considerations (except to the extent that penalties that are too severe are not likely to be enforced), therefore, fairness considerations limit the size of penalties. Fairness requires that similarly situated taxpayers bear the same penalty and just as importantly that the severity of penalties be proportional to the culpability of the noncompliant taxpayer.

(5) Compensation. Penalties should not only be set at a level at which the expected cost of noncompliance exceeds the taxpayers expected benefits. But also such penalties should arguably at least compensate the government for the enforcement costs it incurs in collecting the tax from those that do not comply.

(6) Consistency in Application. Applying penalty often and consistently has a great role on enforcement.⁸⁷ Research has shown that lower penalties which are applied more consistently are more effective in deterring evasion than high penalties applied fairly infrequently.⁸⁸

An important, but elusive objective, of a rational system of civil penalties is the uniform treatment of taxpayers in the application of the penalties.⁸⁹ A frequent criticism of the administration of revenue penalties is that tax department officials do not administer them consistently.⁹⁰

Back to criminal liability, penalties for criminal liability have two fold purposes. The first element is deterrent element which insure that taxpayers are aware of the consequences of non-compliance and thus endeavor to make correct tax payment.⁹¹ Deterrent function depends on

⁸⁶ Id.

⁸⁷ See Alm, Supra note at 72, at 25.

⁸⁸ See Hartnet, Supra note at 77.

⁸⁹ Id.

⁹⁰ Id.

⁹¹ Rita de la faria and Parintira Tanawong, Surcharges and penalties in UK tax law, July 2015. At 1, available at www.sbs.ox.ac.UK/.....taxation/.....\Wp1510. (accessed at 21\5\2016).

two important assumptions. The first is that it is possible to determine and create a likely punishment that appropriately outweighs the prospect of gain.

The second is that people will act in a way that measurable and understandably rational.⁹² And there is a punishment element act as a guarantor of equity and fairness among taxpayers, ensuring everybody pays due share of tax.⁹³ Fraud or evasion is usual considered as a crime, but difficult to prove. Criminal offenses would be in addition to civil penalty.⁹⁴

CHAPTER THREE

3. Ethiopian law on income taxation of Business organization in Ethiopian case

An effective tax policy that ensures adequate domestic revenue is a crucial determinant of a country's ability to pursue development policies.⁹⁵ But tax revenues in most developing

⁹² See Gordon Supra note ,at 55, at 23.

⁹³ See Faria and Tanawong, Supra note at 104.

⁹⁴ See Gordon, Supra note at 65, at 36.

⁹⁵ Jomo kemame sundaram, united nations assistant secretary – general for economic Development and G-24 research coordinator published on march 10,2013 (vol13, No67) Fortune.

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countries including Ethiopia are low, impeding progress toward more balanced, inclusive, and sustainable economic development that can improve public health and raise standards of living.⁹⁶

Developing countries are confronted with social, economic and administrative difficulties in establishing a sound finance system. As consequence, developing and emerging countries are particularly vulnerable to tax evasion and avoidance activity of individual taxpayers and corporations.⁹⁷ While tax revenues in OECD- countries amount to almost 36% of gross national income in 2007, the share in selected developing region amount around 23% in Africa (in 2007) and 17.5% Latin America (2004).⁹⁸

In Ethiopia, there is significant amount of economic activity which is greater than 36% that is not reported and captured by the official statics.⁹⁹ The econometric estimation reveals that the underground economy in Ethiopia amounted to about 35.9% of the official economy over the estimated period reaching the highest level of 51.8% and 51.4% in 1979 and 1985.¹⁰⁰ It is estimated that the amount of the hidden economy is about 28.2% over the years since 2000.¹⁰¹ According to available data, Ethiopian is still far away from countries in sub-Saharan Africa as it is collecting only 13 percent tax from its total GDP.¹⁰² The ratio of evaded tax to official GDP is as high as 10% over the entire period.¹⁰³

To finance development project, poor and lower middle income countries must devise and implement tax strategies to increase domestic revenue.¹⁰⁴ Developing – country leaders must draw on the experience of both developed countries and their peers to design tax policies that meet the basic requirements of operability, buoyancy, and stability.¹⁰⁵ This includes broadening

⁹⁶ Id.

⁹⁷ See GIZ, Supra note at 27, at 7.

⁹⁸ Id.

⁹⁹ Emerta Asaminew, The underground economy and tax evasion in Ethiopia ; implication for tax policy, Ethiopian economic policy research institute(EEPRI), Ethiopian economic association(EEA) , October 2010, at 1.

¹⁰⁰ Id.

¹⁰¹ Id.

¹⁰² Ethiopian herald, Tax collection showing progress yet untapped. M.onlinenewspaper.com/Ethiopia.htm (accessed April 14,2016)

¹⁰³ See Asaminew, Supra note at 101.

¹⁰⁴ Id

¹⁰⁵ Id.

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the tax base, reducing tax avoidance and evasion, improving tax collection, and developing new cooperative international taxation strategies.¹⁰⁶

In the meanwhile in the Ethiopian income tax law regime, actually, there is no specifically designated law that deals with tax evasion and avoidance, rather provisions scattered through different legislations. The different remedies provided under the income tax proclamations for tax evasion hold principal place as far as the consequences that will follow the practice of tax evasion in violation of what stipulated in the income tax proclamations is concerned.

Mostly, these income tax proclamations provide different form of measures against taxation evasion behavior of tax payers. The prominent form of measures can be classified as criminal and civil liability. Having saying that much about this, let me see them in detail in the subsequent part of this research

3.2 Formality requirement

Disclosure mainly serves the purpose of putting economic transaction to light which makes difficult for the business actor to deny the burden, for example tax, that accompany the business transaction. Disclosure requirement can have valuable help in the effort of insuring compliance to tax laws so that it can be manipulated towards the effort of tackling tax evasion.

This Disclosure requirement will promote transparency of day to day business operation of firms. This transparency will make the operation of the firms susceptible to audit trial. This will increase the risk of being caught for tax evasion whenever they got engaged in such activity. As empirical evidences suggested the frequency and the level of audit to be undertaken by the tax authority is directly related with the rate of tax evasion by the taxpayer.¹⁰⁷

This thing to have meaningful help towards the minimization of tax evasion, adequate level of audit trial needs to leave behind. Transparency of the day to day operation of the firm mainly realized by the formality requirements to be put in place by the general law.

¹⁰⁶ Id.

¹⁰⁷See Gordon, Supra note at 65.

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The first formality requirement is written requirement for the business transaction said to be performed legally, and to be enforced by court of law whenever dispute arises between the contracting parties in a certain contract. The Ethiopian contract law in this regard provides written formality for a certain immovable property and special contracts.¹⁰⁸

But this formality is not enough to insure disclosure required for tacking tax evasion by share companies. This is because there are plenty of contract concluded by these share companies besides the contract required to be made in a written form in their day to day operation.

To the worse, the federal cassation division bench comes up with a decision that even further relaxes in pretext of promoting the expediency of business transaction. For this kind of far-fetched statement, as to the nexus between the non-existence of formality requirement and expediency of business transaction, there are no logical and empirical evidences to support such sort of assumptions.¹⁰⁹

. Unfortunately, beside its use to tackle, or at least to reduce, the incidence of tax evasion, formality requirement has evidential value in the event of dispute between the contracting parties which is inevitable to occur. This will in turn construct the confidences of the contracting parties as one of the parties cannot snatch the legal right of the other contracting for lack of evidence.

It seems even goods to extend the written formality for the contracts to be concluded by share companies irrespective of the nature of the goods under contract. This in fact justified by the fact that share companies engage in complex and huge contract relative to other forms of business organization. So that ample opportunity will be created for audit trial as to the day to day operation of the share companies.

¹⁰⁸ See Art 1723 of the Civil CODE.

¹⁰⁹ It seems that for the firms to comply with this formality requirement, it is a matter of one or two hours to fully comply. Actually, it will be a problem to comply with this formality if the contract is to be concluded between businesses in different country or when it is difficult to present in person.

This is in fact the manifestation of globalization. Globalization while it creates difficulty to comply with this formality requirement, it also creates a way to make problems to comply easy.

This is through fax or other devices to send a contract to be concluded. What the contracting parties need to do is coming up with standard form which the two parties already agreed on. If there is registration requirement, the parties can agree as to where the registration of the contract to be made while they develop the standard form of contract between themselves

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Payment through check, invoice and other way of indicating business transaction indeed occur will also serve a lot, but the way it should have introduced calls for greater scrutiny. That is because these rules could have the effect of making business transaction more difficult to be undertaken.¹¹⁰

As part of disclosure requirement, publication through media, newspaper and other devices of reaching the public at large also have its own role in the effort towards dealing with tax evasion as empirical evidences confirms.¹¹¹ Such publication would have the role of non-financial punishment on the taxpayer.¹¹²

As empirical evidences indicated, publication should not be limited to mere act of tax evasion, but also the detail of the audit report of the taxpayer who found in the act of evading the tax due.

Art.103 of proclamation No.286\2002 indicated publication of the name of tax payer who convicted of offences under art.93-101. An offence by entity which is provided under art.102 of the same proclamation is not covered by art.103 which contemplates the publication of name of those who engaged in the act of tax offences or tax evasion.

This means entities like share companies are exempted from such sort of publication by daily Gazettes. Further the provision only contemplates the publication of the name of the taxpayers who found engaging in evading tax. But the publication of the tax audit report along the name of the taxpayer who found in tax evasion practices would have the role of increasing the deterrent effect of such publication.¹¹³

¹¹⁰ For that matter, the business should find it simple to comply whenever they get involved in business transaction. Otherwise the business man's moral of being engaged in business transaction will get minimal. This condition could create motivation to avoid the effort of these legal rules.

¹¹¹ See Alm, Supra note at 72.

¹¹² See Mugal and Akram, Supra note at 73.

¹¹³ Such scenario is against empirical evidences and other countries experience, like UK and U.S.A, where the publication of the act of evading tax by companies considered being one device of insuring compliance by companies concerned. In the first place, this publication has deterrent effect on the other taxpayer. This is mainly because this act send message to taxpayer that they would be the next target of the tax authority. Secondly such publications have implication over the business reputation of the company concerned.¹¹³ The companies will never want their reputation to ruin down because of their tax evasion practices. Thus potential share holder will lack confidence on this company and at least may hesitate to buy it shares available in the stock market.

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As far as the practices of publication of the act of tax evasion is concerned, there is only occasional publication based on the gravity and educative nature of tax evasion act.¹¹⁴ These seem further undermines the role of such publication towards the aim of controlling the tax evasion practices of taxpayers. Such practices are reflective of only educating the general public about tax evasion while it ignore the other purpose of creating reputational risk over the businesses found engaging in the act of tax evasion.

3.3 Consequences of income tax evasion by business organization

Consequences following the act of evading tax will ultimately determine the level of compliance by the tax payer concerned. Human being by nature is calculative of the risk involved which in turn creates fear to the tax payers. Unless this consequence of tax evasion is good enough to create this fear in the mind of the tax payers, the tax payers will keep on violating the tax laws and be ready to face the minimal consequences of tax evasion.

In the meanwhile, tax evasion under art.96 of proclamation No.286/2002 defined as one who evades the declaration or payment of tax due. This definition is pretty much general and not well articulated as it fails to show acts which constitute tax evasion. It is obvious that the consequence of tax evasion is under declaration or under payment, but what kind of action result to under declaration or understatement?

For example deliberately omitting or under-reporting income could be considered as tax evasion as it obvious that it result into understatement of income. But what about of keeping two set of books, or engaging in fraudulent accounting activity? It is not clear in light of the definition given by the income tax proclamation whether this act constitute tax evasion or not.

This is because the definition focuses on the underpayment or underreporting of tax due rather than dwelling upon the acts that constitute tax evasion. What about of claiming false or overstated deduction on return. What about also the over stating deduction misrepresenting travel cost or claiming personal expenses as business expenses?

¹¹⁴ Interview with w\ro Tsion Admasu, vice senior Prosecutor in the Revenue and Customs Authority, in Addis Ababa (June. 25, 2016).

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One cannot provide a concrete answer based on the definition of tax evasion provided by the proclamation.¹¹⁵ This means is that the definition needs a detailed legal interpretation. This situation provides taxpayer with a wider chance of evading the tax due. Articulated definition of term provides well founded foundation for the proper achievement of the purpose aimed to be attained by the definition.

Secondly it would serve as reminder to taxpayers that they are engaging in tax evasion while they embark on any of the indicative list of acts. This means that it has the potential of threatening taxpayers not to engage in those acts. Saying that much about the definition of tax evasion let me proceed into discussing the civil and criminal liability for tax evasion as provided under the income tax proclamation.

3.3.1 Civil liability

Art 87(1) of income tax proclamation No.286 /2002 provide penalty of 10% against the one who found in the act of understating the amount of tax required to be shown. Or 50% of the understatement if it considered being substantial which is more than 25% of the understated value as stated under sub-Article two of the same Article.

The other civil liability considered under the income proclamation is the penalty for failure to keep proper records. As per 89 of the income proclamation No.286/2002 the taxpayer who fail to keep proper records will face the penalty of 20% of the tax assessed. The other civil liability is the penalty for failure to withhold tax. As provided under art.90 of the income tax proclamation, the withholding agent who fails to withhold tax is personally to pay to the tax authority the amount of tax that is has not been withheld.

As empirical evidences found out when the liability is expected to be above the payment of tax liability there will be better compliance with tax law.¹¹⁶ Contrary to that Ethiopian income tax proclamation provides very small proportion of tax liability. The cost of being caught is so small

¹¹⁵ Indeed it is not possible to list down exhaustively those acts that constitute tax evasion, but it is possible to come up with indicative list of acts which out rightly be declared as an act of evading tax besides to providing well-articulated definition of tax evasion. This will fulfill two fold purposes. The first is that the tax authority would be informed of those potential acts to be considered in its effort of tracing the act of evading the tax due.

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which means that the taxpayer would choose to avoid the payment of tax due and face the probable civil liability to be imposed.

It is inevitable that the taxpayer will undertake a sort of weighing the benefit and burden of engaging in tax evasion and choose a course of action that maximizes their best interests. Whenever the taxpayer found out that the benefit is greater than the risk to be ensued, certainly the taxpayer will engage in tax evasion.

According to srininivasan taxpayer compliance to the tax laws is based on the risk aversion, and penalty to be imposed. This means whenever the taxpayer found out that the risk to be ensued from the penalty to be imposed being minimal the taxpayer would for sure choose to engage in tax evasion activity. If we want taxpayers not participate in tax evasion activity, we needs to make the risk higher.¹¹⁷

Civil penalties should exist for the purpose of encouraging voluntary compliance.¹¹⁸ The penalty to be provided determines the level of voluntary compliance by the taxpayer. We need to make the civil penalties to be a drive engine of voluntary compliance by the taxpayers. Failure to understand the role of penalty in insuring compliance would lead to widespread practice of tax evasion as we readily infer from the empirical research considered above.

On this background, the civil penalty provided by the income tax proclamation is far from constituting risk for taxpayer in the event of tax evasion. It rather invites the taxpayers to participate in tax evasion and, in case they caught, to face the minimal civil penalty indicated under the above cited provisions. We remember that the pillar of our tax system is voluntary compliance.

If we are about to insure effective and efficient voluntary compliance to tax laws, we need to make the civil liability a sanction that pose greater risk for the taxpayers who venture into tax

¹¹⁷ Other study also indicate that if we want taxpayer to fully comply with tax laws we need to make the civil sanction too costly relative to benefit to be maximized by tax evasion. The taxpayer behavior of tax evasion is highly influenced by the sanction to be put in place. The taxpayer compliance practice directly related with the sanction provided by the tax laws.

¹¹⁸ Tax practice responsibilities committee, Report on civil penalties; the need for reform, American Institute of certified public accountants, April 11,2013, at 1.

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evasion activities. The one provided under the income proclamation is far away from constituting such sort of risks indicated above. If individual consider tax payment as gamble, the best choice would be to evade.¹¹⁹

Even the civil penalties provided under the proclamation is more than gambling since the amount of money to be incurred is minimal if they caught in the act of evading tax compared to the money to be gained out of the proceed of tax evasion. Accordingly it is encouraging the taxpayers to engage in tax evasion activity.

This means the civil liability is not crafted in a way to deter bad conduct without deterring good conduct or punishing the innocent.¹²⁰ This means, in turn, the civil penalties are not fulfilling their basic aim of encouraging good conducts and then voluntary compliance to tax laws.

Moreover, the problems with these provisions are that it seems to assume that this understatement or failure to withhold is discovered at any time these acts in fact occur. Furthermore, the penalty will serve nothing in creating a sense of fear in the mind of the tax payer concerned. At least is fair to ask the tax payer the amount of money the tax payer intends to evade.

It is practically impossible to catch up the act of evading tax whenever it committed. This is because our income tax proclamation follows the approach of self – assessment which relies on the honest and genuinely of the tax payer concerned. In exceptional circumstances only the authority will cross check the genuinely of the assessment made by the tax payer himself. Indeed it is practically impossible to cross check all of the assessment made by the tax payers in light of the human resource available in the tax authority.

These all circumstances made the penalty indicated under this Articles as not effective and efficient in dealing with problem of tax evasion by tax payer, especially share companies. The concerns raised above can be covered by two characteristics of effective system of tax collection. These are compensation and deterrence. In the first place, the government needs to be compensated for what it incurs because of the tax evasion practices of the tax payer.

¹¹⁹ See Kircher, Supra note at 46. See also Alm, McClell and schulz, 1991.

¹²⁰ See Tax practice responsibilities committee, Supra note at 132.

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The government deploy it's of professional personnel towards the identification of the act of tax evasion. It is too costly for the government that it needs to be shifted to the one who made the deployment of the professional personnel and others necessary things and mandatory expenditures to insure effective compliance to the tax rules.

In line with that pecuniary punishment imposed on the one found in the act of committing tax evasion need to take account of the costs the government incurs as considered above beside the actual sum of money that would have been evaded. As opposed to that Ethiopian income tax proclamation No 286/2002 imposed small sum of money which seem only based on the sum of money that would be evaded had it not been identified. The government need to be compensated the cost it incur besides the actual sum of money that would have been evaded.

The other characteristic of effective system of tax collection is that the civil penalty should be one that give lesson to the tax payer who found committing tax evasion and to tax payers in general. The civil penalty needs to be the one which made to think the consequences of tax evasions costs so much and so that it will restrain himself from engaging in the act of tax evasion.

In light of that the civil penalty provided under Ethiopian income tax proclamation is not the one that costs much the tax payer who engaged in the act of evading payment of tax due and there is no guarantee that the tax payer will no engaged again in the act of evading the payment of tax due. Therefore, the civil penalty for tax evasion provided under the income tax proclamation lacks the characteristics of deterrence which is the main device to insure effective collection of taxes.

As far as the deterrence effect on overall tax payer concerned it seems that the Ethiopia income tax proclamation have no effect in the same way with the tax payers found in the act of evading the payment of the tax due. Actually, had the civil penalty deterrent enough in the first place it is the tax payer who faced civil penalty for his/her act of evading tax due who would be deterred from future violation of the tax laws. Therefore, the general tax payers are not getting any lesson from the civil penalty imposed on the tax payer who found in the act of evading tax.

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As far as simplicity, fairness and integration concerned it seems that the income tax proclamation fulfills at least at face value of these characteristics of effective tax system. Unless the practical application of the civil penalty result to violation of these characteristics, the standing law seems simple, fair and nobody subject to penalty for which already penalized for.

The last characteristic is continuity in application of the civil penalty provided under the income tax proclamation. This actually is the practical concern that to be examined in light of the working of the enforcement organ entrusted with responsibility of identifying the act of tax evasion and bringing them before the appropriate body to pass decision over this act of evading the payment of tax due. The more the chain of this kind of process continuous, more likely the purposes of the civil penalty would be achieved effectively and efficiently.

Besides, the continuity in the application of these tax consequences has a great role in the fight against tax evasion. This is because lack of continuity will create a sense of confidence in that there will not be consequence to follow the act of tax evading. By insuring continuity in the consequences of tax evasion, we can guarantee the tax payers who intend to engage in tax evasion that there is for sure certain consequence to follow.

As some research suggested lower penalty applied effectively will have higher potential in deterring tax evasion more than higher penalty to be applied infrequently. This is actually the manifestation of how consistency in application of consequences indicated in the appropriate tax laws and other laws.

The first thing that can affect continuity in application is the corruption by the tax officials. Whenever the taxpayers bribed the tax officials they would get a way out from the consequences of tax evasion. As some empirical research suggest, among other reasons, corruption account for the persistence of business working underground. There is positive correlation between corruption and the size of the shadow economy.¹²¹

In response to that the income tax proclamation, under art.99, offences by the tax employee who engaged in activity indicated under the same would subjected to punishment of fine not more than 50,000 birr and imprisonment for a term of not less than 10 years and not more than twenty

¹²¹ See Fuest, Supra note at 30, at 12. See e.g Friedman et al 2000

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years. This would constitute a risk to tax employee who intend to engage in act of corruption and which would have create a break the continuity of bringing those taxpayer who found engage in act of evading tax to entrusted organ of adjudicating the same.

Further, according to Netsanet Abera, the ERA's deputy general director and Addis Ababa's tax programme and development works head, corruption is a major problem that restricts the collection of tax due. In an effort to increase the tax revenue, she stated that the ERCA has installed a modern computerized filling system, where data and personal details of taxpayers will easily be retrieved. This will leave no room for corrupt tax officers who bargain bribes by concealing data.¹²²

3.3.2 Criminal liability

Sanction can have more than one purpose. The most important component is the ability to deter unwanted behaviors, so as to bring about greater compliance. In addition to their deterrence component, sanction may also have an important financial component. Financial sanction may raise revenue, while prison sentence may increase expenditure.¹²³

Besides sanction has a punishment element, which act as a guarantor of equity and fairness among taxpayers, ensuring everybody pays due share of tax.¹²⁴

There is stipulation under the income tax proclamation as to the purpose to be achieved by the penal sanctions considered under the same. But cases provide a sort of clue as to the purposes need to be achieved by criminal sanction. In one of the case, it is stated that penal sanction should be the one that punish, rehabilitate, deter similar kind of criminal behavior and prevent the commission of crimes.¹²⁵ In another case, it is stated that first purpose is giving warning by

¹²² Ethiopia reporter news, Amharic news, available at www.ethiopianreporter.com/tag (accessed at 08 march 2016)

¹²³ See Gordon, Supra note at 65, at 22.

¹²⁴ J. Davison, "The new penalty regime (2009) VAT digest 3, at 4.

¹²⁵ See Federal Inland Revenue Authority Vs. Eyusam General Trading private limited company, Federal First Instance Court, File No. 177942

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letting them know the punishment to follow for certain criminal action, punish those found violating the law and deter potential criminal behavior.¹²⁶

On that background, the income tax proclamation, under art.94, stated that a tax offence is a violation of the criminal law of Ethiopia and shall be charged, prosecuted and appealed in accordance with the Ethiopian criminal procedure law.

Thus every aspects of the crime of tax evasion governed by the criminal procedure code, start from investigation of the same crime to the final stage of trial. This means there are no special circumstances that call for special treatment like the case in corruption and terrorism crimes. But in some jurisdiction the tax authority is conferred with the power of to enter business premise without warrant and to enter a dwelling with warrant.¹²⁷

This seems justified in light of the working of tax administration. The taxpayers are in the possession of every detail evidences which the public prosecutor would use against them before court of law. If the public prosecutor cannot get expedite way of securing such evidences from the taxpayer, the taxpayer would get ample time to hide these evidences from the reach of these public prosecutor. Securing of this search warrant would not be simple task for the public prosecutor in light of the bulky of cases the court of law should have to see and decides. The more cases there with court of law, the more time it would take to secure this search warrant.

Further, self-assessment rule would create another difficulty for the public prosecutor. This self-assessment gives the taxpayer the opportunity of selecting the type of documents to be produced in support of this self-assessment made by the taxpayer. This situation would give the taxpayer wider opportunity to hide important evidences from the reach of the public prosecutor. Had it been possible to enter into business premise as soon as possible it would have been possible to secure important evidences. The more time it take to enter the business premises the more difficult it would be to secure material evidences by the public prosecutor to prove their case.

¹²⁶See Federal Inland Revenue Authority Vs. East African private limited company, Federal High Court, File No. 149462

¹²⁷ Justice F.J Pizzitelli and Sona Dhawan, Tax avoidance and tax evasion in Canada, prepared for the international association of tax judges (IATJ 4th assembly), Amesterdam conference, at 9.

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Moreover, fraud is usually considered as a crime, as is the case also in Ethiopia, but it is often difficult to prove.¹²⁸ This is because the public prosecutor should have to prove their case beyond reasonable doubt as is the case in the ordinary crimes. Devoid of having an expedite way of securing evidences from the taxpayers, it would be quite impossible for the public prosecutor to fulfill this standard of proof.

As far as the practices is concerned, as per my interview with w\ro Tsion Admasu, vice senior public prosecutor in revenue and custom authority, if there is a probability of evidence to be lost devoid of immediate action by the public prosecutor the public prosecutor can enter business premise without warrant as provided under art.66 Of federal tax administration proclamation. But here there seems inconsistency between the practice and the income tax proclamation.

Because the income tax proclamation, the special law in this context, did not contemplate such power of public prosecutor to enter business premise without warrant. It rather the federal tax administration proclamation grants such power. So long as that is case, as far as the cases are the one governed by the income tax proclamation, the practice is against the standing law.¹⁴²¹²⁹

In the meanwhile there seems overlap between the criminal code and this proclamation. The same with the income tax proclamation, the criminal code penalize the act of providing false statement about property, capital or income subject to taxation.¹⁴³

Actually this one is wider than the one in the income tax proclamation, but still dealing with the same issue of making false statement. Thus which sanction would to apply in the case of making false statement by the taxpayer?

In this respect indeed the proclamation declare that all laws which are inconsistence with this shall not apply on matters covered under this proclamation.¹³⁰ Further the federal cassation

¹²⁸ See Gordon, Supra note at 56, at 36.

¹²⁹ The newly enacted Federal income tax proclamation, No.979\2016, under art.81 it stated that the tax administration proclamation shall apply for the purpose of the tax administration of this proclamation. In which case, this contradiction will be reconciled. Thus the public prosecutor will have a power to enter business premise without warrant when there is likelihood for the evidences to be lost.

¹³⁰ See art.119(4) Of income tax proclamation No. 286/2002

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division bench gives a decision that the penal sanction in the income tax proclamation would prevail in time of overlap with the criminal code.¹³¹

There is criminal liability for the failure to observe the rules in the income tax laws, as provided under Art.96 of proclamation No 286\2002, tax offences are considered as a crime that will entail criminal punishment. Art 96 of the same proclamation cross refer to Art 86 which deal with penalty for late filling or non-filling. But Art 96 is dealing with tax evasion and in fact talking about understatement of income as states in the same Article which is considered under Art 87 of the same proclamation.

It seem that Art 96 is referring back to Art 86 which in fact intend to cross refer to Art 87 which deal with understatement of tax which also indicated under Art 96. So that it is good to be recognized that Art 86 is cross referring back to Art 87 not to Art 86, even though Art 96 mistakenly cross refer back to Art 86.

Those taxpayers who make false or misleading statement in material particular commit offence and are liable on conviction.¹³² This article sets two criteria for the taxpayer said to commit an offence. The first is that false or misleading statement should to be made by the taxpayer. This statement could be made in different manner and circumstances. Secondly the statement should in material particular. This means mere statement would not be considered as offence, rather the statement that should brought about change to the amount of tax that would have been paid. Omission of statement also considered to be offence the same with making of false or misleading statement.¹³³

There is a difference in making the misleading statement whether it made without reasonable excuse and made knowingly or recklessly. When the statement is made without reasonable excuse, if the inaccuracy of the statement undetected may result in the underpayment of tax by amount exceeding 1000 birr, the taxpayer shall liable to a fine of not less than 10,000 birr and

¹³¹ See Federal custom and Revenue Authority Vs. Naima Awol, Federal Supreme Court Cassation Division Bench, Vol. 10, File No. 149462

¹³² See art.97 Of income tax proclamation No. 286/2002

¹³³ See art.97(1)(b) Of income tax proclamation No. 286/2002

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not more than 20,000 birr, and imprisonment for a term of not less than one year and not more than three years.¹³⁴

If the underpayment of tax is in an amount exceeding birr 1,000, he shall be liable to fine not less than twenty thousand birr and not more than 100,000 and imprisonment for a term of not less than three years and not more than five years.¹³⁵

Where the statement is made knowingly or recklessly, the inaccuracy of the statement undetected may result in the underpayment of tax by amount exceeding 1000 birr, the taxpayer shall liable to a fine of not less than 50,000 birr and not more than 100,000 birr, and imprisonment for a term of not less than five year and not more than ten years.¹³⁶ .

If the underpayment of tax is in an amount exceeding birr 1,000, he shall be liable to fine not less than 75,000 birr and not more than 200,000 and imprisonment for a term of not less than three years and not more than five years.¹³⁷ But these two sub article used ‘or’ in making appear that the monetary sanction and imprisonment used alternatively. But the Amharic version used conjunction of ‘and’ which seems is the correct one. This is because statement made without reasonable excuse is less heinous offence as compared with statement made knowingly or recklessly.

As far as the practice is concerned, tax evasion act considered under art.96 apply for act of evading tax without production of certain document that would led to underpayment or under declaration of income tax that is due.¹³⁸ As opposed to that, the act of evading tax indicated under art.97 seem to requires forged document that will result to under payment or under declaration of income tax due.¹³⁹

¹³⁴See art.97(2)(a) Of income tax proclamation No. 286/2002

¹³⁵ See art.97(2)(b) Of income tax proclamation No. 286/2002

¹³⁶ See art.97(3)(a) Of income tax proclamation No. 286/2002

¹³⁷ See art.97(3)(b) Of income tax proclamation No. 286/2002

¹³⁸See Federal Inland Revenue Authority Vs. East African private limited company, Federal High Court, File No. 149462.

¹³⁹ See Federal Inland Revenue Authority Vs. Genesis Computer Solution Private limited company, Federal high court , File No. 164063.

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For offences by entity, where an entity commit an offence, the manager of that entity at the time of the commission of the offence is treated as having committed the same and liable to a fine and imprisonment under the proclamation.¹⁴⁰ But manager would exonerated from liability if the offence is committed without his consent or knowledge and exercised such person the degree of care, diligence and skill that reasonable prudent person would have exercised in comparable circumstances to prevent the commission of the offence.¹⁴¹

3.4 Income Tax avoidance by company

Tax avoidance is an act meant to avoid a payment of tax due up on the conclusion of certain activity which declared by the concerned tax law as it has tax implication. It is not illegal. It is something legal, but it has implication over effective and efficiently collection of tax due and the neutrality of business decisions to be made in certain market. For the mere fact that it is not illegal, does not mean that it will not create problem as tax evasion does.

As the case with tax evasion, certain mechanism to curb the act of avoiding tax need to be develop and the different problems to be ensued because of this tax avoiding practice will successfully managed and get fixed.

The second one is that for the mere fact of avoiding the payment of tax due, they chooses to venture into a course of action which produces the smallest of all benefits relative to other factors which contributes for the attainment of better benefit to the company concerned, in particular, and to the general economy in general. For example, a certain company may come across with the possibility of merging or transferring their company, but such transaction entails the consequence of tax payment up on the occurrence of either of the transactions above contemplated.

This company, for the single reason of avoiding the payment of the tax due, may choose not to undertake such transaction. But from the perspective of efficiency and affectivity in a certain market, the company will be more effective and efficient, i.e. produce a better output relative to its prior output before such transaction occurs. The market this company operating its business

¹⁴⁰ See art.102(1) Of income tax proclamation No. 286/2002

¹⁴¹ See art.102(3) Of income tax proclamation No. 286/2002

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will loss the output it would have produce had the transactions in fact taken place by the company concerned.

So here, it is justifiable and legitimate to try to find a way to deal with this tax avoiding practices of companies. There is certain mechanism of combating tax avoidance practices of business which called as anti-avoidance measures. Anti-avoidance measures can be perceived as a sieve that prevents the reduction of the tax liability to tax. Specific measures engrained in the article serve as effective control measure that can tighten the tax net or deter the avoidance of tax by taxpayer.¹⁴² General anti-avoidance measures serves their purpose as a barrier that filter transactions and schemes which are set up for the avoidance of tax, particularly those having a fictitious or artificial purpose.¹⁴³

We don't find any of anti-avoidance measures considered above in the Ethiopian income tax proclamation or regulation or directive. To the worse, some of the provisions in the income tax proclamation No 286/2002 seem to be cause for the share companies to get engaged in the practices of avoiding the payment of tax due. But the newly enacted federal income tax proclamation comes up with provisions that deal with anti-tax avoidance. But it is far from being enough to deal with the issues of tax avoidance practices of taxpayer.

Therefore, in addition to looking for a mechanism to curb tax avoiding practices of company, to examine the effect of provisions in the income tax on tax avoiding activity of companies seems logical and mandatory for problems surrounding tax avoidance act of share companies said to be considered entirely, though not solved. The first measure is to introduce rule that regulate acts that deal with anti-avoidance measure. That actually not exist in the previous proclamation, though introduce in the new proclamation.

In the mean while the increase in a capital of a share company, as provided under Art. 21(b) of proclamation No.286 \2002, will not be considered as deductible expense from the gross income the companies get. While the loan from banks, as provided under Art 21(e) ,the contrario reading of this sub article of proclamation No.286\2002, considered to be deductible expenses as long as

¹⁴² Denis Healey, Tax avoidance or tax evasion?, symposia melitensia number 10 (2015), at 228.

¹⁴³ Id.

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it is not in excess by two percentage point of the interest rate used between the national bank of Ethiopia and the commercial banks.

Actually the root of the problem lies, according to Doctor Walela, on the failure to differentiate between undistributed dividends and distributed dividends.¹⁴⁴ Whether it is distributed to the shareholders or not dividend tax will be imposed.¹⁴⁵ But as the experience in America reveals, as punishment on the share company an income tax called retaining tax will be imposed on those profit that remain to deposited.¹⁴⁶ In other word if the retaining is used for other purpose, like for reinvestment this retaining tax would not be imposed.

The denial to be considered as deductible may be because of controlling the act of avoiding the payment of tax due as dividend tax as provided under Art.34 of proclamation No.286\2002. With the presumption that company shareholders set free from the payment of 10% of their dividend as income tax and the same used to increase the capital of the company to be considered as a deductible expense. The law stands seem that once the dividend tax is forfeited, it is unfair to consider again the same profit to be considered as deductible expense.

Here it seems that such controlling or compensation scheme will not achieve what it meant for. This is because the companies have the same or even better means of achieving the need to increase the capital of the company. Rather causing other problem over other important concerns. It would be better of adopting the experience of America in this respect as it is proposed by doctor Walelu. It is obvious that the level of investment in certain country is good manifestation of the economic growth the country concerned achieved.

These double benefits are the deductibility of the loan as expense and the interest rate which accompanies the loan is considered as expense too. More than the costs to be forfeited because of permitting the company to be consider as cost of increasing the share of a capital as deductible,

¹⁴⁴ The federal income tax proclamation comes up with something complex. Income tax of 10% will be paid on the undistributed profit, except when reinvested. On the other hand art.27(b) increase of capital of share company will not be considered as deductible expense. Here it seems that undistributed profit used to increase share capital of company will not be considered as deductible expense. At this point, the proclamation is introduced two conflicting articles. Because increase of capital is one form of reinvestment, but the proclamation seems tend to assume that increase of capital of Share Company from the undistributed is not reinvestment. Contrary to this loan from individuals are considered as deductible expense as it is provided under art.23(1)

¹⁴⁵ Ethiopia reporter news, Amharic news, available at [www.ethiopianreporter.com/tag.](http://www.ethiopianreporter.com/tag/)(accessed at 08 march 2016)

¹⁴⁶Id.

the costs to be forfeited because the loan and interest over the same is greater. This is because in addition to the base loan, the interest, which may be greater whenever the time span of the loan get longer, which even be equal with base loan or constitute large sum of money, which may be intentionally set higher as far as it is in line with Art 21() of the same proclamation. This cost is higher to be considered as cost to be deducted from the gross income of the company that it is very convincing and legitimate not to consider as cost or expense to be deducted.

To the extent possible rules in different parts of a certain country law need to be one that promote investment or facilitate the way for a greater investment. In line with that the scenario over the non-deductibility of the cost of interest on the loan could have the effect of discouraging the bringing in of new source of investment by resorting to loan from the banks. Which is already be set as a part of investment which would have been used by potential investor who have no other possibility of getting such source of investment.

3.5 Aggressive income tax rules in Ethiopian case

The term aggressive rule, in the context of this study, used in the loose sense of the term would imply. Aggressive rule to mean those rules which may be unacceptable to the moral of reasonable tax payer. Actually, there are tax payers to what so over extent the tax rules stick to the fairness principle of optimal taxation system who would keep on doing those acts that undermine the whole system of the tax regime.

The reference made to reasonable tax payer was intentional which is because these groups of tax payers have a reason why they got engaged with acts that violate the tax rules at hand. That means if the reason why they commit such act is no more exist, hopefully, they would no more involved in such acts.

As far as the non – reasonable tax payers concerned, removing these aggressive rules may not be a solution rather rules on consequences of tax evasion, disclosure requirement and others, which I dealt above in this chapter, would be the appropriate devices to deal with these tax payers. This is indeed one of the criticisms that directed towards psychological theory of compliance to tax rules.

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Any of the tax rules in fact do not respond to problems with regard to compliance in comprehensive fashion, rather these theories resolve some aspects of compliance while they serve nothing for other problems of compliance. The affectivity and efficiency of these theories also rely on the kind of tax payer the concerned tax law meant to be applied.

If the tax payers are the one who are well educated and a person of reason, they might be influenced by the psychological and economic theory of compliance while they deny giving a little weight for the sociological theory of compliance. So that according to the type of tax payers the tax law aimed to be enforced, the type of theory of compliance to be relying on for effective and efficient enforcement of the tax law at hand would vary.

As far as Ethiopian income tax law is concerned the legitimacy of the working of the taxation regime and it rules in the mind of the tax payers matter most for effective and efficient implementation of the tax rules found their way in different tax laws. Constructing the legitimacy of the tax system by complying with the principle of fairness have great contribution in insuring better compliance by the tax payers as it serves as a fuel for the tax payers to inform any case of tax violation by any other tax payer.

The reward envisaged under Art 84 of proclamation No.286/2002 will never get effect unless the legitimacy of the tax regime of the tax payers get corrected to the one which made the tax payer to accept the legitimacy of the working of the tax system.¹⁴⁷ Actually like group reward and individual rewards have shown to provide a significant positive inducement for greater compliance.¹⁴⁸ Here, there is no intention of saying that the Ethiopian tax regime is not legitimate rather the writer is trying to portray how being legitimate contribute a lot for a better compliance.

¹⁴⁷ Beside the reward the informer would entitle to, the legitimacy of the tax system would influence much the informer in his/her decision of either to give information as to the tax evasion practice of any of the tax payer or not. With mere intention of getting the reward that the informer supply the information of evading the payment of income tax, the former will later on may felt being guilty of supplying such information as the tax system lacks legitimacy the tax payer is trying to minimize the effect of illegitimate tax system. But, if he/she believes that the tax regime is legitimacy, he/she would indeed feel that in informing such practices of disobeying the tax rules as fulfilling one of the prominent obligations of being a citizen of a certain country, in our case being Ethiopian.

¹⁴⁸ Miller Berstein, Tax evasion and avoidance and impact on your business, at 18.

4.5.1 Corporate flat rate of taxing income of Company

Vertical justice proved to be relevant for tax evasion.¹⁴⁹ This means that whether there is vertical injustice or not would have effect on the intensity of tax evasion activity of taxpayers. Accordingly whenever there is vertical injustice among taxpayer, there is high probability of tax evasion by the taxpayers. Flat rate of taxing taxpayer is among the reasons that create vertical injustice among taxpayers.

Further the structure of the overall tax system and tax rate has an impact in the compliance practice of taxpayer. If, for example, the tax rate on corporates is relatively low, but individuals are facing high tax rate on their personal income, they may perceive their personal burden as unfair and choose to declare only a part of their income. Tax rates and the overall tax structure, therefore, have significant effect on the disposition to evade and avoid taxes.¹⁵⁰

Further the analyses of the distributional impact of taxation account for the presence of evasion.¹⁵¹ Whenever the distribution impact of taxation uneven or affecting part of the taxpayer more than the other there is more likely there to present high level of tax evasion activity by the taxpayer. As opposed that, if the distributional impact of taxation even among taxpayer there would only minimum disposition to tax evasion by the taxpayer.

Moreover among the fair and effective taxation, the ‘‘four R’s’’, redistribution progressive tax system is a device to insure economic equality among the taxpayers. Taxation is one of public policy device whereby the economic inequality among individuals kept. Economic growth does not generally leads to a more equal distribution, but may increase inequality.¹⁵²

The tax rate should be the one that insure economic equality among individuals. Otherwise it would lead to more economic inequality among the taxpayer. Besides the tax rate should not discourage infant establishment.¹⁵³ Tax rate should be the one that encourage infant establishment by providing differential treatment among taxpayers.

¹⁴⁹ See Kirchler, Supra note at 46, at 10.

¹⁵⁰ See GIZ, Supra note at 27, at 14.

¹⁵¹ Joel Slemrod and Shlomo Yizhaki, Tax avoidance, evasion and administration, chapter 22, at 1446. See also Bishop, Chow and Ho(1994) find this for the united states using the 1985 TCM data.

¹⁵² Eric Toder, Focus on the tax ‘avoidance’ gap, 2009, at 6.

¹⁵³ See Asaminew, Supra note at 112, at 21.

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On that background, all share companies operating in Ethiopia will subject flat rate of 30% of their taxable income.¹⁵⁴ The size or other different aspects on the share companies is not a matter of consideration as far as the tax rate to be applied are concerned. The giant share companies, like MEDROC or MNCs established in Ethiopia their branch or their principal, will subject to the same rate with the one at infant stage of formation in Ethiopia.

This actually administratively simple to apply to collect the income tax due, but it seem to result to something unpleasant to the part of the share companies which ought to pay equal sum of money with that of the giant share companies generating profit in billions. As I considered above, this would ultimately result to vertical injustice among taxpayer. Vertical justice calls for separate treatment among taxpayer based on their ability to pay. This means the probability of taxpayer to engage in tax evasion practices is high as empirical researches suggests.

As provided under Art. 19(2) of proclamation No. 286/2002 tax payers, who are not body corporations ,sometimes, pay income tax with tax rate of 35% of their income which is a greater than the flat rate of 30% to be applied to the share companies , including the giant share companies.

At this juncture, one factor alone should not be considered with the existence of other equally relevant and important factors to be considered in the determination of the tax rate to be applied on the taxable income of the share companies. The adoption of flat rate to tax body corporate, like share companies, have implication over two important stakeholders.

The first implication is over infant share companies. The share companies at infant stage of development are generating nominal amount of money as profit relative to the middle and giant share companies. To the worst, if these share companies engaging in the same business with these giant share companies they would find it difficult to compete equally with these giant companies.

¹⁵⁴ Id.

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This scenario can serve the giant companies as a device to make it difficult for the small companies to penetrate the market they are operating their business. This means that the tax rate is discouraging infant establishment rather than being one that encourage their establishment.¹⁵⁵

The other is on the businesses which are bodies as defined in the respective laws, which are expected to pay their income tax on progressive manner. Surprisingly, business which gets annual income of 42,601-60,000 will subject to 30% of tax rate which is equal with the general flat rate to be imposed in all share companies.

This income is annual income of these businesses which is nominal amount relative to even the infant share companies, let alone the giant share companies. These scenarios in much unambiguous way make the tax rate adopted by Ethiopian income tax proclamation to fall short of fairness principle which underlines every optimal taxation system across the globe. This means, as I discussed above, this affect the perceived fairness of taxpayer towards the tax administration system. This makes the taxation system aggressive towards the part of taxpayers. This in turn would lead to widespread tax evasion practices of taxpayer as overwhelming empirical researches suggested.

Further it affects the distributional impact of taxation on taxpayer. The income taxation is affecting more part of the taxpayer more than part of taxpayers. As empirical research found out this distributional impact accounts for the presence of tax evasion. Accordingly the flat rate of taxing the income of the share companies in Ethiopia is one of the reasons for the persistence existence of tax evasion.

The second one is with regard to the revenue to be generated by the government out of the income tax to be collected from the income of these share companies. The government main source of revenue is the wealthy share companies which realized the lion share of profit to be generated from certain market. While these share companies paying the small portion of their income relative to the infant share companies that pays greater sum of money as income tax

¹⁵⁵ This means is that flat rate of taxing share companies could have effect on the market competition of the share companies in shifting the balance in favor of the giant companies which already is in possession of the large part of the share of market. Because of taxation the Business environment is being disturbed as the taxation system favoring one against the other.

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relative to the income they get. This is stem out of the regressive effect of using flat rate as a standard of taxing the income of tax payers.

Ability to pay tax principle is all in all compromised by the application of flat rate of taxing the income of the share companies. This is because the flat rate of taxing income irrespective of the ability of tax payer, which measured by the income generate by the concerned tax payer, require the payment of sum of money as income tax with the same rate of the income they generate.

Here the problem is that the income tax is undermining the ability of part of share companies while boosting the ability of the wealthy share companies. In boosting the ability of the wealthy share companies, the government is losing some part of revenue which could be conveniently collected from these wealthy share companies had progressive or different type of rate applied on the income of the share companies. This manifests that the tax rate is not being used as one economic device of decreasing economic inequality among individuals which economic growth cannot achieve it.

The income tax to be collected from the infant share companies, despite it constitute the large part of their income, is small relative to the income tax to be collected from the wealthy share companies.

Therefore, this flat rate of taxing share companies is not only affecting the infant share companies and the other business which are not corporate body, but also the government annual revenue because it over emphasizing in taxing the one which did not generate large sum of money as profit rather the one which generate nominal sum of money as profit.

Moreover, in the united states of America and other developed state, for example, which have a well-developed experience of taxing companies and proper understanding of the various issues involved in taxing companies, which seem mainly emanate from the various researches undertaken by their scholars which in turn serve as a device to enhance the understandings on taxing companies, is using progressive form of taxing the income of these companies earned annually.

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This actually justified in light of the move of Ethiopia to join the WTO, even though the process paused for a time being, the accession sooner or later will hopefully realized as Ethiopia cannot succeed to avoid the driving force of Globalization in trade. Following which the giant multination corporation will easily penetrate the market of Ethiopia which, relative to these MNCS, mainly filled with domestic companies with little capital to finance to the market they are operating. Which would in turn makes the domestic companies vulnerable to the attacks of these MNCS in their competition to grab their share from the Ethiopian market.

So, are we going to tax them with flat rate of 30% equal with the domestic companies? If the answer is affirmative, which is the case if the income tax proclamation to remain intact, so what is Ethiopia benefit to retain from enjoying the membership of WTO?

This actually an independent theme for any interested person to work on but it is obvious that taxation is one of the dominant device to insure the Ethiopian economic benefit to be maximized. As one instrument of achieving Ethiopian economic policy, the income tax proclamation needs to be the manifestation of the purposes the tax laws potentially could be used.

4.5.2 Appeal right in income taxation

Tax assessment is the process of determining the tax obligation of individual tax payer. In simple terms, it is a means to ascertain the tax due from the general revenue generated by the concerned tax payer which can be monthly or annual revenue of the tax payer under consideration. As far as the assessment of category “A” tax payers, which are the main group of tax payer this study focus on, there are two method of assessing taxable income of the payer which are standard assessment and assessment by estimation as provided under Art 68 and 89 of proclamation No. 286/2002 of Ethiopia. The standard assessment is fixed amount of tax which provided under the council of minister regulation that establish a schedule of standard assessment reflect variations in the type of business, business size and business location.

The other is estimation that to be done via directives to be issued by the minister of revenue when there is no record and books of account or for any other reason the record and books of account are unacceptable to the tax authority. The assessment by estimation more likely the

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general assumption towards the income to be generated and the cost to be incurred to generate the income would be used to determine the tax due.

Therefore, the exceptional situation of individual taxpayer will not be considered that would have been the case in the standard assessment as the assessment base on the record and book kept by the tax payer himself. After the assessment via the two methods of assessing the tax due, disagreement between the tax payers and tax authority inevitably will arises which call a certain way of resolving such dispute.

Up on the notification or the assessment made by the tax authority, the unsatisfied tax payer can apply to the review committee within 10 days of receipt of tax assessment notification. The review committee has the duty to examine and decide on all application submitted by the tax payer for compromise of interest, penalty and waiver of tax liability.¹⁵⁶ Up on the approval of the head of the tax authority, recommendation of the committee would give effect. Further, the committee may waive administrative penalties as per the directive issued by the minister of revenue.

The second possible avenue for measure against the tax assessment made authority is to appeal for the appeal commission.¹⁵⁷ Up on depositing the fifty percent of the disputed amount,¹⁵⁸ and within 30 days after the receipt of the assessment notice or from the date of the review committee pass decision, the tax payer can appeal to this tax appeal commission. Tax appeal commission a tribunal set up within the executive branch under the Ministry of Justice. Although the Commission is still within the executive branch of government, the Tax Appeal Commission enjoys relative autonomy and independence as it is organized outside the Tax Administration.¹⁵⁹

Further, on the ground of being erroneous on any matter of law within 30 days from the date of receipt of the written decision of the appeal commission can appeal to the competent court of

¹⁵⁶ See art. 105 (1) Of income tax proclamation No. 286/2002.

¹⁵⁷ See Art.107 Of income tax proclamation No. 286/2002.

¹⁵⁸ As per the new draft income tax proclamation, the 50% percent requirement to appeal to review committee is reduced down to 25%. This issue has been subjected for series of contention by taxpayers. From the expectation of the public at large, the change introduced is much minor.

¹⁵⁹ See Lencho, Supra note at 1, at 373.

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appeal.¹⁶⁰ An appeal from the decisions of the Tax Appeal Commission lies to the High Court—the first opportunity the regular courts have to entertain tax cases; even then, only when an error of law (rather than fact) is found in the judgment of the Tax Appeal Commission.¹⁶¹ Any party who dissatisfied by decision of this court of appeal, can appeal to the second appeal court. But for the exercise of such appeal to these courts, the tax payer should have to pay the tax liability determined by the appeal commission.¹⁶²

This means is that the payment of the tax liability determines by this appeal commission is mandatory condition for the enjoyment of the result from the appeal to the successive competent courts. Here is exactly where the tax payers are echoed their concern over their appeal right to competent courts.

The payment of the full tax liability determined by the appeal commission as a condition for appeal to competent court seem as sort of indirect form of denying the appeal right of the tax payer concerned. In spite of the fact that, after even paying the tax liability determined by the appeal commission, the appeal avenue is provided for looking into mistake of law, not fact.¹⁶³

Back to the condition of paying full liability based on the tax determined by the appeal commission, it sound like prohibiting the tax payer from appealing, especially when the tax payer has no the required money to pay the full tax liability determined.¹⁶⁴

.On this concern the writer has conducted an interview with some taxpayers. Accordingly, the first interviewee stated that whatever error I think to exist in the assessment of tax authority, I

¹⁶⁰ See Art.112 (1) Of income tax proclamation No. 286/2002.

¹⁶¹See Lencho, Supra note at 1, at 375.

¹⁶² See Art 112 Of income tax proclamation No. 286/2002.

¹⁶³ The narrowing down of the issue to be considered to matter of law is justified in light of the possibility provided by the income tax proclamation for review of the decision over the tax assessment made by the respective tax authority. If it is possible to resort to appeal for mistake of fact and law, the establishment of such reviewing body by the income proclamation would be without anything to contribute to the resolution of tax dispute than just there to review decision of the tax authority over the assessment of tax obligation of the tax payer.

Further, it is justified in light of the special expert skill and knowledge of the judge appointed in these commissions or committee. They are in a better position than ordinary judge in a court of law which reviews the decision of the appeal commission. Therefore, the limitation of the issue to matter of law is justified and legitimate.

¹⁶⁴ Actually, it should not be forgotten that there is legitimate concern the government is trying to protect in requiring the full payment of tax liability.

A matter of one day in the payment of the tax liability will make a difference on the benefit to be accrued from the use of the money paid as income tax liability. This may seem justified in light of the available avenue for reviewing the decision of the tax authority on tax assessment

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would not think of asking for reconsideration by review committee and the second layer of appeal recourse because of the requirement of paying 50% of the tax assessed to appeal to appeal commission and paying 100% of the tax assessed to access regular court. Which in fact made him feel that no probability of reversal by the either appeal commissions or regular courts.

He added whatever assessment to be made by the tax authority, I have two options which are either to pay the full amount of the assessment made or asking for revocation of my business license. The second one stated that whenever I made the full payment of the tax assessed by tax authority I feel that my money is being snatched unfairly because am deprived of the possibility of check by regular courts as to the fairness of the decision by review committee or appeal commission.

As far as I am concerned, I felt that the review committee and appeal commission have bias to the tax authority. This perception would have not created had I get the chance of bringing my case before regular courts which I think more neutral than the two layers of appeal. Thus the belief of biasness of the two layers of appeal would have successfully avoided.

The third one stated that choosing to go to regular have no solution, on the top of 50% and 100% payment of tax assessed by tax authority as condition to appeal, than incurring extra money as court fee and scarifying valuable time by the long adjournment practices of court.

I would rather choose to save my money and time, and engage into my regular business. He added that bringing your case either to review committee or appeal commission or regular court will poisons your future relationship with tax authority and you will further become prime focus of the tax authority as far as tax evasion is concerned.

Interview also held with w\ro Tsion Admasu, vice senior public prosecutor in revenue and custom authority, but apart from stating the change introduced by the newly enacted income tax proclamation, did not try to justify the position of the income tax proclamation. Actually such response impliedly admits the concern raised by the general taxpayers.

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On that background one empirical research found that the relation between tax authority and taxpayers has greater contribution for the tax evasion and avoidance practices of taxpayers.¹⁶⁵ The more the relation becomes weaker, the more probable that taxpayer will engage in tax evasion and avoidance activity. Moreover Pommerhne et al (1994) conducted study in order to recognize the determinants of tax evasion. Results indicated that as the sentiment of grievance increased in absolute term, the level of tax evasion increased and the level of tax moral decreased.

As we discern from the above relation of tax authority and taxpayer, the relation is more of hate and the belief of unfairness by taxpayer. We can also discern that the taxpayers aggrieved of the limitation put in their appeal rights. Thus this condition will result in widespread practice of tax evasion.

Such scenario would make the position of the income tax proclamation questionable in light of the fairness of such measures. Statute that prohibits or undermines judicial review of taxpayer penalty determination undermines voluntary compliance by under cutting taxpayers' faith in the system and eliminating an essential and expected avenue of potential redress.¹⁶⁶

Therefore this scenario calls for some kind of measures to be taken by the concerned law making organ and fix the poor relationship and grievance created by the appeal right of taxpayers.

In the meanwhile there are different interests to be compromised for putting such condition for such appeal to competent courts. The first is that the tax payers who have no means of satisfying their tax liability determined by the appeal commission will deprive of the possibility of appeal to competent court on the issue of law.

Secondly, which follow from the first reason ,the income tax proclamation seem to have no concern over mistake of law as it deny for the possibility of such thing to be examined by the competent court with condition of full payment of the tax liability confirmed by the appeal commission.

¹⁶⁵ See Mugal and Akram, Supra note at 73, at 221.

¹⁶⁶ See Tax practice responsibilities committee, Supra note at 132, at 11.

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Thirdly, the requirement to pay for 50% of the tax in dispute to appeal for the appeal commission as were redundancy of condition to exercise appeal right of the tax payers. This 50% requirement is meant to alleviate the benefit forfeited because of the different layers to review the decision on the tax assessment. This double condition of paying the full tax liability on the event of decision rendered by the appeal commission on the tax assessment to appeal to competent court seems to be burdensome and unreasonable to tax payers who have no means of paying their full tax liability and exercise their appeal right.

These all things cumulatively would undermine the legitimacy of the tax administration which in turn has implication on overall compliance practice of tax payer concerned. There are different mechanisms to insure the same purpose meant to be achieved by the condition of full payment of the tax liability determined by the tax appeal commission.

The first is through reduction of the number of days, which is to appeal within 30 days from the notification of the tax assessment by the tax authority, between the notification of the assessment to appeal to the appeal commission and appeal to the competent court. The special interest of the government involved in the dispute will justify this as with condition of the payment of 50% of the tax in dispute to bring action against the tax authority.

The second one is removing out the review committee indicated under the income tax proclamation. This is because its role is more of recommendation with regard to the possible solutions to the dispute at hand. Secondly it is wastage of time as the decision of this committee requires the approval of the head of the tax authority which can cause further delay to the case at hand. There is also possible abuse of such power as there are no indicated grounds for the exercise of such discretion by such tax authority. Again the impartiality of the head of tax authority is under question since it is like being a judge on own case.

The third one is allowing one further appeal to competent court and requiring the payment of full tax liability determined by the appeal commission and confirmed by the first competent court. So that the whole fear contemplated by this study would get fixed. One thing to be noted is that the exceptional circumstances involved in tax dispute is not ignored, rather how these exceptional

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circumstances to be handled without resulting into undermining the legitimacy of the whole working of the tax administration system of Ethiopia.

CHAPTER FOUR

CONCLUSION AND RECCOMENDATIONS

5.1 CONCLUSION

Tax is the main source of finance to be made available for the government of a certain country. Thus the government will use this source of finance to engage in different development activities to be undertaken within and outside of the country. Specially, country like Ethiopia calls for huge source of finance to get engaged in the development activity. This is because the country is at infant stage of development.

In the meanwhile, tax evasion and avoidance work against the above considered matters. This tax evasion and avoidance decrease down the finance available to the government of certain country. Share companies are one of the giant tax payers to the government but also they are the one which take the lion share of tax to be evaded and avoided.

So that searching certain way of dealing with this share companies practices of tax evasion and avoidance seems logical and reasonable endeavor. The first way to deal with tax evasion and avoidance is through disclosure requirement. This disclosure requirement manifested by two important mechanism. The first is through increasing the visibility of contract to be concluded by the share companies. Ethiopian contract law requires written formality for the business transaction to be concluded with regard to immovable and special movables.

But, the writer believes, this is not enough, it should extended to every business transaction this company engaged in should be made in written form. Thus the visibility of the business transaction would increases and, as the opportunity for audit trial increases, the probability for tax evasion and avoidance will be minimized.

The other is publication of the tax evasion act of taxpayers. Income tax proclamation limited the publication to the act of tax evasion, by leaving out the publication of audit result against the

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empirical evidence finding. Further practically such publication of tax evasion practices of taxpayer made only occasionally based on their educative nature and gravity of tax evasion act of taxpayer. The purposes of publication of the act of tax evasion not just educating the general public rather it also has the purpose of creating reputational risk to the businesses engaged in tax evasion. Further the law did not contemplate such condition for publication. Thus the practice is against the purpose of publication of tax evasion act of taxpayer and the income tax proclamation.

The other is with regard to the consequence of tax evasion and avoidance. This also has two layers. The first one is with regard to the penalty to be imposed. The civil penalty imposed is small in light of the purpose of such penalty. The penalty is not the one that constitutes real danger for the tax evader. Absence of such danger, which in turn creates fear on taxpayer, the taxpayer would keep on engaging in tax evasion activity as overwhelming number of empirical research found out.

Secondly the civil penalty to be imposed needs to be the one which fulfills the six characteristics of an effective and efficient system of tax administration. Ethiopian income tax system seems to fulfill the four characteristics of an efficient and effective system of tax administration. But it falls short of two characteristics, i.e. Compensation and deterrence.

As far as the criminal liability is concerned, the public prosecutors are deprived of special power of entering the business premises of the taxpayer without securing search warrant issued by court of law. But practically public prosecutor enter business premise without warrant, as it is indicated under federal tax administration proclamation, when there is likelihood for evidence to lose. This practice is against what is stated under the income tax proclamation which dictates that the rules in the criminal procedure code to be guiding rules for income tax evasion crime. Thus the practice is against the standing law that the public prosecutor should not enter business premise in any case so long as the standing law not changed in away allow such practice as this research proposing. Contrary to the case in Ethiopia as far as the standing law concerned, not the practice, in certain jurisdiction public prosecutor has this special power of entering the business premises of the taxpayer without search warrant. Devoid of this power it would for certain put

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high pressure on the public prosecutor who should have prove their case beyond reasonable doubt.

The other is with regard to tax avoidance practices of share companies. Ethiopian income tax proclamation let alone to provide devices to tackle tax avoidance activities, seems to encourage tax avoidance by share companies. The capital which would have distributed in the form of divided to shareholders used to boost the capital of the share company concerned is not considered as deductible expenses. While loan from banks, along its interest, that used to increase the capital of the share company is considered as deductible expense. Thus it favors loan from banks over rising of capital from the profit obtained by share companies which would have distributed to shareholders.

The other is with regard to aggressive income tax rules. As some scholar and compliance theory suggests that these aggressive rules by themselves one factor for nonobservance of the income tax rules. This means is that the more the income tax law becomes fair more probability of adherence by the taxpayer to tax laws. Thus the legitimacy of the income tax rules by itself one factor for the proper observance of income tax rules.

In light of this situation, Ethiopia income tax rules fall short of fairness and equity principles as far as the rules on the rate of income taxation of corporates and the procedures for appeal are concerned. Flat rate of taxing income would create vertical injustice to taxpayer. Empirical evidences proved that vertical injustice account for the persistence existence of tax evasion by taxpayer. Moreover distributional impact of tax is the other reason for existence of tax evasion. As it is obvious flat rate has uneven impact on taxpayer. Thus it is the other source for the existence of tax evasion by taxpayer. Beside flat rate of taxing income of corporates are not fair for small business in the same category and business in other category of tax payer.

The other is with regard to appeal right of tax payer. The 50% condition to appeal to the review committee and 100% to appeal to regular court restrict the appeal right of taxpayer. This situation in turn makes the relation of taxpayer and the authority bitter. As studies found out the relation between taxpayer and authority has effect over the tax evasion practices of taxpayer. Thus the more bitter their relations becomes, more likelihood for taxpayer to engage in tax

evasion activity. Thus this situation could be is the other potential source of tax evasion by taxpayer.

4.2 Recommendations

Based on the aforementioned points and findings the writer would like to recommend the following:

- There should be an independent corporate taxation law.
- Publication requirement under the income tax proclamation should to be inclusive of income tax evasion by share companies. Further the audit report also publicized along the name of the taxpayers who engage in tax evasion.
- The amount of civil liability should be set beyond the amount of income tax that would have been paid. Further the civil liability to follow out of the act of tax evasion is not in line with the two criteria of effective and efficient system of tax administration. These are compensation and deterrence that it should revisited in light of these characteristics of effective and efficient collection of tax due.
- The public prosecutor should have given with the power of entering the business premises of taxpayer who involved in tax evasion activity.
- Capital, which is reinvested, which would be divided among shareholders should to be considered as deductive expense.
- Flat rate of taxing Share Company needs to be changed to progressive kind of taxing income of share companies as is the case in U.S.A and other countries.
- The role of review committee is obscure that it is better if it is removed from the income tax proclamation.
- Span of time provided for appeal to different layers of concerned body should be decrease down to the possible minimum span of time.
- The condition of fifty percent payment to the tax authority should be removed before the submission to competent court and rather payment of fifty percent should be put in place to access to the regular court by the way of appeal.

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- The tax payer should pay their full tax liability when the tax liability determined by the appeal commission and confirmed by the first competent court.

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