



**JIMMA UNIVERSITY**

**COLLEGE OF LAW AND GOVERNANCE**

**SCHOOL OF LAW**

**TITLE: ASSESSMENT OF TAX AUDIT: THE LAW AND PRACTICAL STUDY OF SOUTH WESTERN PEOPLES REGIONAL STATE: KAFFA ZONE BONGA CITY ADMINISTRATION**

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**Approved by Board of Examiners**

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## **DECLARATION**

I Tibebe Yohannes; hereby declare that this research paper is original and has never been presented in any other institution. To the best of my knowledge and certainty, I also declare that any information used has been duly accredited.

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This research has been submitted for examination with my approval as University advisor,

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## Table of Contents

page

Acknowledgement .....	viii
Acronyms .....	ix
List of annexes .....	x
Abstract.....	xi
UNIT ONE .....	1
1. Introduction .....	1
1.1 Background of the study .....	1
1.2 Statement of the problem .....	10
1.3 Objective of the study.....	13
1.3.1 General objective .....	13
1.3.2 Specific objective .....	13
1.4 Research questions .....	13
1.5 Significance of the study .....	14
1.6 Scope of the study .....	14
1.7 Methodology of the study .....	14
1.7.1 Data gathering tools.....	15
1.7.2 Primary method of data collection tools .....	15
1.7.2.1 Semi-structured interview .....	15
1.7.2.2 Sampling Technique.....	15
1.7.2.3 Interview with key Actors .....	15
1.7.3 Secondary sources of data .....	15
1.7.4 Sample size.....	16
1.7.5 Method of data collection .....	16
1.8 Limitations of the study .....	16
1.9 Structure of the Study.....	16
UNIT TWO .....	18
2. THE INTERNATIONAL ASPECT OF TAX AUDITING.....	18
2.1 Introduction .....	18

2.2 Critical analysis of Tax Audit .....	18
2.3 Historical background and classification of tax audit .....	20
2.4 Tax audit and its classifications under the international context.....	21
2.4.1 Classification of tax audit based on audit scope and Periods under examination .....	21
2.4.2 Classification based on the stage of tax audit .....	21
2.2.1.1 Preliminary phase of tax auditing system.....	22
2.2.1.2 Main types of auditing after preliminary phase of tax audit.....	23
2.2.1.3 Core phase of the tax auditing system .....	23
2.2.1.4 Tax notice of the tax auditing system .....	24
2.2.2 Classification tax audit based on Internal Revenue Service (IRS) of United States of America (2020).....	25
I. Correspondence Audit .....	25
II. Office Audit .....	25
III. Field Audit .....	26
IV) Taxpayer Compliance Measurement Program (TCMP) Audit .....	27
2.3 The legal framework of tax administration under the international aspect .....	27
2.4 Tax auditing standards under the international perspective .....	28
2.5 Ethical and professional standards for tax auditors under the international perspective.....	29
2.5.1 International Federation of Accountants (IFAC) code of professional standard and Ethics for auditors .....	29
Ethics Guideline of International Federation of Auditors /Accountants (IFAC) (2006) .....	30
A. Ethical and professional Guidelines Applicable to All auditors based on (IFAC).....	30
B. Ethics Applicable to Professional Auditors/accountants in Public Practice.....	31
C. Ethical standard applicable to Employed Professional Auditors and accountants (Business) .....	33
2.6 Related international standards for tax auditors/accountants. ....	33
2.6.1 International Standard on Auditing (ISA).....	33
2.6.1.1 International Standard on Auditing/accounting (ISA) and Ethics Applicable to Professional Auditors/auditors in Public Practice .....	34
2.7 Breaching of the professional and ethical standard by auditors and the effect under international instruments.....	35
UNIT THREE.....	37
3. TAX AUDITING AND THE LEGAL FRAME WORK IN FEDERAL STATES OF ETHIOPIA .....	37
3.1 Introduction .....	37

3.2 The definition of tax auditing in Ethiopia.....	38
3.3 Types of tax auditing practiced in Federal government of Ethiopia.....	39
3.4 National Legal and Policy framework .....	40
3.4.1 FDRE constitution of 1991 and the taxation.....	40
3.4.2.1 FDRE constitution, principles of taxation and the tax audit .....	41
3.4.3 Modern historical back ground of income tax and the tax administration in Ethiopia.....	43
3.4.4 Tax auditing and the current tax laws of Ethiopia .....	45
3.4.4.1 Federal Income tax proclamation no. 979/2016 .....	45
3.4.4.2 Classification of tax payers under the income tax proclamation No. no. 979/2016 .....	46
I. Scheduler classification of tax payers .....	46
II Categorical classification of tax payers .....	48
3.4.4.1.1 The tax officials and the Ethical and professional standards by the federal income tax proclamation.....	50
3.4.4.3 Federal tax administration proclamation no. 987/2016.....	51
3.4.4.3.1 The federal tax administration proclamation No.987/2016 and duties and responsibilities of tax officials .....	52
Federal Government VAT proclamation No. 285/2002.....	53
3.6 Criminal code of Ethiopia proclamation No. 414/2004 .....	54
UNITT FOUR .....	56
4. THE LEGAL FRAMEWORK CONCERNING TAX AUDIT IN SOUTHWESTERN PEOPLES REGIONSL STATE .....	56
4.1 The new regional state of southwestern Ethiopia .....	56
4.2 The constitution of the Southwestern peoples regional state .....	57
4.2 The legal framework of taxation and tax auditing.....	57
4.2.1 The income tax proclamation No. 165/2016 of the SNNPR state .....	58
4.2.2 The SNNPR state tax administration proclamation No. 166/2017 .....	59
3.2.3 The SNNPR state, amended Ethics and anti-corruption proclamation 142/2012 in conjunction with Federal corruption crime proclamation No.881/2015 .....	61
UNIT FIVE .....	63
5. THE PRACTICE OF TAX AUDITING IN SOUTHWESTERN REGIONAL STATE KAFFA ZONE, BONGA CITY ADMINISTRATION .....	63
5.1 Introduction .....	63

5.2 The practice in Bonga city administration concerning the ethical and professional standards of the tax auditors and related tax officials .....	65
5.2.1 The practice of tax administration and the views of tax payers in Bonga city .....	65
5.2.2 Practice in Bonga City Tax administration and the views of professionals and officials of the tax administration.....	68
5.2.3 Bonga city tax administration and the outlook of Kaffa Zone High court .....	70
5.2.4 The Anti-corruption commission of Bonga city Administration and the tax authority of Bonga city administration.....	71
5.3 Challenges against the realization of virtuous tax auditing system in Bonga City Tax administration .....	72
1. Challenges associated with the Law .....	72
2. Institutional encounter in the tax administration.....	73
4. Discrimination .....	74
3. Challenge related with implementation legal remedies whenever there is professional or ethical violation in the tax administration.....	75
5. Non-existence of Tax appeal Commission .....	75
6. Lack of awareness .....	76
Conclusion.....	76
UNIT SIX.....	77
6. CONCLUSION AND RECOMMENDATION .....	77
6.1 CONCLUSION.....	77
6.2 Recommendations .....	79
BIBILOGRAPHY .....	81
ANNEXES .....	84

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## **Acronyms**

ISA: International Standard of Auditing

IFAC: International Federation of Accounting

IAASB: International Auditing and Assurance Standard Board

IRS: Internal Revenue Service

FDRE: Federal Democratic Republic of Ethiopia

ERCA: Ethiopian Revenue and Custom Authority

VAT: Value Added Tax

TOT: Turn Over Tax

HPR: House of Peoples Representative

HF: House of Federation

SNNPRS: Southern Nation Nationalities and the Peoples Regional States

SWPRS: South-Western Peoples Regional State

ETB: Ethiopian Birr

IMF: International Monetary Fund

OECD: Organization for Economic Cooperation and Development

## **List of annexes**

Annex 1 Questionnaire for Sample from the taxpayers

Annex 2 Interview with the tax auditors in Bonga City administration, Bonga, Ethiopia

Annex 3 Interview with Mr. Admasu the head of Bonga city tax administration, Bonga, Ethiopia

Annex 4 Interview with Mr. Fikadu Judge in Kaffa Zone High court Bonga, Ethiopia

Annex 5 Interview with Mr. Tamirat head of an anti-corruption commission of Bonga city Administration, Bonga, Ethiopia

## *Abstract*

*The thesis examined the international, federal, and regional legal frameworks and the practical implementations of tax auditing, the ethical and professional set up of the auditors and bodies in Bonga city tax administration in realizing fair and equitable treatment of the taxpayers and just tax system, it also examined the legal framework and the adequacy of commitment by the administration and the government in realizing fair and equitable tax auditing system. The thesis ultimately forwards possible solutions in this regard. Accordingly, the data was collected through interviews from the taxpayers under the category A and B in Bonga city and concerned governmental bodies. The analysis of data and information collected are made concerning obligations that Ethiopia has undertaken, at the federal as well as regional level. Accordingly, the findings revealed that taxpayers in the Bonga city administration are subjected to several unfair and discriminatory treatments and system of auditing which is unjustified and arbitrary, again unethical and malpractice of professional standards by the tax auditors, irresponsible act of the tax administration intensified the challenge of the taxpayers and the justice system. Even though several taxpayers remained in the market with the existing injustice many taxpayers are forced to leave the market and lead their lives and their fellow employees abandoned. The tax law stresses that taxpayers should be treated fairly and in an equitable manner nevertheless due to incompetence on technical duties of auditing, unethical behavior, and breach of the professional standards particularly through corrupt acts, bias toward the taxpayers is a challenge. The commitment of the tax administration to train the tax auditors to build the skills and knowledge is unsatisfactory and there is no trained of keeping the data of taxpayers in a well-organized manner. Again the nonexistence of a tax appeal commission in the area affected adversely the taxpayers and the justice system of the taxation. The report of high court of Kaffa zone and an anti-corruption commission of the city administration exposed the existing problem. The thesis recommends that the tax there has to be simply documented ethical and professional standards for the tax auditors again the tax law must retain from a frequent amendment of the tax laws. In Bonga city administration the government has to provide capacity building training for the tax auditors, it is indispensable to form a tax appeal commission and bring before justice the taxpayers violating the law and the government should provide a platform that anti-corruption commission to investigate.*

## UNIT ONE

### 1. Introduction

#### 1.1 Background of the study

Tax does not have a universally accepted definition consequently it's not possible to exhaustively define it nevertheless it is possible to provide some common concept that is considering a tax as an exception to the right to property and economic rights provided constitutionally<sup>1</sup>. In general terms, Tax is a process of demanding or imposing a tax, adjusting and fixing the amount, the process of examining the items in an attorney's bill of costs, and making the proper deductions, if any<sup>2</sup>. Taxes are important sources of the public revenue; public goods and services<sup>3</sup>. Taxation, in general, comprises an issue of leaving tax, regulating and determining the amount to be taxed, an inspection of the items, and conducting fair taxable amounts. It is a central engine for the development of most of the nations' it also builds the capacity of a country by ensuring financial security, meeting the basic needs, fostering economic development, building legitimacy, and creating consensual, accountable government<sup>4</sup>

The Government intervention in the supply of public goods is inevitable and can only be done if the public pays taxes for the production and supply of such goods yet again taxation in some form is an invariable attribute of an organized political society and under whatever name it exists, it becomes sooner or later the principal means of raising revenue for public purposes; that is the correlative to the services which government performs for the community.<sup>5</sup>

Governments plan the means to create revenue to carry out their responsibilities. Historically, this has been done through the levying of various forms of taxes. Ethiopian scholar called Gebrie Worku Mengesha defined taxation as “is a financial charge or other levy imposed on an

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<sup>1</sup> *Fundamentals of taxation: an introduction to tax policy* by Pasquale Pistone, g'p 2. 2019

<sup>2</sup> Black's law dictionary 4th edition HENRY CAMPBELL BLACK, M. A. Author of Treatises on Judgments, Tax Titles, Intoxicating Liquors, Bankruptcy, Mortgages, Constitutional Law, Interpretation of Laws, Rescission and Cancellation of Contracts, ST. PAUL, MINN. WEST PUBLISHING CO.1968

<sup>3</sup> Public goods and services refer to roads, power, municipal services, and other public infrastructures

<sup>4</sup> McKerchar et.al, the book titled “*Challenges in Understanding Compliance Behavior of Taxpayers in Malaysia*” 2009.p 80

<sup>5</sup> Ethiopian Chamber of Commerce and Ethiopian Business Development Services Network, Taxation in Ethiopia, Addis Ababa, 2005

individual or a legal entity by the government” to consider there is an imposition of taxation there must need a supreme authority and citizens who are subjected to the charge.<sup>6</sup>

In pre-modern times, taxation was viewed as a direct exchange of bargain in which the taxing authorities and the taxpayer each expected to receive an equal benefit about what it gave out. Taxes were looked upon as the wages paid to the government for its services and foremost among them being security. As the result of growth in population with its attendant demand for infrastructure and other social and economic investment, it becomes very crucial for governments all over the world to look for a better method of tax collection that lead taxation legally accepted in various countries as one of the most suitable means of generating revenue. Nowadays, taxation has become part and parcel of all economic activities. It also provides to the government funds that benefit to expand the investment, reduction of poverty and delivering public service and has the role for fulfillment of the very needs of citizens in the countries and the economic development of a country, ensuring the acceptance of the government by the citizens. Taxation grants governments the role of endorsement for a capacity to carry out their goals; by forming one of the central arenas for the conduct of state-society relations. Again taxation shapes the balance between accumulation and redistribution of resources that gives states their social character. Most essentially it is a remedy to relieve dependency in developing countries and provides fiscal reliance and sustainability that is needed to promote growth<sup>7</sup>.

Even though having a strong tax system has an indispensable role for economic growth of states nevertheless numerous encounters has been threatened the tax systems of numerous countries, especially in the developing countries it is featured with, weak capacity, corruption, and the missing reciprocal link between tax and public and social expenditures remain as challenges<sup>8</sup>

To accomplish the appropriate tax revenue system, there are several progressions conducted by governments and among all tax audits the crucial one. The definition of tax audit is stipulated by various scholars in many ways, Mc. Kirchar defined tax audit as “an examination of an individual or organization’s tax report by the relevant tax authorities to ascertain compliance

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<sup>6</sup> *Tax Accounting in Ethiopian Context* p23, 2nd Ed., Alem Printing Press, Gebrie Worku Mengesha, Ethiopia, 2008.

<sup>7</sup> Report by IMF, OECD, UN & World Bank, 2011

<sup>8</sup> Ibid

with applicable tax laws and regulations of state”<sup>9</sup> in other words it is a process where the internal revenue service goes to confirm the numbers that the taxpayer have put on a tax return or taxpayer has reported the tax liability and fulfilled other related obligations. Another scholar called Ola (2001) stated that “tax audit is a process that involves tax returns that are selected for audit using some selection criteria”<sup>10</sup> in this regard the books and records of the taxpayer shall be critically examined and compared with tax returned. As stipulated by experts tax audit has the impression of detecting or evaluating the compliance of the tax report of the taxpayers by governmental authorities in line with the laws and regulations of taxation. According to Biber (2010) “the role of an audit program in a modern tax administration must extend beyond merely verifying a taxpayer’s reported obligations and detection of discrepancies between a taxpayer’s declaration and supporting documentation”<sup>11</sup>

Taxes consist of one prominent, prudent and feasible source of revenue for the government. Governments, therefore, impose taxation on the people of the state on citizens who are earning income. Taxes offer a high percentage of revenue for the nations. Funds provided by taxation have been used by States and their functional equivalents throughout history to carry out many of these functions. Governments use different kinds of taxes and various forms of tax rates. This is mainly to distribute the tax burden among individuals or classes of the population involved in taxable activities, such as businesses, or to redistribute resources among individuals or classes in the population<sup>12</sup>. Taxes are contributions from the national dividend; they must ultimately come out of the annual earnings of the nation.<sup>13</sup>

In Ethiopia, the Constitution of the Federal Democratic Republic of Ethiopia when taxes are levied; the citizens are liable for payment at the time and in the manner required and provided by law authorizing the assessment and collection to be made by the government. Whereas it assured the source of every taxation is wealth, the issues of taxation raise when there is a maximization of wealth or income by the citizens in the state, while establishing the powers and duties of the government, clearly states that the levying of taxes and the collection of duties on revenue

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<sup>9</sup> Kircher, E.E(2008) Enforced versus Voluntary Tax Compliance: The Slippery Framework. Journal of Economic Psychology

<sup>10</sup> Income tax law and practice in Nigeria, by Christopher Sunday Ola, 2001, p 91

<sup>11</sup> Edmund Biber , *Revenue Administration: Taxpayer Audit Use of Indirect Methods*, (2010), p 36

<sup>12</sup> Abinet Lulseged , Assessment of Tax audit practices and its Effect in Increasing Governments Revenue in Ethiopia: 2006, p 23

<sup>13</sup> Armitage-Smith, George, *Principles and Methods of Taxation*, J. Murray, London, 2012, p112

sources is among the duties of the government<sup>14</sup> It assures the powers and functions of state governments, amongst which is the levying and collection of taxes and duties on revenue sources reserved to the States<sup>15</sup>.

Ethiopia has a federal tax system, with tax powers and revenues divided between the federal government and the regional states. In the Federal government of Ethiopia, some laws are enacted to regulate the tax system. That includes income tax proclamation no.979/2016, federal tax regulation no.410/2017, and 983/2016 tax administration proclamation. The regional government together with the SNNPR state has various proclamations governing the tax system. The power to levy and collect different taxes is allocated either exclusively to the federal government; exclusively to the regional states; concurrent to both the federal government and the regional states or is undesignated<sup>16</sup>. The Ethiopian tax collecting system is categorized into three domestic direct taxes, domestic indirect taxes, and trade taxes. Domestic direct tax includes all domestic direct taxation which is governed by Proclamation No. 979/2016 income tax and Council of Ministers Regulation No. 410/2017 these laws provide for the taxation of income under five schedules( schedule A, B, C, D, E) income from Employment, rental building, business activities, other incomes<sup>17</sup>, and exempt income. Ethiopia operates a scheduler rather than a comprehensive personal income tax system. This means different sources of personal incomes are taxed separately and subject to their tax rate schedules, rather than being aggregated together and taxed according to the same tax schedule<sup>18</sup>.

The Ethiopian tax system classifies into three categories based on annual gross income – A, B, and C according to whether the business is incorporated or not, and the size of the business as measured by its turnover. Incorporated taxpayers (corporations) are classified as Category A and face the same tax rate (30%) and administrative requirements regardless of their size. For

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<sup>14</sup> Art 51 of Federal Democratic Republic of Ethiopian Constitution proclamation No. 1/1991

<sup>15</sup> Ibid Art 52

<sup>16</sup> FDRE Constitution, 1995 – Proclamation No. 1/1995 Art, 96 to 99.

<sup>17</sup> Here, other incomes include royalties, dividends, interest, income from games of chance, and capital gains. The applicable rate for income from royalties is 5% of the gross amount, for dividends it is 10% of the gross amount, and for interest income derived from a saving deposit with a financial institution that is a resident of Ethiopia it is 5% of the gross amount; otherwise it is 10%.

<sup>18</sup>Institute for fiscal studies R187, 2019/20 survey of Ethiopian tax system, by international trade center in partnership with Ethiopian investment commission p 13

unincorporated (natural persons) taxpayers, these categories determine the information that firms are required to submit when reporting to the revenue authority<sup>19</sup>

Among the activities which have a significant role in fair and equitable tax administration is a tax audit. Tax audit is defined as an examination of an individual or organization's tax report by the relevant tax authorities to ascertain compliance with applicable tax laws and regulations of the state<sup>20</sup>. It is a means to assess accounting and other documentary shreds of evidence to prepare the correct tax return as well as to prepare the statements showing the detailed computational working for different heads of income or items in a tax return and other required evidential statements regarding allowances and disallowance for deductions and all these are to be followed by an audit report giving the auditor's opinion about the degree of correspondence between the information contained in the tax return and the regulatory provisions of the existing tax laws<sup>21</sup> it is also considered as tax process that involves tax returns that are selected for audit using some selection criteria.

In the Ethiopian context tax audit is defined as an activity performed by tax auditors to determine the accurate tax liability of the taxpayers, through examination of taxpayers' financial records and evaluation of the compliance of tax law and verify the true, fair, reliable, and accurate financial return<sup>22</sup>. Tax audit has several techniques which the tax auditors are supposed to bear in mind is first having an all-inclusive document is a set of audit policies, and procedures need to be based on principles of accuracy, efficiency, fairness, transparency, completeness, consistency requirements, and a systematic approach planning.<sup>23</sup>

Under the international level based on the classification of Internal Revenue Service (IRS), there are four types of auditing which include, first correspondence audit it is the simplest form of auditing that the internal revenue service sending a letter in the mail to taxpayers requesting more information about a particular tax return. The second one is office audit; it is relatively large and complex, it is more detailed and has more issues, office audits typically surround issues

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<sup>19</sup>ibid p.14

<sup>20</sup>Kircher, E.E Enforced versus Voluntary Tax Compliance: The Slippery Framework. Journal of Economic Psychology (2008) p 12

<sup>22</sup> Tax and auditing policy and strategy by Ethiopian revenue and custom authority 2010, p 25-27

<sup>23</sup>Organization for economic cooperation and development: Strengthening Tax Audit Capabilities: General Principles and Approaches Forum on Tax Administration's Compliance Sub-group Oct 2006



about itemizing deductions through classifying into different schedules, that of the source from business, rental, and related sources. Thirdly there is a field audit, conducted by internal revenue service revenue agents who are generally more skilled and knowledgeable than other representatives of the revenue authorities. It also includes home or place, a business visit, they ask to see things outside of certain records, the audit for a business including a review of financial records interview with the taxpayer. A field audit is the most serious intrusive and serious form of auditing. Fourthly there is a tax compliance audit compliance measurement program audit, it analyses every item on the tax return and every part of the return must be substantiated by documentation and it is time-consuming in that a taxpayer must find checks, invoices, contracts, bank statements<sup>24</sup> .

The domestic tax audit manual in Ethiopia has been prepared by (*Ethiopian revenue and customs authority ERCA*) which governs tax auditing procedures. It stated several types of tax auditing in Ethiopia, classification is mainly, based on the audit scope and intensity, periods under examination, and location under examination.

As per the Ethiopian Federal Government revenue and Custom Authority (ERCA manual of 2014), major types of tax audits includes, first Comprehensive audit: it is an audit that is all-encompassing in scope and entails an in-depth examination of all information relevant to the calculation of a taxpayer's tax liability for all tax type for a given period. Also, tax officers informing taxpayers about their visit and the types of documents that they will review and the taxpayers are ready for their review<sup>25</sup> it has a broad scope and is typically costly to undertake in terms of time and resources, and thus reduces the rate coverage of taxpayers that could otherwise be audited.

Secondly, there is *an Issue Audit or spot audit* a limited scope audit that may be confined to specific issues in a tax return and/or a particular tax type, objective here is to examine key potential risk areas to have intensive auditing. It normally focuses on a single tax type, period, or item, this audit is recommended because it consumes relatively fewer resources than comprehensive audits and allows for increased coverage of the taxpayer population. Issue audit

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<sup>24</sup> Southern California's Law Firm: the four types of Internal Revenue service (IRS) of tax audits , 2021

<sup>25</sup>Organization for economic cooperation and development: Strengthening Tax Audit Capabilities: General Principles and Approaches Forum on Tax Administration's Compliance Sub-group Oct 2006

classified into three, (I) *Desk Issue Audit*, it is can be conducted about the specific issue(s) of a taxpayer or enterprise when the auditor is confident that all the necessary information can be ascertained by examining the office. All the required or relevant information or data may be accessed from internal sources or official references without the need to contact the taxpayer. (II) *Field Issue Audit* is the escalation of a desk issue audit into a field activity or exercise. It is important to remember that the audit is limited to key issues of compliance or a tax type or period. Field issue audit is commonly used in examining whether a taxpayer has met his/her obligations in respect of PAYE, VAT/TOT and Excise tax, Withholding Tax, or Income Tax normally for a specified tax period. (III) *Desk Audit* is the third type of tax auditing in Ethiopia, which is concerned with a preliminary examination of declarations analyzing accuracy, completeness, ratios, and crosschecking information to determine if further audit or investigation is warranted. By implication, returns are stated on a certain level of risk. Desk audit executed within the office of the tax officials. The essence is to carry out some administrative checks on returns filed to ensure compliance with tax laws. When conducting this audit, prior notice is not given to the taxpayer. The taxpayer only becomes aware of the audit when he is requested to produce certain documents or to show up for a possible interview. The outcome of the desk audit may lead to a field audit when the tax official is dissatisfied with the level of compliance of the taxpayer

The new South-western peoples' regional state that was part of SNNPR State and the new regional state formed secession through a referendum conducted by the peoples of five Zones and one Woreda to form an independent regional new state. The councils of the new regional state passed a resolution on the extension of the laws of the previous regional(SNNPR state) henceforth some proclamations including tax laws of the previous regional state will have an effect<sup>26</sup> the tax laws of the SNNPR state which are quite analogous to the federal law that comprise the income tax proclamation of SNNPR, No.165/2016, tax administration proclamation number 166/2016 of SNNPR State, Proclamation No 143/2004 Proclamation issued to Re-establish the Revenue Authority of the South Nations, Nationalities and People's Regional and

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<sup>26</sup> Decisions by the state councils of the new Southwestern Ethiopian Peoples regional state, November 24, 2021, Bonga. Interview with Mr. Bizuayehu Girma the head of kaffa zone revenue authority, Nov 10, 2021

other related tax laws will have the effect<sup>27</sup> The Southern Nation Nationalities and Peoples regional state revenue authority have the objective of establishing modern revenue assessment and collection systems; and provide customers with equitable, efficient and quality services, this principle has similar effect with the new regional state of Southwestern Peoples Regional state<sup>28</sup> The tax administration proclamation No.166/2016 of SNNPR State insist on more about executive requirements patrons expected to comply in the tax system of regional state. It encompassed the duties of taxpayers, tax authorities, the duties of employees in the tax administration, and the responsibilities of the tax appeal commission. Based on the administration proclamation of SNNPR state, the tax authorities and staff of the tax administration are mandated to ensure fair execution of all tax-related laws of the regional state<sup>29</sup> again the personnel in the tax administration or any worker of the tax authority is required to be loyal, fair and responsible and serve the taxpayer with integrity<sup>30</sup>

As per Art 6(2) tax administration proclamation No. 166/2009 of SNNPR state every single tax official is required to perform their profession fairly, with integrity and responsible manner and required to respect taxpayers, similarly the previous proclamation no. 56/2003 specified the codes of conduct of employees, and professionals in tax administration in which as per the new proclamation Article 97(6) of SNNPR state income tax proclamation no.165/2009 and Art 131 of SNNPR state tax administration proclamation no. 166/2009 previous regulations and directives previous proclamations will have effect under the existing proclamation as long as it does not contradict with the existing income tax proclamation or unless expressly repealed by new regulations and directives. Hence as per the art 40(1), (b) of 56/2003 code of conducts employees of the tax authority are required to respect and apply laws, regulations, and cases based on objective facts and being impartial to all taxpayers and individuals seeking service.

Similarly an Article 100 proclamation 136/2010 directive there is any act deemed to be an offense by tax employees which includes, (a) any person employed by the tax authority

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<sup>27</sup>Art 3 of income tax proclamation no 165/2017 Sothern Nation Nationalities Peoples Regional State, 25th year No 1 Hawassa, Feb 16, 2017

<sup>28</sup> Proclamation No 143/2004 Proclamation issued to Re-establish the Revenue Authority of the South Nations, Nationalities and People's Regional State. 18th Year No 2 Hawassa February 20/2004

<sup>29</sup> Art 5(1) of tax administration proclamation number 166/2009 of Sothern Nation Nationalities Peoples Regional State, 25<sup>Th</sup> year No 2 Hawassa, Feb 16, 2016

<sup>30</sup> Art 6(2) of the tax administration proclamation no. 166/2009 of SNNPR state State, 25<sup>Th</sup> year No 2 Hawassa, Feb 16, 2016

committing in connection with any duties directly receive or ask to receive payment or reward not which a payment or reward not being lawfully entitled to receive. (b) An Employee of tax authority who enters or acquiesces in an agreement to do or abstain from doing that is contrary to the provisions of this proclamation and or to the proper execution of his/her duty consider to be liable and committed an offense. (c) Any employee who acts beyond the power conferred up tax law or misuses the authority entitled and commits an offense shall be entailed imprisonment based on the severity of the act. Similarly, the same article under sub-article (3) states any groundless delay toward the taxpayer by the tax employees of the tax authority shall be liable for damage and imprisoned for not less than one year or not more than two years.

For this thesis, the target area is the new Southwestern Peoples Regional State, Kaffa Zone particularly Bonga city administration. Kaffa zone is located in the southwestern part of Ethiopia, According to the Kaffa zone revenue authority, Kaffa zone there are around 13115 taxpayers from all categories among them around category “A” taxpayers are 572 and 646 taxpayers are under category “B” and based on Bonga City tax administration in Bonga city there are around 5673 taxpayers among 379 Category “A” taxpayers and category “B” taxpayers a 162 and the remaining are under the category “C”. There are around ten tax auditors in the city administration which concludes the auditing activities. The governing law in Kaffa Zone Bonga city administration with tax system primarily is the laws of SNNPR state that comprising, Income Tax Proclamation no. 165/2009, Tax administration proclamation No.166/2009 and Tax regulation proclamation No. 165/2010 of SNNPR State, several directives. The civil code, federal criminal code, anti-corruption proclamations are among. As per the revenue authority of Bonga city administration, they use three types of tax auditing systems are experienced, that consist of comprehensive audit, desk audit, and spot auditing. A comprehensive audit as its name implies it an all-encompassing audit conducted by the auditor and the taxpayers are required to provide the books and accounts that lasted not less than ten years, whereas a spot or issue audit is a yearly income of taxpayers to be audited and it is the usual form of auditing as the tax auditors say, finally the desk audit shall be conducted whenever there a need to further investigation on the taxpayers' proper compliance<sup>31</sup>.

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<sup>31</sup> Interview with Mr. Bizuayehu Girma the head of kaffa zone revenue authority, November 10, 2021.

## 1.2 Statement of the problem

Tax audit guarantees the adequate compliance of return of taxpayers based on the revenue they are achieved in the budget year, it also shapes the degree of tax avoidance and tax evasion, ensure strict compliance of tax laws and improve the degree of voluntary compliance by taxpayers and ensuring the amount that ought to be due and remitted to government as a revenue<sup>32</sup> Hence tax audit plays an indispensable role on the proper declaration of a tax return by the taxpayers instantly reduce the infringement of taxation and improving the readiness of the taxpayers for the proper compliance of their tax duties.

Tax is the main sort of government revenue that may be accustomed to finance all the government expenditure and stabilize the economy. In Ethiopia, the government imposed tax (direct and indirect)<sup>33</sup>, among others; as major and vital sources of public revenue for the promotion of its economic process. Despite the vital role taxation contributes to the economy of Ethiopia several encounters are explicitly experienced in the tax system of Ethiopia. As per Dr. Teklu Kassu, The Ethiopian tax is known to be in serious challenges that are particularly related to tax auditing; lack of skill and competence beginning from the tax auditors up to the tax appeal commission. Even if the tax authorities are training their workers, which is workers are academically certified but there is a challenge regarding skill, knowledge and as to the ethical and professional conduct of the tax auditors and there is a serious complaint from the side of the taxpayers, closely many taxpayers are faced to leave the market and abandoned their employees<sup>34</sup>

Regarding tax audit, the developing countries are predominantly experienced with weaker capacity on effective implementation of taxation laws and incapability of professionals in the system taxation. The playing field of the tax system is marked by the authorities who prerequisite tax revenues for their expenditures and taxpayers who want to be protected by sound tax law and again want to be entertained by fair pay and a prospect of personal development: This playing field is exactly the area where lack of integrity, non-compliance, corruption, ethical and

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<sup>32</sup>International Monetary fund, Organization for economic development and corporation(OECD), United Nations and World Bank, 2011.

<sup>33</sup> A survey of Ethiopian tax system in 2019/20 the institute for fiscal studies

<sup>34</sup> An Interview with Dr Kassu Teklu, (lecturer on tax and custom field in civil service university and consultant of tax finance and work) on ESAT “ኢኮኖሚያችን” program hosted by Fikrte Temesgen august 26, 2021

professional malpractice.<sup>35</sup> Tax authorities are powerful and privileged, tax laws as well as tax administration laws granted certain powers among the powers: assessment of taxes; a collection of revenues; adjustments and fines on tax declarations; property seizures; payments (and delays) on tax returns; interest provisions on late payments; garnishment of bank accounts; closure of business activities, the commencement of criminal or civil proceedings; and exchange of information with other governmental authorities.

Having a law-abiding, fair, ethical tax system with officials, auditors, and comprised of essential legal institutions that can adjudicate tax-related grievances has a vital role for the taxpayers and the just tax system as a whole. Among all the professional and ethical conduct for the tax officials and related employees of the tax authorities have crucial prominence for just tax system. To realize these tax Laws in SNNPR state several tax-related proclamations are enacted. Laws related to professional and ethical standards of tax authority employees including the professionals in the tax system. As per Art 6(2) tax administration proclamation No. 166/2009 of SNNPR state, every tax official who acquired several powers by the tax laws are required to perform their profession fairly, with integrity and responsible manner and required to respect taxpayers while delivering their profession, despite this fact in SNNPR State Kaffa Zone Bonga city Administration, Taxpayers and the tax system in the city administration are being faced up to by the ill-mannered tax auditing system in which a tax revenue system that is perceived to be arbitrary or predatory discourages investment. As per the new proclamation Article 97(6) of SNNPR state income tax proclamation No. 165/2009 previous regulations and directives previous proclamations will have effect under the existing proclamation as long as it does not contradict with the existing income tax proclamation or unless expressly repealed by new regulations and directives. Hence as per the art 40(1), (b) of 56/2003 code of conducts employees of the tax authority are required to respect and apply laws, regulations, and cases based on objective facts and be impartial to all taxpayers and individuals seeking service. Similarly, in Article 100 proclamation 136/2010 directive there is any act deemed to be an offense by tax employees. There are weaknesses in the enforcement capacity of the tax auditing professionals and lack of ethical conduct intended to unlawfully enrich, which contradict with proc. 136/2010, art 100(2) that stipulate *(a) any person employed by the tax authority committing in connection*

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<sup>35</sup> Prof. Dr Victor van Kommer , *Integrity Ethics for tax administration* by,2009, p 10

*with any duties directly receive or ask to receive payment or reward not which a payment or reward not being lawfully entitled to receive and art 6(1) of 166/2009 tax administration proclamation of SNNPR state the tax authority employees are entitled different responsibilities by the tax laws of the regional state and they are required to perform those duties effectively.*

The tax administration in the city administration put law-abiding taxpayers at a competitive disadvantage, as their competitors in the informal sector are allowed to get away with tax evasion, and similarly, it reduces incentives for new businesses to join the formal and legal track of the business. Challenges in the city administration tax authority which is specific to the category “A” and “B” taxpayers including tax declarations made about their annual revenue occasionally precluded by the tax authorities and the arbitrary unilateral decision of the authorities experienced. Also challenge on the subject of inadequate tax administration, insufficient and ineffectiveness of legal expertise and bad tax collecting system, dubious auditing system, and corruptions and incapability to comply with the governing tax laws. It also quizzed the overall credibility of the auditors’ job role, the quality of auditing outcomes, and the legal responsibility of auditors, the latter of which desires a professional review to improve performance quality and eventually rationalize the decisions made by the tax officials. At the same time no tax appeal commission in the area that critically affected the judicial system of tax administration. In doing so several taxpayers under categories A and B are being dropped out of the market and there is a specific case that traders pulled out of the market due to unfair and irrational audit and corruption by the tax authorities <sup>36</sup> As per an interview with some taxpayers in Bonga city administration “the failure of the tax authority to enforce its legal duty twisted difference in the treatment of legal and the illegal taxpayers”. Such differences also, contradict with economic, market, and tax policies of the country, encouraging unfair trade between the traders. Additionally, the government loses major revenue leakages as dishonest revenue officials allow unjustified tax breaks to willing tax evaders. Honest taxpayers suffer from corruption in the revenue system, inflated auditing eventually high litigation costs, and leniency towards non-compliant competitors. Again the nonexistence of tax appeal commission in the area that taxpayers have no institutionalized tax appealing commission in which they could file their grievance regarding the tax dispute, the practice in Kaffa zone and Bonga city

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<sup>36</sup> Interview aniley, and others the tax payers in Bonga city administration, Bonga Ethiopia, November 2021

administration that ad hoc committees to act on behalf of tax appeal commission, which does not have the required expertise on taxation and so exhaustive and taxpayers cannot easily get remedies for their tax grievance.

### **1.3 Objective of the study**

#### **1.3.1 General objective**

The general objective of the research is to point out the practical gap on implementation of tax law during the conduct of tax audit in Kaffa Zone Bonga City administration the adverse consequence on the taxpayers and to suggest the possible remedy.

#### **1.3.2 Specific objective**

- To scrutinize the international ethical and professional legal frameworks concerning tax audit.
- To analyze the federal government legal framework concerning professional and ethical standards for the bodies in the tax system of Ethiopia.
- To examine the laws of Southwestern Peoples Regional State on the subject of professional and ethical standards of officials and related affiliates of the tax system.
- To examine the practical implementation of tax auditors and related associates in SWPR State Kaffa Zone, Bonga City Tax Administration.
- To inspect whether the Bonga city Tax administration is implementing the legal mandates about ethical standards enacted by the Federal and Regional states.
- To suggest the possible remedies for the breaks in proper implementations of the mandated laws and indicate and evaluate the sanction and remedies whenever there is an unlawful violation.

### **1.4 Research questions**

This thesis sought to answer the following questions,

1. What does the international concern regarding tax audit and the process of a tax audit by the professionals?



2. What does the Ethiopian Federal and the regional state tax law and the regulation, and directives stipulate about the tax Audit?
2. To what extent those laws are implemented in the platform of tax audit in southwest regional state Kaffa Zone Bonga City Administration?
3. What are the challenges experienced in state Kaffa Zone Bonga city administration in the implementations of laws and the practice of tax audit by the tax officials?
4. What will be the possible way out to the challenges tax auditing system in Kaffa Zone Bonga City Administration?

### **1.5 Significance of the study**

The study will have significance by uplifting the proper/lawful implementation of a tax audit by the auditors and will have a contribution to uphold, encouragement of faithful taxpayers, and the effective compliance of the tax system in the southwestern state kaffa zone Bonga city administration. It will have a positive impact to enhance the justice system about tax auditing.

### **1.6 Scope of the study**

The study focuses on category “A” and “B” taxpayers in Bonga town, Ethiopia. The research particularly studies on auditing system of the tax administration and fulfillment of their professional and ethical standard as stipulated by the tax law and other related legal instruments.

### **1.7 Methodology of the study**

The research is conducted in a mixed form of research which comprises both doctrinal and empirical research methods and that included quantitative and qualitative. Analysis of laws and other data collected from primary and secondary sources. Accordingly, the researcher referred to the primary sources of international, legislation and both the federal and regional government laws and data from different parties in the tax system of the Bonga City Administration, which consisted of taxpayers and tax authorities in Bonga city administration. A qualitative method of research shall be employed through interview tax authorities as well as taxpayers of the targeted. Additionally, the researcher targeted tax authorities of the kaffa zone High Court and Bonga city administration Anticorruption commission. The researcher used as a specific target primarily on category “A” and “B” taxpayers of the city administration that are included under the income tax

proclamation no.165/2009 of the regional state since auditing is conducted on the above-mentioned taxpayers.

### **1.7.1 Data gathering tools**

The data was collected from the taxpayers in the Bonga city administration. Those are under category “A” and “B” Interview with auditors and the higher official of Bonga city Administration tax authority, Kaffa zone high court judges, and higher official the city administration anti-corruption commission.

### **1.7.2 Primary method of data collection tools**

#### **1.7.2.1 Semi-structured interview**

The researcher employed semi-structured interviews and open-ended questionnaires for the taxpayers, the structure allows following questions and additional comments made by the informant that was deemed to be essential and relevant for the research. Before the interview, the taxpayers are informed that the participation neither harms nor benefits them in person.

#### **1.7.2.2 Sampling Technique**

To identify respondents i.e. taxpayers under categories A and B, the researcher conducted Under random or probability sampling particularly stratified sampling, that involves in-between the taxpayers into strata’ category “A” taxpayer in one stratum and category “B” in other strata.

#### **1.7.2.3 Interview with key Actors**

Among the non-probability sampling techniques tax auditors and the high official of the tax administration, again judges from the high court and the officer of city administrations anticorruption commission are selected based on purposive sampling technique, which mainly enables the researcher to reach the specific needs for the fulfillment of the research. The target aimed to assess how concerned bodies are acting to ensure a fair equitable auditing system in Bonga city tax administration.

### **1.7.3 Secondary sources of data**

The study of this research used secondary data from different sources like books, researches, journals, articles, and other reports of governmental and non-governmental organizations.

#### **1.7.4 Sample size**

The sample size is the required number of individuals selected from the population even though it is recommended to use a large sampling size to have general findings however the researcher limited the numbers of taxpayers because of time and budget constraints. The study has 47 informants i.e. 40 taxpayers from both categories, 3 tax auditors and one higher official from the city administration, two judges from the Zonal high court, and a higher officer of the city administration's anti-corruption commission.

#### **1.7.5 Method of data collection**

The data was collected through the qualitative data collection method, during the data collection the interviewer used audio records based on the permission of the respondents. Take a note to record expressions of a participant who refused to be recorded. Used information categorizing thematically based on the specific objectives of the study. The researcher also prepared the data analysis by describing briefly each of the participant's views, and by using direct quotes from the interviews. The local language transcripts were translated into English and analyzed through triangulation of various data sources to increase the validity and reliability of the findings of the study.

#### **1.8 Limitations of the study**

Concerning the thesis while collecting the information, the unwillingness of some officials of the government was the challenge; again the period was transitional that the formation of a new regional state of Southwestern peoples regional state that made data collection a bit awkward. The challenge is related to finance because the researcher is self-sponsored and has no budget allocation from the research center of the University.

#### **1.9 Structure of the Study**

The thesis is organized into six chapters, the first part dealing with the background of the study, statement of the problem, the objective of the study, research questions and significance of the study, methodology, and limitations of the study.

The second part examines the relevant international instruments that classify the different types of tax auditing whereas the ethical and professional standards for the tax auditors under the international laws.

The third part states the federal laws law that has a direct relation to the tax auditing and the professional as well as ethical standards prepared for the tax auditors and bodies who are part of the tax administration.

Fourthly the laws of the regional states, this part dictate the regional government laws that deal with the equitable and fair practice of tax auditing, treatment of the taxpayers, and the possible remedies that the taxpayers may get whenever there is a breach of laws.

The fifth part examines the pragmatic implementation of laws specified under different hierarchical orders and to what extent the authority, auditors, and other related members of Bonga city tax authority, whether they are applying the laws and their commitment to fair and equitable tax system taxation and ensuring the rights of the taxpayers.

Sexily the part is about the conclusion and recommendations based on the findings of the research.

## UNIT TWO

### 2. THE INTERNATIONAL ASPECT OF TAX AUDITING

#### 2.1 Introduction

This chapter provides an introduction to the subjects of tax auditing under the international context, that begin with critically analyzing tax audit; definition, historical background in the worldwide framework and whenever we assert about the issues of tax audit we must remember the auditors and related employees of the tax authority and the issue of the professional and ethical standard of experts.

Under the international context, several legal instruments are dealing with tax auditing, auditors ethical and professional standards even though they are somehow sprinkled form. The paper tried to fold some classifications of tax audits and the ethical standards of the professionals in the auditing system. This thesis looks upon some guidelines under which professionals in the revenue system are required to behave and the related consequences of breaking the ethical and professional standards to some point.

#### 2.2 Critical analysis of Tax Audit

From the international perspective, a Tax audit is an examination of an individual or organization's tax report by the relevant tax authorities to ascertain compliance with applicable tax laws and regulations of the state<sup>37</sup> it is also considered as a taxing process that involves tax returns that are selected for audit using some selection criteria. Tax audit is evaluating the accounting and other documentary pieces of evidence to prepare the correct tax return as well as to prepare the statements showing the detailed computational working for different heads of income or items in the tax return and other required evidential statements regarding allowances and disallowance for deductions based on the audit report<sup>38</sup>

Tax audit essentially consists of activities of fact and law-finding, which determines the amount of taxes in respect to specific situations based on the concrete application of tax rules. Originally, this activity was an exclusive prerogative of the tax authorities, which assessed the relevant facts for each taxpayer (also based on the information supplied by them) and then requested them to

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<sup>37</sup>Kircher, E.E Enforced versus Voluntary Tax Compliance: The Slippery Framework. Journal of Economic Psychology (2008)

<sup>38</sup> Christopher Sunday Ola, *Income tax law and practice in Nigeria* 2001

pay the amounts of tax that were calculated. In such circumstances, taxpayers had the right to request revisions of such calculations before and after making the payment.

More recently, tax systems have come to reserve tax assessment primarily for the taxpayer and involve third parties in such activity to a more limited extent. In general, taxpayers should report all relevant facts to the tax authorities; organize them in a tax return following the categories established by law for tax purposes; determine the corresponding tax due in conformity with the applicable rules, and pay it in one or more installments after officially submitting the tax return. The submission of tax returns by third parties supplements the flow of information concerning the taxpayer, including the tax that such parties withheld at source and paid to the tax authorities<sup>39</sup>

It is an independent examination of financial statements of related financial information of taxpayers, whether profit-oriented or not, and irrespective of its size, or legal form, when such an examination is conducted to express an opinion thereon<sup>40</sup>

A tax audit is also an examination of whether a taxpayer has correctly assessed and reported their tax liability and fulfilled other obligations and is often more detailed. There are, of course, exceptions to this rule. Conditions and approaches vary from country to country<sup>41</sup>

It is also considered as a structured examination of a business' relevant commercial systems, financial and non-financial records, physical stock and other assets, internally generated data that is produced independently of the business. It determines the taxpayer's accurate tax liabilities for a particular accounting or tax period, by examination of a taxpayer's organization procedures and financial records to assess compliance to tax laws and verifying the true, fair, reliable, and accuracy of tax returns and financial statements.<sup>42</sup> Again tax audit is a systematic process of objectively obtaining and evaluating evidence regarding declarations about economic actions and events to ascertain the degree of correspondence between those declarations with established criteria and communicating the results to interested users. In a narrower sense, the audit is an

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<sup>39</sup> *ibid*

<sup>40</sup> *ibid*

<sup>41</sup> Definition by Organization for Economic Co-operation and Development(OECD) October 2006

<sup>42</sup> Definition by Ethiopian Revenue and Custom Authority of Ethiopia in June (2010)

‘attestation communication’ because it presents the auditor’s opinion or judgment concerning the degree of correspondence between accounting information and established criteria by law<sup>43</sup>

Tax audits also examine the issues seen as most significant to achieve the accurate assessment of a taxpayer’s tax liability. Typically these issues include any indications of significant unreported income (for example, as may be suggested by a very low ratio of net/gross business income ratio computed from a taxpayer’s return) or potentially over-claimed deduction items that may be apparent from an examination of a taxpayer’s tax return and other information. As well as income tax returns and other reporting, this includes supporting documents, which the taxpayer should normally have. In the case of business audits, national law often requires a business to obey certain bookkeeping and accounting standards. The audit may also involve physical inquiries, such as the inspection and examination of goods in stock, premises<sup>44</sup>

### **2.3 Historical background and classification of tax audit**

Historically auditing predates the Christian era. Anthropologists have found records of auditing activity dating back to early Babylonian times (around 3000 BC). There was also auditing activity in ancient China, Greece, and Rome. The Latin meaning of the word “auditor” was a “hearer or listener” because in Rome auditors heard taxpayers, such as farmers, give their public statements regarding the results of their business and the tax duty due<sup>45</sup>

Historically, Auditors existed in ancient China and Egypt. They were supervisors of the accounts of the Chinese Emperor and the Egyptian Pharaoh. The government accounting system of the Zhao dynasty in China included an elaborate budgetary process and audits of all government departments. From the dawn of the dynastic era in Egypt (3000 BC) the scribes (accountants) were among the most esteemed in society and the scribal occupation was one of the most prestigious occupations<sup>46</sup>

Egyptian Pharaohs were very severe with their auditors and each royal storehouse used to have two auditors, one counts the goods when they came in the door and the second counts the goods

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<sup>43</sup> Ibid

<sup>44</sup> Strengthening Tax Audit Capabilities: General Principles and Approaches, by Forum on Tax Administration’s Compliance Sub-group October 2006 p 9

<sup>45</sup> Principles of auditing: an introduction to international standards on auditing 2<sup>nd</sup> edition, Ricky Hayer, Roger Dassen, Arnold Schilder, and Philip Wallage

<sup>46</sup> ibid

after they were stored, the supervisor looks at both auditors. If there was a difference, the auditors were both killed. Bookkeeping as a support mechanism for the determination of profit or wealth or as a decision support system for achieving profit maximization was unknown in ancient cultures like the Mesopotamian, Egyptian, Greek, or Roman. Auditing in English-speaking countries dates to 1130 AD. Then, although they had highly developed economic systems, registration of economic facts or events were limited to the recording of single transactions whose sole purpose was to support the short-term memory of the trading partner<sup>47</sup>.

## **2.4 Tax audit and its classifications under the international context**

### **2.4.1 Classification of tax audit based on audit scope and Periods under examination**

Based on international standards on auditing, audits can vary in their scope and the level of intensity to which they are conducted, the first one is full audits scope of this audit is all-encompassing. It typically entails a comprehensive examination of all information relevant to the calculation of a taxpayer's tax liability for a given period. The objective is to determine the correct tax liability for a tax return as a whole. In some countries, full audits are carried out as part of random audit programs that are used to gather data on the extent, nature, and specific features of tax compliance risks, for compliance research purposes and/or the development of computerized audit selection formula. Given their broad scope, full audits are typically costly to undertake. Limited scope audits on the other side are confined to specific issues on the tax return and/or a particular tax scheme arrangement employed by the taxpayer. The objective is to examine key potential risk areas of noncompliance. These audits consume relatively fewer resources than full audits and allow for increased coverage of the taxpayer population<sup>48</sup>.

### **2.4.2 Classification based on the stage of tax audit**

From a structural perspective, tax audits can be divided into two main phases. In the preliminary phase, the tax authorities essentially carry out inspections and additional fact-finding activities to compare said facts with the information put forward by the taxpayer. In the core phase of tax

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<sup>47</sup> *ibid*

<sup>48</sup> Ricky Hayer and others *Principles of auditing: an introduction to international standards on auditing 2nd edition*, 2013.



audits, the tax authorities elaborate such materials in light of the applicable law, intending to determine whether to issue a tax notice, take other action, or do nothing at all<sup>49</sup>

### **2.2.1.1 Preliminary phase of tax auditing system**

The preliminary phase of tax auditing essentially focuses on fact-finding in which tax authorities gather facts to supplement those provided by the taxpayer and determine whether they paid taxes in compliance with the requirements established by law. Since tax authorities may not audit every single situation for tax purposes, it is important to understand what may trigger their initiative to audit a given case within the framework of technical discretionary power to single out particular taxpayer situations. It includes that the tax authorities may receive targeted information that indicates the existence of a potential tax violation. In such a case, the high degree of likelihood of this violation usually prompts the tax authorities to start the preliminary phase of tax auditing<sup>50</sup>

On the other side tax authorities may take the initiative to audit some situations that appear abnormal or difficult to justify in light of statistical data concerning taxpayers and their standards of living. Despite not constituting actual evidence of a possible tax violation, these indicators are often reliable elements to single out situations that are usually more worthy of being audited for tax purposes. For such purposes, the tax authorities usually gather information from all possible sources, including banks and other financial institutions. The tax authorities may have some relevant information from preliminary tests for conformity with the law in the documents submitted by taxpayers in their tax returns, also arising in connection with a cross-check of consistency with information supplied by third parties within the framework of their reporting obligations connected with the levying of withholding taxes. The tax authorities may have some relevant information from preliminary tests for conformity with the law in the documents submitted by taxpayers in their tax returns, also arising in connection with a cross-check of consistency with information supplied by third parties within the framework of their reporting obligations connected with the levying of withholding taxes.<sup>51</sup>

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<sup>49</sup> *Fundamentals of taxation : an introduction to tax policy and tax administration*, Pasquale Pistone, Jennifer Roeleveld, Johann Hattingh, João Félix Pinto Nogueira Craig: West 2019

<sup>50</sup> Ibid

<sup>51</sup> ibid

Generally, the outcome of this preliminary phase is particularly important for the tax authorities to determine how to proceed to secure the levying of taxes in conformity with the requirements established by law. This phase can essentially yield two possible situations. First, the tax authorities may decide not to continue tax auditing beyond the preliminary phase. In such circumstances, they may refrain from issuing a formal act, formally request the taxpayer to pay additional tax compared to the amount resulting from the previous assessment, or issue a formal act to acknowledge the taxpayer's prerogative to receive reimbursement for a certain amount of tax. The second and third options are only possible insofar there is documental unquestionable evidence that proves the right for tax authorities to request an additional amount of tax without further need for auditing, or obliging them to dispose of the repayment. Second, the tax authorities may decide to proceed further with the tax audit. In such circumstances, they summarize their fact-finding in a document that constitutes the basis for the core part of tax auditing, in which they elaborate such data and compare it further with the information provided by the taxpayer, as well as with the requirements established by law. In such circumstances, they should also decide whether the core part of tax auditing should proceed along with the normal standard or require some more intensive form of auditing<sup>52</sup>

#### **2.2.1.2 Main types of auditing after preliminary phase of tax audit**

Based on the inspection made at the preliminary phase, there are essentially two main types of tax audits that get ahead, that of normal standard for this type of activity and those that are more intensive. Both types of auditing require the tax authorities to elaborate their reconstruction of the facts and motivate their position based on the applicable law, indicating clear reasoning and taking into account possible relevant remarks made by the taxpayer and/or third parties. Both may result in the issuance of a formal act, which gives the power to assess taxes in a potentially definitive way, obliges taxpayers to conform to its content, and is subject to administrative review and judicial scrutiny<sup>53</sup>

#### **2.2.1.3 Core phase of the tax auditing system**

In principle, each system gives taxpayers the right to have the tax authorities analytically determine the essential elements of the tax. When taxpayers are obliged to self-assess their tax

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<sup>52</sup> *ibid*

<sup>53</sup> *ibid*

due and fulfill such obligations. The right to analytical determination implies that the tax authorities essentially reiterate all of the activities already carried out by the taxpayer and justify the request for additional tax by using relevant factual and legal arguments to deviate from the amounts determined by the taxpayer. In some cases, taxpayers are obliged to keep evidence of such facts in their accounting records, such as in respect of the determination of business income. In such circumstances, insofar as the taxpayer keeps their record books in good order and their content includes reliable information, the right to analytical reconstruction obliges the tax authorities to assess every single entry and item to override the facts declared by the taxpayer and request the payment of additional tax<sup>54</sup>

#### **2.2.1.4 Tax notice of the tax auditing system**

The issue of tax notice shall be raised when such obligation does exist whenever they disagree with the determination of tax about the facts or applicable law and consequently request the payment of additional tax or dispose of the right of the taxpayer to obtain a tax refund or reimbursement.

The formal act typically issued by tax authorities at the end of an audit for requesting the payment of an additional tax is the tax notice. Tax notices must contain the precise determination of tax and indicate the relevant factual and legal arguments for tax authorities to reach conclusions that are different from those put forward by the taxpayer in the tax return about the tax due. This may raise significant problems in practice, especially when taxpayers are simply not aware that a tax notice was issued in respect of them and are therefore not in a position in which they may activate any remedy. Such problems also arise due to the circumstance that tax procedures generally establish a deadline for (i) taxpayers to request the administrative review; and/or (ii) promoting the judicial appeal in respect of the tax notice. For this reason, tax authorities are generally required to give precise evidence of the correct notification before executing the tax notice or proceeding with the tax procedure towards the forcible collection of tax.<sup>55</sup>

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<sup>54</sup> *ibid*

<sup>55</sup> *ibid*

## **2.2.2 Classification tax audit based on Internal Revenue Service (IRS) of United States of America (2020)**

The IRS is charged with obtaining the United States government's major source of funding. The IRS, through the U.S. Treasury, helps execute and enforce many of the crucial economic, financial, and tax policies that influence the economy<sup>56</sup> there are four types of audit classification of tax audit under IRS.

### **I. Correspondence Audit**

Correspondence audits are the most common type of IRS audits. They comprise roughly 75% of all IRS audits. Correspondence audits are the simplest type of audit and involve the IRS sending a letter in the mail (typically a 566 letter) requesting more information about a particular part of a tax return. For example, the IRS may have questions regarding auto expense and request you send in receipts to substantiate your deduction.

Taxpayers never ignore a letter requesting information, as doing so will only aggravate what should otherwise be a simple correspondence. If they prepared the tax return correctly and taxpayers have the source documentation (receipts, invoices, payments, etc.) to back up the items on return, a taxpayer can generally handle correspondence audits on their own and likely won't have to meet with an IRS agent in person. Simply providing the requested documentation should put the matter to rest.

### **II. Office Audit**

The second type of audit is an Office Audit. If the IRS has questions about your return that are too complex or large for a correspondence audit, but too small for a field audit, you will get a letter in the mail requesting that you come into an IRS office for the audit. Generally speaking, an office audit is more detailed and may have more issues. Office audits typically surround issues about itemized deductions (Schedule A), business profits/losses (Schedule C), or rental income/expenses (Schedule E). Often one issue with a schedule can trigger an audit, but audits can quickly expand if the auditor suspects there may be problems in other areas of the return.

The office interview will consist of questions related to the issue under examination. There may also be more generalized questions about employment, financial position, and lifestyle in an

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<sup>56</sup> Internal Revenue Service (IRS) Written By Paul Tracy Updated November 4, 2020

attempt to find other causes for concern (like the possibility of underreported income). An individual should give careful consideration to the answers and documentation provided to the IRS. It's very easy for a taxpayer to unintentionally give the auditor a reason to expand the scope of the audit.

Auditors are well-trained tax professionals who are very good at getting nervous taxpayers to provide damaging information. It is in your best interest to seek legal advice from a tax attorney before an office audit. An office audit with the IRS will typically conclude after just one day. If the Agent wants additional information, they will give you time to supply the necessary information.

### **III. Field Audit**

A field audit is the most comprehensive of the four types of tax audits and detailed IRS audit. It involves the IRS visiting the taxpayer at their home or place of business to examine records. Field audits are performed by IRS revenue agents, who are generally more skilled and knowledgeable than most other IRS representatives. IRS revenue agents will also often specialize in a certain industry.

When the IRS visits a home or places a business, they may ask to see things outside of certain records. They do not want to limit themselves to a particular item. A typical audit for a business includes a review of financial records, interviews with employees, and a tour of the business facility. Interviews will be used to ascertain an overview of management structure, accounting procedures, and internal controls. For an individual, the audit will just consist of a review of financial records and an interview with the taxpayer. The audit could last anywhere from one day to a week, depending on the complexity of the account.

Field audits are by far the most intrusive and serious form of an audit. If you've been selected for a field audit, you should retain the services of a tax attorney who can be present at the time of the audit. Anything you say can be used against you to expand the scope of an audit. A tax attorney can communicate with the auditor on your behalf to ensure the scope is not accidentally expanded.

#### **IV) Taxpayer Compliance Measurement Program (TCMP) Audit**

The fourth type of audit is a Taxpayer Compliance Measurement Program (TCMP) Audit. The primary purpose of this type of audit is to update the data for the IRS' DIF scores. DIF scores are developed from analyzing a large group (involving up to 50,000 randomly selected returns) of intensive audits, conducted every few years. In a TCMP audit, the IRS will analyze every item on the tax return and every part of the return must be substantiated by documentation. A standard audit is time-consuming in that a taxpayer must find checks, invoices, contracts, bank statements, etc. for the items selected for audit. In a TCMP audit, every line of the tax return is audited therefore you have to provide documentation for all deductions, not selected few items.

Whichever audit you may be confronted with, it is always best to get organized and stay calm. For instance, pull all your canceled checks, receipts, and other information related to the items to be audited and get that information in sequential order.

#### **2.3 The legal framework of tax administration under the international aspect**

The legal framework has a role of protecting the rights of the taxpayers and specifying the duties, and also stipulating the required procedures that tax officials are expected to comply with. legal duties of taxpayers and the tax audit usually, auditing activities rely on the books and records kept by taxpayers hence taxpayers are expected the auditor access to all tax-relevant information during an audit. Tax-relevant information is any piece of information (such as books and records, bank statements, trade letters, contracts, etc.), which is essential to determine the correct amounts of tax due<sup>57</sup>

The duty above, particularly for those taxpayers who are required to keep books and accounts and they, are duty-bound to disclose all relevant those are a vital instrument which that determines the amount of tax to be paid and the deductions that taxpayers may have.

The organization and management of tax audit bodies have to achieve a balanced program of audits—one that balances 'coverage', 'audit quality, and 'overall deterrent' considerations. Audit operations should be underpinned by sound management practices including the use of a

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<sup>57</sup> ibid

comprehensive set of performance measures/indicators (output and, ideally, outcomes-focused), and with close monitoring of the results and quality of operations achieved in practice<sup>58</sup>

#### **2.4 Tax auditing standards under the international perspective**

Besides the classification of types of auditing, there are international standards used as a guideline for the national tax auditing system. There are several ethical and professional standards prepared by the organizations which have an international setup.

International Standards on Auditing (ISAs) are developed by the International Federation of Accountants (IFAC) through its International Auditing and Assurance Standards Board (IAASB). The efforts of IFAC, founded in 1977, are directed towards developing international technical, ethical, and educational guidelines for auditors, and reciprocal recognition of practitioners' qualifications. The membership of IFAC member bodies represents several million accountants in public and private practice, education, academe, and government service. Similarly the Ethics Committee, the Education Committee, and the Public Sector Committee with an interest in governmental financial reporting

The Public Interest Oversight Board (PIOB) will oversee IFAC standard-setting activities in the areas of audit performance standards, independence, other ethical standards for auditors, audit quality control, and assurance standards. The PIOB will decide other areas that might fall within the scope of its oversight after consulting with the Monitoring Group (MG) and the IFAC Leadership Group (ILG) (see below). The composition of the PIOB will be selected by the MG. It will be made up of members of the organizations within the MG or their representatives.

General Principles Standard ISA (International Standard of Auditing) 200, ISA 200 states that an auditor should comply with the Code of Ethics for Professional Accountants issued by IFAC. The ethical principles governing the auditor's professional responsibilities are independence, integrity, objectivity, professional competence and due care, confidentiality, professional behavior, and technical standards.

As per the international standard on auditing 200 regarding ethical requirements "*The auditor should comply with relevant ethical requirements relating to audit engagements*" ISA 200 further states that "*the auditor should conduct an audit following International Standards on*

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<sup>58</sup> *ibid*

*Auditing. The auditor would plan and perform the audit with an attitude of professional skepticism recognizing that circumstances may exist which cause the financial statements to be materially misstated*<sup>59</sup>

## **2.5 Ethical and professional standards for tax auditors under the international perspective**

Ethics represent a set of moral principles, rules of conduct, or values. Ethics apply when an individual has to decide between various alternatives regarding moral principles. All individuals and societies possess a sense of ethics in that they have some sort of agreement as to what right and wrong are.<sup>60</sup>

Ethical behavior is necessary for society to function in an orderly manner. The need for ethics in society is sufficiently important that many commonly held ethical values are incorporated into laws. However, a considerable portion of the ethical values of a society such as integrity, loyalty, and pursuit of excellence cannot be incorporated into law. By establishing a code of ethics, a profession assumes self-discipline beyond the requirements of the law<sup>61</sup>

As per black's law dictionary profession is "a vocation, calling, occupation or employment involving labor, skill, education, special knowledge, and compensation or profit"<sup>62</sup> such professions have their standards that shape the activities of the workers in it. The professional standard is a scheme that the legal mandate given to given professions in which whosoever is a member to such profession is expected to comply and who fails to fulfill is subjected to a specified legal liability.

### **2.5.1 International Federation of Accountants (IFAC) code of professional standard and Ethics for auditors**

The ethical guidelines set out by the International Federation of Accountants (IFAC) are developed by the IFAC Ethics Committee who reports their recommendations. The Code is intended to serve as a model on which to base national ethical guidance. It sets standards of conduct for professional accountants and states the fundamental principles that should be

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<sup>59</sup> International standard on auditing 200: objective and general principle governing an audit of financial statement June 15, 2006

<sup>60</sup> Pasquale Pistone, Jennifer Roeleveld, Johann Hattingh, João Félix Pinto Nogueira Craig: West Fundamentals of taxation : an introduction to tax policy and tax administration, 2019, p 74

<sup>61</sup> ibid

<sup>62</sup> Black's law dictionary fourth revised edition 1968



observed by professional accountants to achieve common objectives. A member body of IFAC or firm may not apply less stringent standards than those stated in this Code. However, if a member body or firm is prohibited from complying with certain parts of this Code by law or regulation, they should comply with all other parts of this Code<sup>63</sup>

***Ethics Guideline of the International Federation of Auditors /Accountants (IFAC) (2006)*** stipulates ethical standards by classifying them into three main parts. “*Part A applies to all professional auditors unless otherwise specified. Part B applies only to those professional accountants in public practice. Part C applies to employed professional accountants or auditors, and may also apply, in appropriate circumstances, to accountants employed in public practice*”

***A. Ethical and professional Guidelines Applicable to All auditors based on (IFAC)***

It contains fundamental principles that are not intended to be used to solve professional auditors’ ethical problems in a specific case. However, it provides detailed guidance as to the application in practice of the objectives and the fundamental principles regarding the number of typical situations occurring in the auditing profession. The followings are all ethics guidelines applicable to all auditors

Integrity and Objectivity it deals with, Professional auditors should be straightforward and honest in performing professional services whereas Resolution of Ethical Conflicts, Auditors may encounter situations when the responsibilities that may conflict with internal or external demands. There may be pressure from an overbearing supervisor, manager, director or partner, or family member, the resolution for such conflict may be an immediate superior, seek counseling and advice on a confidential basis with an independent adviser. The other is Professional Competence and Due Care, Professional competence requires a high standard of general education followed by specific education, training, examination in relevant subjects, and work experience. Confidentiality, Professional auditors should respect the confidentiality of information about a client’s (or employer’s) affairs acquired in the course of professional

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<sup>63</sup> The preface of code of ethics for professional accountants by International Federation of Accountants(IFAC) The Code was issued in June 2005 and became effective on June 30, 2006

services. Auditors respect the confidentiality of information acquired during performing professional services<sup>64</sup>

Tax Practice, An accountant performing tax services may put forward the best position in favor of a client or employer, provided the service is done with professional competence, does not in any way impair integrity and objectivity, and is consistent with the law. An Auditor should not represent to a client or an employer that the tax return prepared and the tax advice given is above challenge. He should make sure that the client is aware of the limitations involved in the interpretation of tax law and tax reporting. Misleading Tax Returns should not be associated with any tax return if he has reason to believe that it contains a false or misleading statement or omits important information. When estimates are used in the tax return, they should not be presented in a manner that implies greater accuracy than exists. The tax preparer usually relies on information furnished by the client but should consider whether supporting data needs to be provided. If the accountant discovers a material error or omission in a tax return of a prior year, he should advise his client<sup>65</sup>

### ***B. Ethics Applicable to Professional Auditors/accountants in Public Practice***

Part B of the Ethics Guideline of the International Federation of Auditors /Accountants (IFAC)'s Code of Ethics is only applicable to accountants/auditors in public practice. A professional accountant in public practice refers to each partner or person occupying a position similar to that of a partner, and each employee in a practice providing professional services to a client irrespective of their functional classification (*e.g. audit tax or consulting*), and professional accountants in a practice having managerial responsibility.

Ethical guidance for accountants in public practice is offered in the areas of independence; responsibilities to clients such as fees, commissions, clients' monies; and responsibilities to colleagues such as relations to other professionals, advertising, and activities incompatible with practice.

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<sup>64</sup> Ibid section 1 to 4

<sup>65</sup> Ibid section 5 to 6

### ***I) Independence requirement by the auditors of public practice/public office***

The independence of the auditor from the firm that he is auditing is one of the basic requirements to keep public confidence in the reliability of the audit report. Independence adds credibility to the audit report on which investors, creditors' employees, government, and other stakeholders depend to make decisions.

As per the Code of Ethics for Professional Accountants (2006), Section 8 "Independence" is described as: "*having a position to take an unbiased viewpoint in the performance of audit tests, analysis of results, and attestation in the audit report; independent in fact: auditors ability to maintain an unbiased attitude throughout the audit, so being objective and impartial; independent in appearance: the result of others' interpretations of this independence*" Every auditor are required to act in the manner of non-discrimination, being an objective mainly based in the performance of audit, independence in fact and independence in appearances.

### ***II) Professional Competence and Responsibilities***

If an auditor does not have the competence to perform a specific part of the professional service, technical help may be had from experts such as other accountants, lawyers, and related evaluators. However, since the auditors have ultimate responsibility for the service, it is their responsibility to see that the requirements of ethical behavior are followed. As Ethics Guideline of International Federation of Auditors /Accountants (IFAC)'s Section 8: "*All professionals participating in the assurance engagement to be independent of the assurance client*"<sup>66</sup>

### ***III) Activities Incompatible with Practice***

Professional auditors in public practice should not concurrently engage in any business, occupation, or activity that impairs or might impair integrity, objectivity or independence, or the good reputation of the profession. The simultaneous engagement in another activity unrelated to assurance or accounting services, which reduces the accountant's ability to conduct his accounting practice according to ethical principles, is inconsistent with public practice<sup>67</sup>

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<sup>66</sup>*Ethics Guideline of International Federation of Auditors /Accountants (IFAC)'s Section 8, (IFAC)(2006)*

<sup>67</sup> *Ibid* Section 11

### ***C. Ethical standard applicable to Employed Professional Auditors and accountants (Business)***

Based on the Ethics Guideline of the International Federation of Auditors /Accountants (IFAC)'s there is also a standard applicable to professional auditors and accountants which includes the following,

**Conflicts of Loyalties** Auditors who are employed by non-audit firms owe loyalty to their employer as well as to their profession, but there may be times when the two conflict. An employee's normal priority should be to support his or her office. However, an employee cannot legitimately be required to break the law, breach the ethics, rules, and standards of the accounting profession, and lie to their employ<sup>68</sup>

**Professional Competence** An auditor/accountant employed in industry, commerce, the public sector, or education may be asked to undertake important tasks for which he has not had sufficient specific training or experience. When undertaking these tasks, an accountant should not mislead his employer as to his degree of expertise. Where it is appropriate, expert advice and assistance should be requested from the employer<sup>69</sup>

**Presentation of Information** A professional accountant/auditor is expected to present financial information fully, honestly, and professionally so that it will be understood in its context. Financial and non-financial information should be kept describing clearly the true nature of business transactions, assets, or liabilities and whether transactions are recorded in a timely and proper manner<sup>70</sup>

## **2.6 Related international standards for tax auditors/accountants.**

### **2.6.1 International Standard on Auditing (ISA)**

ISA is primarily aimed to establish standards and provide guidance on the objective and general principles governing an audit of financial statements and it describes managements' responsibility for the preparation and presentation of the financial statements and for identifying

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<sup>68</sup> Pasquale Pistone, Jennifer Roeleveld, Johann Hattingh, João Félix Pinto Nogueira Craig: West Fundamentals of taxation: an introduction to tax policy and tax administration, 2019, p104

<sup>69</sup> ibid

<sup>70</sup> ibid

the financial reporting framework to be used in preparing the financial statements, referred to in the ISAs as the “*applicable financial reporting framework*”<sup>71</sup>

This standard considers auditing of financial statements to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, following an applicable financial reporting framework. ISA has an ethical requirement that “*auditor should comply with relevant ethical requirements relating to audit engagements*”<sup>72</sup>

International Standard of Auditing 220 identifies fundamental principles of professional ethics established by Parts A and B of the IFAC Code and sets out the engagement partner’s responsibilities for ethical requirements, IFAC requirements include (A) Ethics Guidelines Applicable to All auditors and (B) Ethics Applicable to Professional Auditors/auditors in Public Practice<sup>73</sup> (C) Ethical standard applicable to auditors employee of a business<sup>74</sup>. For the case of our research, we look at only standards particular to Ethics Applicable to Professional Auditors/auditors in Public Practice.

### **2.6.1.1 International Standard on Auditing/accounting (ISA) and Ethics Applicable to Professional Auditors/auditors in Public Practice**

As per the code of international standard of auditing/accounting, professional auditors are required more than mere standard since they are undertaking the interest of the public. ISA under section 200 of the code stipulated several Ethical and professional standards to be complied by auditors under the public domain.

Among the ethical standards, one is Integrity it’s “an obligation on all professional auditors/accountants to be straightforward and honest in professional and business relationships. Integrity also implies fair dealing and truthfulness”<sup>75</sup>

Being an objective “all professional accountants not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others”<sup>76</sup>

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<sup>71</sup> Objective and general principles governing an audit of financial statements(2006)

<sup>72</sup> Introduction to the ethical requirement related to audit engagement paragraph 1 and 2: International standard on auditing 220(2006)

<sup>73</sup> *ibid*

<sup>74</sup> *ibid*

<sup>75</sup>Section 110 of International standard on auditing 220(2006) Code issued in June 2005 and became effective on June 30, 2006

Professional Competence and Due Care “(a) to maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service” and (b) to act diligently under applicable technical and professional standards when providing professional services”<sup>77</sup>

Confidentiality is an obligation on professional accountants “to refrain from: (a) Disclosing outside the firm or employing organization confidential information acquired as a result of professional and business relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose” and “Using confidential information acquired as a result of professional and business relationships to their advantage or the advantage of third parties”<sup>78</sup>

Professional Behavior “imposes an obligation on professional accountants to comply with relevant laws and regulations and avoid any action that may bring discredit to the profession. Again “Professional employees as auditor or accountant are expected to refrain from any business activity that will have the effect of impairing the integrity or good reputation of the profession and the professional service”<sup>79</sup>

## **2.7 Breaching of the professional and ethical standard by auditors and the effect under international instruments**

The effectiveness of enforcing ethical standards varies from country to country that in many countries an auditor who violates the ethical standard may be disciplined by law or by a professional organization. The penalties range from a reprimand/warning to expulsion or fine. Regarding the execution of disciplinary action International Federation of Auditors/accountants has no authority. Rather IFAC relies on legislation or the constitution of professional bodies in each country<sup>80</sup>

The International Federation of Auditors ethics code guidance disciplinary action and common sanctions. It states disciplinary sanctions as a disciplinary action as “ordinarily arises from such

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<sup>76</sup> ibid

<sup>77</sup> ibid

<sup>78</sup> ibid

<sup>79</sup> International standard on auditing 220(2006) Code issued in June 2005 and became effective on June 30, 2006 , section 200.1

<sup>80</sup> Ibid

issues as failure to observe the required standard of professional care, skills or competence; non-compliance with rules of ethics and discreditable or dishonorable conduct” and the sanction imposed is “reprimand, fine, payment of costs, withdrawal of practicing rights, suspension, and expulsion from membership”<sup>81</sup>

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<sup>81</sup> Ibid

## UNIT THREE

### 3. TAX AUDITING AND THE LEGAL FRAMEWORK IN FEDERAL STATES OF ETHIOPIA

#### 3.1 Introduction

Tax is a burden or charge which is only imposed by the legislative power on persons or property to raise money for public purposes or it is exacted not based on direct quid pro quo relations. Moreover, the payment of tax cannot be imposed except by law. The tax also plays an important role in stabilizing the economy. As an essential component of fiscal policy, tax aims to bring about high employment and acceptable price levels<sup>82</sup>

Ethiopia has a long history of the tax system that traced long years and the modern tax system of Ethiopia started in the 1940s, has developed and evolved by fits and starts as the needs for revenue arise, as governments change and as the economy and international situations shift. Throughout this period, the Ethiopian tax system went through some major revisions and numerous piecemeal amendments<sup>83</sup>

As per FDRE constitution states “*Every Ethiopian has the right to engage freely in economic activity and to pursue a livelihood of his choice anywhere within the national territory*”<sup>84</sup> it expressly states that every citizen has the right to enjoy their economic right as long as the economic activities do not contradict with the laws and moral of the country. The same constitution necessitates the citizens with the economic activity to pay tax for the government; in our case, the federal and regional government based their hierarchy to collect taxes accordingly unless and otherwise provided contrary all citizens accompanying with any economic activity are required to pay taxation<sup>85</sup>

When we comprehend the existing tax policy of Ethiopia it is geared towards promoting investment, supporting industrial development and broadening the tax base, and decreasing the

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<sup>82</sup> Solomon Nigussie, Fiscal Federalism in the Ethiopian Ethnic based Federalism, Utrecht Institute, Netherlands, (Wolf Legal Publishers, 2008)

<sup>83</sup> The major tax reforms in Ethiopia occurred in the 1940s, in the aftermath of the Ethiopian revolution of 1974, after the fall of the Derg in 1991 and most recently in the 2002 tax reforms. Finally after the reformation of government in Ethiopia 2018 several revisions made.

<sup>84</sup> Art 41(1) of FDRE constitution, proclamation no. 1995, 1<sup>st</sup> year No.1 Addis Ababa August 1<sup>st</sup> 1995

<sup>85</sup> Ibid



tax rate, at least maintaining the current reduced tax rates compared to most other countries, because of financing the ever-growing needs of the government expenditure. On the other hand, the policy is designed towards discouraging certain production and consumption activities, which had /and will have adverse effects on the health, moral, economic, and social settings of the community<sup>86</sup>

More specifically the tax policy of Ethiopia made its base on the introduction of the efficient tax system that supports the economic development of the taxpayers as well as the country by addressing and fairness to the tax system<sup>87</sup> Similarly aimed to reduce “the problem of prolonged pendency of taxpayers’ cases resulting from the divergent interpretation of tax laws within the tax administration” and “*establish a system for review of taxpayers’ complaints on tax decisions which is accessible, well organized and capable of efficient disposition of cases*”<sup>88</sup> To ensure the proper compliance of constitutional duties of citizens (obligation to pay tax) there is a system called “tax audit” in which competent professional auditors under supervision of the tax authority conduct the practice of audit based on the tax report of taxpayers.

### **3.2 The definition of tax auditing in Ethiopia**

In the Ethiopian context tax audit is defined as an activity performed by tax auditors to determine the accurate tax liability of the taxpayers, through examination of taxpayers’ financial records and evaluation of the compliance of tax law and verify the true, fair, reliable, and accurate financial return<sup>89</sup> Based on this analysis it can be concluded that under the perspective of Ethiopia tax audit consider to the activity which is performed by the tax auditors which are employees of the tax authority entitled to regulate fair tax liability of the taxpayers by detecting the financial records and reports, ultimately measure the compliance of tax report with the tax laws and regulation of Ethiopia.

Whereas as per the Domestic Tax Audit Manual of ERCA, (2014), a tax audit is a systematic examination of a business’s relevant commercial system to determine whether a taxpayer’s declaration states the tax liability correctly and complies with the provisions of the tax laws and

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<sup>86</sup> Tax policy and strategy of Ethiopia by Ethiopian revenue and custom authority 2010

<sup>87</sup>The preamble of Federal income tax proclamation number 979/2016. 22<sup>nd</sup> year No 104 Addis Ababa 18<sup>th</sup> august, 2016

<sup>88</sup> The preamble of Federal tax administration proclamation No. 983/2016. 22<sup>nd</sup> year No 103, august 2016, Addis Ababa,

<sup>89</sup> *Tax and auditing policy and strategy* by Ethiopian revenue and custom authority 2010

related subsidiary legislation. Auditing involves the examination of financial statements, books of accounts, and vouchers of a taxpayer by Tax Auditors to ascertain whether the taxpayer has accurately considered revenues and expenses when determining the taxes shown in the declarations as per the requirements of the tax laws. It also involves other approaches such as observation of premises, direct monitoring of receipts in cash businesses, use of mark-up techniques, and analysis of key ratios.

### **3.3 Types of tax auditing practiced in the Federal government of Ethiopia**

The domestic tax audit manual in Ethiopia has been prepared by (*Ethiopian revenue and customs authority ERCA*) which governs tax auditing procedures. It stated several types of tax auditing in Ethiopia, classification is mainly, based on the audit scope and intensity, periods under examination, and location under examination.

As per the Ethiopian Federal Government revenue and customs Authority (ERCA manual of 2014), major types of tax audits includes, first *Comprehensive audit*: it is an audit that is all-encompassing in scope and entails an in-depth examination of all information relevant to the calculation of a taxpayer's tax liability for all tax type for a given period. Also, tax officers informing taxpayers about their visit and the types of documents that they will review and the taxpayers be ready for their review<sup>90</sup> it has a broad scope and is typically costly to undertake in terms of time and resources, and thus reduces the rate coverage of taxpayers that could otherwise be audited.

Secondly, there is *an Issue Audit or spot audit* a limited scope audit that may be confined to specific issues in a tax return and/or a particular tax type, the objective here is to examine key potential risk areas to have intensive auditing normally focuses on a single tax type, period, or item, this audit is recommended because it consumes relatively fewer resources than comprehensive audits and allows for increased coverage of the taxpayer population. Issue audit classified into three, (I) *Desk Issue Audit*, it is can be conducted about a specific issue(s) of a taxpayer or enterprise when the auditor is confident that all the necessary information can be ascertained by examining the office. All the required or relevant information or data may be accessed from internal sources or official references without the need to contact the taxpayer. (II)

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<sup>90</sup>Organization for economic cooperation and development: Strengthening Tax Audit Capabilities: General Principles and Approaches Forum on Tax Administration's Compliance Sub-group Oct 2006

*Field Issue Audit* is the escalation of a desk issue audit into a field activity or exercise. It is important to remember that the audit is limited to key issues of compliance or a tax type or period. Field issue audit is commonly used in examining whether a taxpayer has met his/her obligations in respect of PAYE, VAT/TOT and Excise tax, Withholding Tax, or Income Tax normally for a specified tax period.

(III) *Desk Audit* is the third type of tax auditing in Ethiopia, which is concerned with a preliminary examination of declarations analyzing accuracy, completeness, ratios, and crosschecking information to determine if further audit or investigation is warranted. By implication, returns which are stated on a certain level of risk. Desk audit executed within the office of the tax officials. The essence is to carry out some administrative checks on returns filed to ensure compliance with tax laws. When conducting this audit, prior notice is not given to the taxpayer. The taxpayer only becomes aware of the audit when he is requested to produce certain documents or to show up for a possible interview. The outcome of the desk audit may lead to a field audit when the tax official is dissatisfied with the level of compliance of the taxpayer<sup>91</sup>

### **3.4 National Legal and Policy framework**

#### **3.4.1 FDRE constitution of 1991 and the taxation**

The current constitution of Ethiopia has been adopted in 1995 and is commonly called the federal democratic republic of the Ethiopian constitution hereinafter referred to as (the FDRE constitution). The FDRE constitution of 1995 has not included an explicit statement that indicates directly everyone's obligation to pay tax. Unfortunately, the FDRE constitution does not contain duties of citizens rather it specifies the entitlements, rights, and liberties of everyone in a dispersed manner article 9(2) of the FDRE constitution has imposed implied obligation on everyone to pay tax, though the provision declares everyone's obligation for the observance of the constitutional provisions<sup>92</sup>Article 41(1) of the FDRE constitution states “*Every Ethiopian has the right to engage freely in economic activity and to pursue a livelihood of his choice anywhere within the national territory*” The same constitution under Art 43(1) stipulate “*The Peoples of Ethiopia as a whole, and each Nation, Nationality, and Peoples in Ethiopia, in particular, have*

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<sup>91</sup> Adediran et al. 2013; Olaoye & Ogundipe, 2018, Oyedokun, 2016

<sup>92</sup> A Review of Constitutional Principles Regarding Taxation: Ethiopian and Turkish Perspective by Yonas Girma Adimassu, L.L.B (Hawassa University, Ethiopia), L.L.M (Addis Ababa University (Ethiopia), Lecturer in Dilla University, PHD candidate in Selçuk University (Konya-Turkey)

*the right to improved living standards and to sustainable development*”<sup>93</sup> The constitution stress that every citizen of Ethiopia are allowed to engage freely in whatever economic activity as long as it does not contradict the moral and laws of the country and the Nation nationalities and peoples of Ethiopia are entitled the right to get better life hood and progressive development, in order to ealize this citizen needs suitable atmosphere from the sectors of the government as well as the civil societies. Primarily governmental structures in the investment commissions, tax authorities, and courts are supposed to have indispensable roles.

The FDRE constitution comprises a provision that enables the two tiers of government two have concurrent power of taxation. Moreover, the residual power of taxation power has never been vested to any tier of government rather the constitution called it 'undesigned tax' and the two federal houses have the power to decide over the issue of which tier of government has the power of taxation<sup>94</sup>

#### **3.4.2.1 FDRE constitution, principles of taxation, and the tax audit**

The Constitution of the Federal Democratic Republic of Ethiopia empowers the House of Peoples Representatives to enact laws that are referred to as proclamations. Accordingly, the HPR issued proclamations discussed in this guide to levy taxes and duties on revenue sources reserved to the federal government. The Council of Ministers is, in turn, authorized to issue regulations according to powers vested in it by the HPR in the respective proclamations and its establishment proclamation. The Council of Ministers is, in turn, authorized to issue regulations under powers vested in it by the HPR in the respective proclamations and its establishment proclamation. The proclamation or regulation shall, as the case may be, authorize the concerned minister to issue implementation directives.<sup>95</sup>

To have an effective auditing system of taxation, it is crucial to strictly look at the principles of taxation, our current constitution even though has no explicit stipulation about the principles of taxation in Ethiopia some provisions impliedly mention the principles concerning taxation and the following are some of the implied principles.

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<sup>93</sup> Art 41(1) and 43(2) The FDRE constitution of 1995, from article 95-100 Proclamation No. 1/1995 1st year no.1 Addis Ababa 21st august 1995

<sup>94</sup> The FDRE constitution of 1995, from article 95-100 Proclamation No. 1/1995 1<sup>st</sup> year no.1 Addis Ababa 21<sup>st</sup> august 1995

<sup>95</sup>Tax compliance guide for investors Ethiopia by international trade center in partnership with Ethiopian investment commission 2020 p. 3

The Principle of 'Ability to Pay' is one of the principles in which taxpayers granted as a right, it entitles every taxpayer is under obligation to pay taxes according to his financial resources. Under article 100 sub-article (1) that, in exercising their taxing powers, States and the Federal government shall ensure that any tax is related to the source of revenue taxed and that it is determined following proper considerations as per the principle of the constitution and the tax auditing system of the country required to consider the “progressive taxation” in which taxpayers to pay based on their equivalent profit acquired in the tax year<sup>96</sup>

In fact, provision Art 100(1) of the FDRE constitution is aimed to deal with the relation between the federal and state government concerning taxation. The phrase following proper considerations shows the procedural fairness is required and the peoples' ability to pay should also be taken into consideration<sup>97</sup>

The Principle of “Equality” although, there is no special principle of equality for taxation in the FDRE constitution, article 89 sub 2 underlines the principle of equality as economic policy principle by stating that government has to ensure that all Ethiopians get equal opportunity to improve their economic condition. Moreover, Article 25 of the FDRE constitution has also stated that all persons are equal before the law and are entitled without any discrimination to the equal protection of the law. This principle shall apply to the process of auditing of the taxation that tax authority or auditors in the tax system are required to treat every taxpayer without bias mainly ethnic, religious, political stands, etc.

The principles of legality, FDRE constitution it is one of the governing principles that “Tax legality is a principle that requires a tax to be based on law. The tax should have a legal basis either by the constitutions or by other subordinate laws”<sup>98</sup> In this regard any practice by the tax authority or auditors which contradict the constitution or any tax law shall be illegal. The

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<sup>96</sup> The title of Article 100 has discrepancy in Amharic and English version. The Amharic version ‘ has equivalent meaning of ‘Principle of tax’ in English. Article 106 of the FDRE constitution states that the Amharic version of the Constitution shall have final legal authority Hence, it is possible to argue that Article 100 specifies the principle of tax mainly that the directive forwarded to the inter relation between the federal government and states regarding tax.

<sup>97</sup> A Review of Constitutional Principles Regarding Taxation: Ethiopian and Turkish Perspective by Yonas Girma Adimassu, L.L.B (Hawassa University, Ethiopia), L.L.M (Addis Ababa University (Ethiopia), Lecturer in Dilla University, PHD candidate in Selçuk University (Konya-Turkey)

<sup>98</sup> *ibid*

principle of tax legality is also one of the main principles of taxation that ensure the supremacy of the legislature over tax matters and as a principle that constrains the powers of the legislature<sup>99</sup>

FDRE constitution 99 has also provided the legislative power on the matters of the federal government to the House of Peoples' representative. Relatively, the house of the federation which is, the upper house of the Ethiopian government, despite its passive role in law-making, has a little legislative role in tax matters. House of the Federation in joint session with the House of Peoples' Representatives has the power to determine by a two-thirds majority vote on the exercise of powers of taxation which have not been specifically provided for in the Constitution<sup>100</sup>

### **3.4.3 Modern historical background of income tax and the tax administration in Ethiopia**

Historically the concept of modern income tax in Ethiopia was introduced in 1944, the foundational principle of income tax in Ethiopia was laid by Emperor Haileselassie in 1882 when the emperor issued a decree requiring all peasants to pay one-tenth of their agricultural products to tax officials. Accordingly, tax officials and tax auditors would seasonally go to the land of the peasants and collect payment following the amount obtained from the land<sup>101</sup>

The decree embodied the idea that each individual would be taxed according to the amount he/she earns. Though it was first related to agricultural income, it was modified on some occasions resulting in changes. One major change that was introduced was the idea of taxation on income from employment<sup>102</sup> Income taxation under this arrangement was classified into four schedules based on the sources of the income including income from employment, income from rent of land, and buildings used for other purposes than agriculture, income from business and income from agricultural activities and the income charged progressively<sup>103</sup>

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<sup>99</sup> Frans Vanistendael, Legal Framework for Taxation, in 1 TAX LAW DESIGN AND DRAFTING 1, 16, 18 (Victor Thuronyi ed., 1996). As cited by Lencho, T. THE ETHIOPIAN TAX SYSTEM: EXCESSES AND GAPS. Michigan State International Law Review 20(2), 2012, pp.9

<sup>100</sup> A Review of Constitutional Principles Regarding Taxation: Ethiopian and Turkish Perspective by Yonas Girma Adimassu, L.L.B (Hawassa University, Ethiopia), L.L.M (Addis Ababa University (Ethiopia), Lecturer in Dilla University, PHD candidate in Selçuk University (Konya-Turkey)

<sup>101</sup> For this purpose, in 1901, tax offices "granary" were set up in each district where the annual tithe had to be deposited.

<sup>102</sup> Eshetu Chole, Income Taxation in Pre- and Post- Revolutionary Ethiopia: A Comparative Review, Ethiopian Journal of Developmental Research, Vol. 9, Number 1, Institute of Development Research, Addis Ababa University, 1987

<sup>103</sup> Ibid

To administer the collection of these taxes, two methods of collection were employed at that time. Where the taxpayer was in a position to keep accounts, the collection was to be made by the Income Tax Authority. Otherwise, income was to be assessed by a local tax assessment committee and the assessment was to be effective for five consecutive years. As is evident from the fact that most taxpayers of the time were farmers, the latter method of collection was the most employed one<sup>104</sup>

The reign of dergue whereas known to have the ideology of socialism amended several tax proclamations, mainly the income tax structure levied on agricultural activities; and thus introduced rural land use fees and taxes on income from agricultural activity. In this regard enacted Income Tax Proclamation No.255/1967) Furthermore, Special Decree No. 18/1990 was passed thereby changing the rate of taxation on business income<sup>105</sup>

The transitional period of Ethiopia, Proclamation No.30/1992 was adopted thus amending the previous laws on personal income taxation. This proclamation was further amended by the Income Tax Amendment Proclamation No. 107/1994, which, among other things, amended the tax on income from business and other profits<sup>106</sup>

Afterward, EPRDF promulgated a new income tax in Ethiopia is Proclamation number 286/2002. This income tax was known to have a broader jurisdiction that includes global jurisdiction on residents whereas it has a source jurisdiction on non-residents. Accordingly, the income tax law applies to residents of the Federal Democratic Republic of Ethiopia for their worldwide income<sup>107</sup>

Also, the income for taxation was classified categorically and scheduler or there were modalities and rates of taxation on such income. The scheduler income includes different sources like employment, business, rental building, and other incomes. Categorical classification also allocated taxpayers to a different level based on their annual gross income<sup>108</sup> To have a

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<sup>104</sup> Gebrie Worku Mengesha, Tax Accounting in Ethiopian Context, 2nd Ed., Alem Printing Press, Ethiopia, 2008, p 34

<sup>105</sup> Ibid

<sup>106</sup> Ibid

<sup>107</sup> Article 3(1), Income Tax Proclamation No. 286/2002

<sup>108</sup> Articles 10-13 of Income Tax Proclamation No. 286/2002, Proclamation' No. 286/2002, 8thYear No. 34 Addis Ababa 4<sup>th</sup> July

progressive accomplishment of the income tax again there was income tax regulation No. 78/2002.

About Ethical and professional standards provided under the regime of EPRDF, mainly under the income tax proclamation No. 286/2002. Under art 99(a-c) any person employed for carrying out the provisions above is the crucial one that impedes improper ethical and professional acts of the tax authorities and the employees including the employees of the tax office with the mandate of assessment and auditing of taxation. Similarly, the sanction for such offense by the tax officials is gravest up to 10 years of imprisonment and 50,000 ETB sanction<sup>109</sup>

### **3.4.4 Tax auditing and the current tax laws of the Ethiopian Federal government**

#### **3.4.4.1 Federal Income tax proclamation no. 979/2016**

Federal Income Tax Proclamation No. 979/2016 was issued to introduce a modern and efficient tax system that supports economic development and that is in accord with the level of economic development achieved. It was further intended to make the tax system fair and bring income into the tax net that was not subject to tax thus far. The proclamation is divided into 11 parts and 102 Articles<sup>110</sup> the income tax proclamation No.979/2016 is currently governing income tax of the federal government and it incorporated several substantive and procedural provisions that facilitate the appropriate application of the income tax and serve as a guideline for the regional state income tax law. Tax audit is among the crucial value of the income tax law in this regard the federal income proclamation classified taxpayers into different sectors based on different sources of the income generated.

Concerning the jurisdiction based on the income tax proclamation of the federal government any source of income from employment in Ethiopia, to the extent that it is derived in respect of an employment exercised in Ethiopia and the employee get the payment from the federal government of Ethiopia wherever the employee is subjected to this income tax<sup>111</sup> and income from business activities by residents in Ethiopia unless the income is by permanent nonresident

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<sup>109</sup> Ibid

<sup>110</sup> Tax compliance guide for investors Ethiopia by international trade center in partnership with Ethiopian investment commission 2020 p. 4-5

<sup>111</sup> Art 6(1)( a and b) federal income tax percolation no. 979/2016 22<sup>nd</sup> year No.104 Addis Ababa 18th august 2016



business man<sup>112</sup> similarly rental building incomes the building resides in Ethiopia and movable asset located domestically<sup>113</sup>

#### **3.4.4.2 Classification of taxpayers under the income tax proclamation No. no. 979/2016**

The federal income tax classified taxpayers into different schedules and categories based on the source from where the income was acquired and based on the annual gross income of the taxpayers.

##### ***I. Scheduler classification of taxpayers***

Two important systems of income taxation have been adopted by countries around the world. These are the global and the scheduler systems of taxation. The basic feature of the global system of income taxation is that the tax is imposed on the total income of an individual regardless of the types of activities that he/she pursues and regardless of the sources from which he/she obtained his/her income. Accordingly, under the global system of taxation, an individual has to declare his/her aggregate income for the purpose of taxation<sup>114</sup>

While the scheduler system of income taxation, which is the system adopted in Ethiopia, takes the different sources of income of an individual into consideration for the purpose of taxation. Accordingly, income is identified by its sources and each source has its own procedures and rates for the determination of income tax; thereby requiring an individual to declare his/her income from each source separately. Under this system, each source of income is considered to have its identifying unique features for the purposes of taxation. Therefore, before taxation, sources of income have to be properly identified according to the correct schedule set by the system<sup>115</sup> Major schedules of the federal income tax proclamation includes

*Schedule “A”* income from employment provides for the tax rate and modality of assessment of income tax collected from employment. Employee is the one who works temporarily or permanent under the authorship and control another individual called with remuneration<sup>116</sup>

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<sup>112</sup> Ibid

<sup>113</sup> Ibid

<sup>114</sup> Under development in Ethiopia by Eshetu chole in 2010

<sup>115</sup> Art 10 -65 of federal income tax proclamation no. 979/2016, 22<sup>nd</sup> year No.104 Addis Ababa 18th august 2016

<sup>116</sup> Ibid Article 2(7)

Under the federal income tax proclamation Art, 12 incomes from Employment includes Art 12(1) salary, wages, an allowance, bonus, commission, or other remuneration received by an employee in respect of past, current, or future employment. The value of fringe benefits received by an employee in respect of a past, current, or future employment and an amount paid to an employee for termination of employment in based voluntarily or based on legal proceeding or compensation for dismissal or loss of employment are considered to be employment incomes and the imposition of tax<sup>117</sup>

Schedule “B” the rate of income tax is specified under the same proclamation, from 0% for an income of 600 ETB per month to 35% for more than 10,900 ETB of employment salary<sup>118</sup> As per Article 15 of the federal income tax, a rental building shall be taxed with the gross amount of income derived by taxpayers and reduced by the total amount of deduction. the taxation of income earned from rental of buildings and taxable rental income for the year and principle that tax has to be paid on income from the rental of buildings remaining as it is, a taxpayer who leases furnished quarters is liable to pay tax on the income that he/she receives from the lease of the furniture and equipment in the leased quarters. The rate for rental buildings begins at 0% for the rent of less than 7,200 and 35% for the rental of buildings for more than 130,800 ETB<sup>119</sup>

Schedule “C” taxation from the income of the business, From art 18 to 27 of the income tax deals with taxation on income from the business, Business income tax or corporate tax as commonly referred to relates to direct tax levied by various jurisdictions on the profits made by companies or associations<sup>120</sup>

As per article 21 of the federal income tax, taxable business income includes the gross amounts derived by the taxpayer during the year from conducting a business; including the gross proceed from the disposal of trading stocks and the fee for the provision of service. Additionally the disposal of business assets other than trading stocks by the taxpayer. Any amount included in the

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<sup>117</sup>Ibid Art 12(1)

<sup>118</sup>Ibid Art 11 ibid

<sup>119</sup>Ibid Article 14, 15 and 16 ibid

<sup>120</sup> Gebrie Worku Mengesha, Tax Accounting in Ethiopian Context, 2nd Ed., Alem Printing Press, Ethiopia,2008

business income of the taxpayer for the tax year is considered to be among the taxable business activities<sup>121</sup>

The rate of taxable income is range from 0% up to 7,200 and 35% for 130,800 and more for physical persons, whereas the rate for a juridical person is 30%<sup>122</sup> among this there are deductible items which includes expenditures that aimed to derive, secure, and maintain amount included in business income, cost of trading stocks, depreciate assets and intangibles, loss of business assets and any amount of deduction which allowed by law<sup>123</sup>

The other classification is Schedule “D” it mainly includes an income by non-residents of Ethiopia who acquired dividends, royalties, management fees, technical fees, or insurance premium based on the various rates<sup>124</sup>

The final scheduler classification is schedule “E” that includes exempt income, it includes an amount paid by an employer for medical expense for treatment of the employee, allowance for transportation, hardship allowance, per diem payment, food and beverage provided for free for to employee by an employee for conducting mining, manufacturing and agricultural business<sup>125</sup>

## ***II Categorical classifications of taxpayers***

The Ethiopian tax system classifies into three categories based on annual gross income –into categories A, B, and C – according to whether the business is incorporated or not, and the size of the business as measured by its turnover. Incorporated taxpayers (corporations) are classified as Category A and face the same tax rate (30%) and administrative requirements regardless of their size. For unincorporated (natural persons) taxpayers, these categories determine the information that firms are required to submit when reporting to the revenue authority<sup>126</sup>

Category “A” taxpayers are taxpayers with over 1 million ETB of annual gross income<sup>127</sup> this threshold applies to unincorporated businesses or individual businesses. For the tax audit

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<sup>121</sup> Art 21(1)(a,b,c) federal income tax percolation no. 979/2016 22nd year No.104 Addis Ababa 18th august 2016

<sup>122</sup> Article 19 ibid

<sup>123</sup> Article 21(2)(a,b,c) ibid

<sup>124</sup> Article 51 ibid

<sup>125</sup> Article 65(1)

<sup>126</sup> Institute for fiscal studies R187, 2019/20 survey of Ethiopian tax system, by international trade center in partnership with Ethiopian investment commission p.14

<sup>127</sup> Federal income tax proclamation number 979/2016 art 3(1)(a)(1)

taxpayers in this category are required to submit a balance sheet<sup>128</sup> or a financial statement and a profit and loss statement showing their gross profit and how it is computed, general and administrative expenses, depreciation, and provisions and reserves. Businesses must keep their accounts on an increased basis and must file their returns within four months of the end of the financial year.

About keeping records category “A” taxpayers are required prepare to keep book and account following financial reporting standards, preparing a record of the business asset and liability of taxpayer including a register of asset showing acquisition date, cost of acquisition, and any cost of improvement about the asset, Similarly a record of all daily income and expenditure related to taxpayer showing trading stock sold and service supplied or received<sup>129</sup>

The second one is category “B” taxpayers having 500,000 to 1 million ETB of annual gross income<sup>130</sup> taxpayers in this category are required to submit a profit and loss statement that summarizes the revenues and expenses of the business over the reporting period, but no balance sheet (financial statement) information is required. They can keep simplified books of accounts using cash basis accounting and must file their returns within two months of the end of the financial year, reflecting the simplified requirements<sup>131</sup>

Regarding keep books and account taxpayers under category “B” are required to keep, a record of daily income and expenditure, a record of all purchase and sale of trading stock salary and wages register and documentary relevant determining the tax liability<sup>132</sup>

Finally, Category “C” they are taxpayers with below 500,000 ETB annual gross income are not required to keep books of accounts, as firms pay their taxes based on an assessment made by the Ministry of revenue of Revenue. However, they can pay according to the information from their

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<sup>128</sup> Balance sheet is a statement made by merchants and others to show the true state of a particular business, When it is desired to ascertain the exact state of a merchant's business, or other commercial enterprise, at a given time, all the ledger accounts are closed up to date and balances struck; and these balances, when exhibited together on a single page, and so grouped and arranged as to close into each other and be summed up in one general result, constitute the "balance-sheet." By *Eyre v. Harmon*, 92 Cal. 580,28 P. 779.

<sup>129</sup> Article 82 of Federal Income Tax Proclamation No. 979/2016 22nd year No.104 Addis Ababa 18th august 2016

<sup>130</sup> Ibid art 3(1)(a)(2)

<sup>131</sup> Federal Income Tax Proclamation No. 979/2016; Mascagni and Molla, 2018, p 16

<sup>132</sup> Art 82(2) Ibid

own books of accounts if the MoR finds that acceptable and permits them to do so<sup>133</sup>. Category C taxpayers must pay their tax liability within one month of the end of the financial year<sup>134</sup>

Scheming of the taxable income is correlated with subjects that vary based on the categories of the taxpayers. For category A and B taxpayers, the gross business income for the year is determined following the taxpayer's profit and loss or income statement for the year. The business income for a given fiscal year is defined to include the gross amount derived by the taxpayer during the fiscal year from the conduct of a business including gross proceeds from the disposal of trading stock and gross fees from the provision of services; any gain on the disposal of business assets other than disposal of trading stock made by the taxpayer during the tax year<sup>135</sup>

If there is any expenditure incurred by the taxpayer during the year in deriving, securing, and maintaining business income can be deducted from income. This includes the cost of labor, property and equipment rental, and materials and trading stock, as well as allowances for the depreciation of both tangible and intangible assets, according to the rates. For the case of this thesis and for the auditing system the researcher focus on category "A" and "B" because they are subjected to keep book and account and category "A" is additionally required to provide a financial statement<sup>136</sup>

#### **3.4.4.1.1 The tax officials and the Ethical and professional standards by the federal income tax proclamation**

The current federal income tax proclamation provided that unless there is no contradiction the previous tax laws regulations and directives will have the effect until they are replaced by new regulations and directives<sup>137</sup>

The previous federal income tax proclamation, there were provisions which dealing with offense by the tax authority employees, it mainly includes offenses such as asking for or receiving in connection with any of the officer's duties, a payment or reward, whether pecuniary or otherwise,

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<sup>133</sup> Art 59 of federal tax regulation No.410/2017, 23rd year, No.82 august 2017 Addis Ababa.

<sup>134</sup> Federal Income Tax Proclamation No. 979/2016; Mascagni and Molla, 2018, p 22

<sup>135</sup> Institute for fiscal studies R187, 2019/20 survey of Ethiopian tax system, by international trade center in partnership with Ethiopian investment commission p. 17

<sup>136</sup> *Ibid*

<sup>137</sup> Art 101 of federal income tax proclamation No. 979/2016 22<sup>nd</sup> year No.104 Addis Ababa 18th august 2016

or promise or security for that payment or reward, not being a payment or reward to which the officer is lawfully entitled to receive shall be an offense that entails legal liability<sup>138</sup>

Any tax official that enters to the agreement to do or to refrain from doing to any act that tax revenue might be defrauded or contrary to the proclamation or to the proper execution of official duty<sup>139</sup> that is related with endangering sources of revenue, that any official or employee of an authority who improperly prevents the payment of taxes or dues, or reduces the amount thereof or intent to save himself or another Similarly employee of tax authority who commits an offense, when the enters in the act of agreement of to do any illegal activity or to do not to act which he is legally required to act, that is contrary with law, the provisions of this Proclamation or to the proper execution of the officer's duty<sup>140</sup>

#### **3.4.4.3 Federal tax administration proclamation no. 987/2016**

Federal tax administration proclamation is primarily enacted to render the domestic taxes administration system more efficient, effective, and measurable. It also introduced a system of advance tax ruling to address the problem of prolonged pendency of taxpayers' cases resulting from divergent interpretations of tax laws within the tax administration<sup>141</sup>

This proclamation applies to the Federal Tax Administration Proclamation applies to income taxes under the Federal Income Tax Proclamation, value-added, turnover, excise tax, and stamp duty.<sup>142</sup> Primarily the proclamation serves as a guide for the administration of all the tax systems in terms of declaration time, declaration forms, tax assessment, penalty, interest, appeal, and other matters; advance ruling, tax agents; tax offense handling; other items<sup>143</sup>

The administration proclamation grants several legal duties related to the proper implementations of tax laws for the tax authorities institutionally and each individuals serving in the tax office. The federal tax administration proclamation mandates the duty to authorities (Ethiopian

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<sup>138</sup> Article 99(1)(a) of the federal income tax proclamation No. 286/2002, 8thYear No. 34 Addis Ababa 4<sup>th</sup> July 2002

<sup>139</sup> Ibid Art 99(b)

<sup>140</sup> Art 351(1,2) of FDRE criminal code, proclamation No. 414/2004, 9<sup>th</sup> of May, 2005 Addis Ababa

<sup>141</sup> Institute for fiscal studies R187, 2019/20 survey of Ethiopian tax system by international trade center in partnership with Ethiopian investment commission p 20

<sup>142</sup> Ibid p, 21

<sup>143</sup> Ibid p, 26

Revenues and Customs Authority) implementation and enforcement of the tax laws<sup>144</sup> the coordination of taxpayers in realizing the proper implementation and enforcement of the tax laws is very crucial.

#### **3.4.4.3.1 The federal tax administration proclamation No.987/2016 and duties and responsibilities of tax officials**

At the level of federal government tax officials are required to exercise or perform their duties as per provided by the tax law and under Ethiopian revenue and customs authority establishment proclamation<sup>145</sup>

The crucial duty and responsibility stipulated for the tax officials<sup>146</sup> which includes being honest and fair in the exercise of any power, or performance of any duty or function, under a tax law, and shall treat each taxpayer with courtesy and respect, The provision stress that tax officials including those conducting the activity of assessment in the field and in the activity of auditing based on the declaration of the taxpayers required to act honest and fair while exercising their professional activity and ethically to be humble and treat taxpayers with courtesy or polite and with respect<sup>147</sup>

The other requirement from the tax officials is neutrality, that no tax official to entertain or exercise a power or perform a duty under a tax law that relates to a person in respect of which the tax officer has or had a personal, family, social, business, professional, employment, or financial relationship or duty which the tax office has a conflict of interest<sup>148</sup>

The other prohibited act of the tax officials; they shall not act as a tax accountant or consultant, or accept employment from any person preparing tax declarations or giving tax advice, once

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<sup>144</sup> Article 5 the Federal Tax Administration Proclamation No. 983/2016, 22<sup>nd</sup> year, No. 13 Addis Ababa, August 20, 2016.

<sup>145</sup> Ibid art 6(1)

<sup>146</sup> Tax officials included the Director-General of the Authority, the Deputy Generals of the Authority; an officer or employee of the Authority appointed under the Ethiopian Revenue and Customs Authority Establishment Proclamation with responsibility for the administration and enforcement of the tax laws; when performing functions on behalf of the Authority:

<sup>147</sup> Article 6(2) the Federal Tax Administration Proclamation No. 983/2016, 22<sup>nd</sup> year, No. 13 Addis Ababa, August 20, 2016.

<sup>148</sup> Ibid Article 6(3)

officials are employees of the tax authority holding several confidential issues, they are required to be the only employee of the tax authority<sup>149</sup>

The tax administration proclamation again specifies the liability for tax officials and auditors in the case of fraud or evasion, a certified auditor or a public auditor aided or supported abetted, counseled, or procured a taxpayer to commit fraud resulting in a tax shortfall or to evade tax any public tax auditor was in any way knowingly concerned in or was a party to, fraud resulting in a tax shortfall or tax evasion committed by a taxpayer.<sup>150</sup>

In the above two scenarios, any tax auditor who is found in violation shall be subjected to withdraw the office or license, that is based on the order of the accounting and auditing board of Ethiopia, or other body having authority for the licensing of the person and request the board to withdraw<sup>151</sup>

### **Federal Government VAT proclamation No. 285/2002**

Value-added tax (VAT) is a tax on exchange. It is levied on the value-added that results from each stage of the exchange. It is an indirect tax in that the tax is collected from someone other than the person who actually bears the cost of the tax, VAT is payable if; the supplies are made in Ethiopia; made by a taxable person; made in the course or furtherance of a business; are not specifically exempted or zero-rated.<sup>152</sup>

VAT shall be levied and paid a tax to be known as value-added tax, at the rate of 15 percent of the value of primarily on every taxable transaction by a registered person; and every import of goods, other than an exempt import and an import of services<sup>153</sup> Every registered person is required: to file a VAT return with the Authority for each accounting period, whether or not tax is payable in respect of that period; to pay the tax for every accounting period by the deadline for filing the VAT return<sup>154</sup>

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<sup>149</sup> Ibid Article (6)(3,4)

<sup>150</sup> Ibid Art 48(1)

<sup>151</sup> Ibid Art 48(2)

<sup>152</sup> *Practice and challenge of VAT administration in Yeka sub City of Addis Ababa City Administration the case of tax payers category "A"* by Misganaw Sinor June, 2016, p 12

<sup>153</sup> Art 7 of Federal VAT proclamation No. 285/2002, 8<sup>th</sup> Year No.33 4<sup>th</sup> July 2002, Addis Ababa Ethiopia

<sup>154</sup> Ibid Art 26(1)



The tax administration is mandated for implementation and enforcement of VAT proclamation, the implementation includes the authority to investigate any statements, records, and books of account submitted by any person at any time<sup>155</sup> Again the VAT proclamation stipulated the legal mandates for the members in the tax administration system. Particularly any tax officer or employee, who directly or indirectly receives payment or any reward in connection to their duties or engage in any activity that that defrauding the tax revenue associated any acts, shall entail accountable<sup>156</sup> the liability further extends to employees who left the tax authority and without court order disclosing any confidential information of the tax administration or taxpayer<sup>157</sup>

### **3.6 Criminal code of Ethiopia proclamation No. 414/2004**

The criminal code of Ethiopia has postulated several liabilities related to breach of professional duty and Corruption crimes that may be committed via public servants in breach of trust and good faith<sup>158</sup>

The implied interpretation of article 69 of the criminal code of Ethiopia states that about professional duty, the act done in exercise of duty will entail liability when it is not done under the accepted practice of the profession and if there is a grave professional fault either negligently or intentionally and to include private sectors whom the fund is collected from the public in the category of corruption and again necessary to rectify practical problems observed by enacting comprehensive legislation to strengthen the fight against corruption<sup>159</sup> Breach of professional duty and Corruption crimes committed by public servants in breach of trust and good faith, it is a breach when any public servant who, with intent to obtain for himself or to procure for another an undue advantage or to injure the right or interest of another<sup>160</sup>

Abuse of power is one of breach of professional duty and breach of trust that misuses their official position or the power proper to their office, whether by a positive act or by fault omission or exceeds the power with which he is officially advanced and the punishment will be simple imprisonment for not less than one year or with rigorous imprisonment 'not exceeding ten years

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<sup>155</sup> Ibid Art 31

<sup>156</sup> Ibid Art 53(1,)

<sup>157</sup> Ibid Art 53(2)

<sup>158</sup> Art 69 and art 407 of FDRE criminal code, proclamation No. 414/2004, 9<sup>th</sup> of May, 2005 Addis Ababa

<sup>159</sup> Art 69 of FDRE criminal code, proclamation No. 414/2004, 9<sup>th</sup> of May, 2005 Addis Ababa

<sup>160</sup> Ibid Art 407

and fine. Based on the above criminal code provisions employees of tax authority are holding the public trust on their shoulder and whenever there is a breach of trust through abuse of power or corruption mainly by a public servant who, with intent to obtain for him or to procure for another an undue advantage will punishable<sup>161</sup>

The punishment may be rigorous imprisonment from seven years to fifteen years and a fine not exceeding fifty thousand ETB when the breach of responsibility based on money gift or consideration that aimed to the extent of harming private or public or state interest<sup>162</sup>

The other issue is corruption that a public servant that seeks to receive or exacts a promise of advantage for himself or other particularly through consideration for a violation of his public duty, which entails simple imprisonment not less than one year and not exceeding ten years when it is rigorous imprisonment and fine not exceeding twenty thousand ETB or Where the purpose of the breach of responsibility or duty solicited, the extent of the advantage received, the official capacity or powers of the person corrupted or the, extent of the harm to private, public or State interests renders the case of particular gravity the rigorous imprisonment shall be to the extent of fifteen years and fine shall be up to fifty thousand ETB and the concurrence of above two offenses shall entail imprisonment up to twenty-five years<sup>163</sup>

The other breach by public servants is acceptance of undue advantages; this is an act by public employee requiring undue advantage before or after the performance of the public duty, the punishment will be up to one year for simple imprisonment and up to seven years for rigorous one<sup>164</sup>

The criminal code also stressed on issues of endangering sources of revenue, that any official or employee of an authority who improperly prevents the payment of taxes or dues, or reduces the amount thereof or intent to save himself or another, whether an individual or a juridical person, from the payment in full or part of dues, taxes or charges due to the government following the law<sup>165</sup>

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<sup>161</sup> Ibid Art 407(1)(a, b)

<sup>162</sup> Ibid Art 407(2)

<sup>163</sup> Ibid Art 408

<sup>164</sup> Ibid Art 410

<sup>165</sup> Ibid Art 351(1, 2)

## UNIT FOUR

### 4. THE LEGAL FRAMEWORK CONCERNING TAX AUDIT IN SOUTHWESTERN PEOPLES REGIONAL STATE

#### *4.1 The new regional state of southwestern Ethiopia*

Southwestern regional state is the new regional state that was formed based on Article 47(2) of the FDRE Constitution; “*Every Nation Nationality People of Ethiopia has a right to form its own regional State. Once the demand for statehood is approved by a two-thirds majority of the Council of the Nation Nationality and People and presented in writing to the State Council*” in doing so the latter should organize a referendum within one year. If through the referendum, the majority of the concerned Nation Nationality People votes in support of forming a region, the Nation Nationalities and peoples will become new members of the federation<sup>166</sup>

For more than two decades the question of statehood has been raised by various ethnics primarily based their identity in Southern Nation Nationalities and the Peoples Regional States<sup>167</sup> the procedures above was conducted by the five zones and one woreda of southwestern peoples and Southwestern regional state become the eleventh regional state of Ethiopia after the referendum conducted on September 30, 2021, that included the ethnic nations of Kaffa, Dawro, Bench sheko, Sheka, West Omo zones and Konta special woreda around 1,262,679 voters around 1,221,092 voted in favor of the formation of the new regional state<sup>168</sup> is presented to the house of the federation and acquired the approval as the eleventh regional states of Ethiopia.

The government establishments held in Bonga City which is the capital of Kaffa Zone and in doing so the state councils of the new southwestern regional state of Ethiopia held a resolution on the perpetuation of the tax laws and other related subsidiary proclamations of the previous regional state of Southern Nation Nationalities and Peoples Regional State (SNNPR). Based on the meeting held in Bonga city, the state council ratified the draft constitution of the regional

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<sup>166</sup> The Procedure for the Creation of New Regional States under the FDRE Constitution: Some Overlooked Issues by Tessema Simachew (LL.B., LL.M., Ph.D), Assistant Professor, Bahir Dar University, School of Law Belay□ and Habtamu Simachew Belay Habtamu Simachew Belay (LL.B., LL.M., LL.M., Ph.D.), Assistant Professor, Wollo University, School of Law September 2019

<sup>167</sup> Splitting Ethiopian Southern Nation Nationalities and peoples of Ethiopia: Article by Bereket Eshetu Mesele lecturer at Bahir Dar University School of Law: Oct 27, 2020

<sup>168</sup> Report by the national election board deputy chairperson of board Wubshet Ayele, October 9, 2021 and the report by addis standard magazine.

state, and other subsidiary laws including the tax laws of Southern Nation Nationalities and Peoples Regional State government will have the same effect on the regional state until it is replaced by new laws<sup>169</sup>

#### **4.2 The constitution of the Southwestern peoples regional state**

The draft constitution of the southwestern regional state ratified by the state councils of the new regional state, the constitution has eleven Chapters and one hundred and twenty-four articles. Peoples of Kaffa, Dawro, Sheka, Bench-Sheko, Western-Omo, and Konta peoples are the constitution formulated<sup>170</sup>

The economic rights of peoples in the regional state, “*whosoever person in the regional state has the right to conduct whatever economic activity he needs to engage*”<sup>171</sup> and “*The peoples of the regional state are entitled to the right to form a better life and sustainable development and any developmental activities ultimate goals required to fulfill the developmental and basic necessity of citizens*”<sup>172</sup>

The constitution provided about the economic rights of peoples in the regional state, which includes the duty for the government to facilitate the fulfillment of economic rights of peoples in the regional state<sup>173</sup> Similarly the constitution stress that peoples in the new regional state are entitled to fair and sustainable exploitation of the natural resources in the regional state and the constitution encourages the indigenous investors of the regional state<sup>174</sup>

#### **4.2 The legal framework of taxation and tax auditing**

The tax system of the new Southwestern peoples regional state is not departed from the Southern Nation Nationalities and peoples regional state, still the income tax law, regulation and administration are based on the previous regional state hence the new regional state one of the recent type and to formulate the tax laws other related laws until the new regional state form its

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<sup>169</sup>Decisions by the state councils of the new Southwestern Ethiopian Peoples regional state, November 24, 2021, Bonga. Additionally the southwestern regional state councils enacted proclamation No.3/2021, Southwestern regional state proclamation for extension of the previous laws of SNNPRS regular governmental activities.

<sup>170</sup> Art 47 of constitution of southwestern peoples’ regional state proclamation No. 1/2021, November 24, 2021, Bonga.

<sup>171</sup> Ibid Art 41(1)

<sup>172</sup> Ibid art 43(1,3)

<sup>173</sup> Ibid Art 111(1)

<sup>174</sup> Ibid Art 111(3)

own tax proclamations will be governed by the earlier laws of SNNPR state<sup>175</sup> based on above mentioned subject the Southwestern peoples regional enacted a proclamation “*The Southwestern Ethiopian peoples’ regional state, Proclamation for continuing proclamations of the previous regional state of SNNPR state*” the preamble of the this proclamation provides state that The Southwestern regional state is established very recent, in order to enact the laws of official works require additional time and other related challenges based on the Art 56(3) (a) of the constitution of Southwestern regional state, the state councils enacted this proclamation.

#### **4.2.1 The income tax proclamation No. 165/2016 of the SNNPR state**

The income tax proclamation of SNNPR states with the federal income tax it appears to be quite analogous, the scheduler classification of the sources of the income and categorical classification based on the annual gross income the taxpayer also has similarities to the federal income tax classification<sup>176</sup>

As the federal income tax classification SNNPR state income tax classified taxpayers into three categories, the income tax proclamation No. 165/2016 SNNPR state classified taxpayers into different categories based on their annual gross income, as per the proclamation Art 3(1) Category “A” taxpayers with an annual income of one million ETB and more annual gross income, category “B” taxpayers are those with and more than 500,000 ETB and category “C” taxpayers are those with less than 500,000 ETB of annual gross income. Similarly, the category “A” and “B” taxpayers in SNNPR state is required to keep the book and account for the purpose of tax auditing and category “C” taxpayers pay their profit tax based on presumption and they are not required to keep book and account<sup>177</sup>

The classification of taxpayers by the SNNPR state tax laws is analogous with a federal income tax that is classified into five schedules, that schedule “A” is income from employment, schedule “B” income from rental building, schedule “C” income from Business, schedule “D” other

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<sup>175</sup> Decisions by the state councils of the new Southwestern Ethiopian Peoples regional state, November 24, 2021, Bonga. Interview with Mr. Bizuayehu Girma the head of kaffa zone revenue authority, Nov 10, 2021.

<sup>176</sup> Art 3 and art 10- 67 of income tax proclamation no 165/2017 Sothern Nation Nationalities Peoples Regional State, 25<sup>th</sup> year No 1 Hawassa, Feb 16, 2017 and Art 3 and art 10 – 65 of Federal Income Tax Proclamation No. 979/2016 22nd year No.104 Addis Ababa 18th august 2016

<sup>177</sup> Art 3 of income tax proclamation No. 165/2017 Sothern Nation Nationalities Peoples Regional State, 25<sup>th</sup> year No 1 Hawassa, Feb 16, 2017

incomes and finally, schedule “E” exempt income<sup>178</sup> Despite classifying the taxpayers into a different category and schedule the income tax of SNNPR state specified the ethical as well as prohibited activities by the employees in the revenue office<sup>179</sup>

The existing SNNPR state income tax proclamation 165/2017 the laws and directives enacted based on the previous proclamations shall be effective unless it contradicts with an existing proclamation and when there is no related law is enacted in this regard the previous income tax provided some ethical standards that need to be acted by the employees of the revenue authorities.<sup>180</sup> As per the code of conduct of tax authorities’ employees, being honest and fair, treating each taxpayer with courtesy and respect, applying the law and regulations and rulings based on objective facts, and showing no partiality furthermore refraining from soliciting or accepting any bribe or performing any improper act relating to the duty to determine or collect any tax<sup>181</sup>

#### **4.2.2 The SNNPR state tax administration proclamation No. 166/2017**

Comparable with the federal tax administration proclamation the SNNPR state proclamation specified the professional as well as ethical standards of the officials and employees in the revenue authorities. Based on the tax administration proclamation No. 166/2017 higher officials of the revenue authorities are required to ensure enforcement and implementation of the tax laws, any official in the tax office must consider the proper execution of the laws, this can be demonstrated through training or providing awareness to the employees of the revenue authority and the taxpayers, inspecting whether there is any fraud or violation to evade taxation, ordering the lawful measure from the side of employees of the tax office they are required to take administrative measure whenever there is a violation of tax laws<sup>182</sup>

The proclamation moreover listed the responsibilities and duties of the employees in the revenue authority by mentioning the re-establishment of revenue authority SNNPR state, proclamation

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<sup>178</sup> Ibid Art 10- 67

<sup>179</sup> Art 97(6) income tax proclamation no 165/2017 Sothorn Nation Nationalities Peoples Regional State, 25th year No 1 Hawassa, Feb 16, 2017 in conjunction with Art 40(1,2) of previous SNNPR state income tax proclamation No. 56/2003, year 8<sup>th</sup> No.5 Hawassa 1<sup>st</sup> march 2003

<sup>180</sup> Art under Art 97(6) ) income tax proclamation no 165/2017 Sothorn Nation Nationalities Peoples Regional State, 25th year No 1 Hawassa, Feb 16, 2017 and interview with Mr. Bizuayehu Girma the head of Kaffa zone revenue authority, Nov 10, 2021.

<sup>181</sup> Article 41(1) SNNPR state income tax proclamation No. 56/2003, year 8th No.5 Hawassa 1st march 2003

<sup>182</sup> Art 5 of tax administration proclamation 166/2017 of SNNPR state, 25<sup>th</sup> year No.2 Hawassa, Feb, 16, 2017

No.143/2004 the proclamation primarily aimed to tax authorities in the region to be aware of their duties and responsibilities and to investigate and prosecute violation concerning fraudulent and evasion, to take educative and instantaneous action on those who violate the law<sup>183</sup>

As per tax administration proclamation responsibilities and duties of employees of the tax authority, Every tax employee including tax auditors are required to execute their duty honestly, fair, mandatory to treat taxpayers politely and with due respect<sup>184</sup>

Correspondingly the revenue authority employees are required to refrain from acting on subjects which are he has an interest or financially he is related with or families, friends party with to prevent the unfair and biased consequences of tax decisions<sup>185</sup>

Tax employees including auditors, accountants, or consultants are forbidden to accept employment from any person preparing tax declarations or giving tax advice since officials are employees of the tax authority holding several confidential issues, they are required to be the only employees of the tax authority<sup>186</sup>

The of tax employees shall be liable for tax whenever there is fraud or evasion in which certified auditor or a public auditor aided or supported abetted, counseled or procured a taxpayer to commit fraud resulting in a tax shortfall or to evade, tax any public tax auditor was in any way knowingly concerned in, or was a party to, fraud resulting in a tax shortfall or tax evasion committed by a taxpayer<sup>187</sup>

The effect for any employee of the tax authority who found in violation shall be ordered to withdraw the office or license to practice; mainly based on the order of accounting and auditing board of SNNPR state and zonal authorities, or other body having authority for the licensing of the person and request the Board to withdraw<sup>188</sup>

Regarding appeal to the tax authority and Tax appeal commission in the tax administration, A dissatisfied taxpayer with the decision of the tax authority can apply displeasure within 21 days

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<sup>183</sup> The preamble of the re-establishment of revenue authority of SNNPR state 18<sup>th</sup> year No.2 Hawassa February 20, 2004

<sup>184</sup> Art 6(2) tax administration proclamation 166/2017 of SNNPR state, 25<sup>th</sup> year No.2 Hawassa, Feb, 16, 2017

<sup>185</sup> Ibid art 6(3)

<sup>186</sup> Ibid art 6(4)

<sup>187</sup> Ibid Art 48(1)(a, b)

<sup>188</sup> Ibid Art 48(2)

beginning from the day the taxpayer gets the notice, the dissatisfaction of the taxpayer may be based on the amount of the tax calculated by the tax authority<sup>189</sup>

Based on the complaint filed by the taxpayer, the tax authority shall form the concerned independent body that will deal with issues of complaint of the taxpayers, there will be rules and regulations on how the body to exercise its power<sup>190</sup>

The tax appeal commission is one of institutionalized structure that is composed of have six members, whereby five permanent members with a vote and one temporary member that appears as the case requires and an individual assigned from the administrative structure will have the authority of serving as chairperson and head of commission office, the remaining individuals shall be assigned from justice bureau, finance, and economic development bureau, individuals from trade and industry bureau and finally individuals Council of Trade and Sectorial associations shall serve as Member<sup>191</sup>

The criteria to be appointed as a member of the tax appeal commission mainly is experience that of a member from administrative institution needs to have sufficient experience of management that is similar to all members that join the appeal commission needs to have sufficient experience and knowledge<sup>192</sup>

### **3.2.3 The SNNPR state, amended Ethics and anti-corruption proclamation 142/2012 in conjunction with Federal corruption crime proclamation No.881/2015**

As corruption and malpractice hamper social, economic, political growth disturb the overall democratic system. The SNNPR state, Anti-corruption proclamation for establishment anticorruption commission formed and the proclamation mainly concerned with combating corruption malpractice it specifies the powers and duties of the members of the commission and a way to prevent corruption in cooperation with other justice organs<sup>193</sup>

For the purpose of criminal charges, the regional states can use the Federal corruption crime proclamation No. 881/2015 as the federal government has the jurisdiction to enact corruption-

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<sup>189</sup> Ibid Art 54(1,2)

<sup>190</sup> Ibid Art 55(1,2,3)

<sup>191</sup> Ibid Art 11(1,2)

<sup>192</sup> Ibid Art 13(1)

<sup>193</sup> Preamble of Amended Ethics and anti-corruption commission establishment proclamation of SNNPR state No. 142/2012, 18<sup>th</sup> year No, 1Hawassa Feb, 28/2012



related crimes. The new Federal corruption crime proclamation No.881/2015 which enacted due to the necessity to clarify and amend some provisions in the Criminal Code of 2004 criminal code of Ethiopia relating to Corruption Crimes which are ambiguous during application<sup>194</sup>

The proclamation considers corruption crime including, abuse of power or responsibilities that any public servant or employee with intent to obtain an undue advantage, through injuring the right or advantage of another, primarily misuse, exceed or acted the official act in which he is entitled to. And the punishment will be punishable, according to the circumstances of the case with simple imprisonment for not less than one year, fine not less than Birr three thousand, or with rigorous imprisonment not exceeding ten years<sup>195</sup>

The bribe is another corruption crime the proclamation articulated and it is an act by any public servant or employee directly or indirectly, seeks, receives or exacts a promise of an advantage for him or another, to act or refrain from acting, in violation of the duties proper to his office and punishable up to rigorous imprisonment not exceeding ten years and fine not exceeding birr forty thousand<sup>196</sup> to bribe any public servant who accepts undue advantage, for the performance of an act proper to his office, solicits or obtains an advantage or exacts a promise before or after the performance of such an act, shall be punishable<sup>197</sup>

For the purpose of taxation, an act of breach of trust is considered, as the usual offense by the employees and officials of the countries tax system. Breach of trust states that any activity public servant or employee of a public organization, with the intent to obtain for him or to procure for a third person an unjustifiable enrichment, appropriates. Or procures for another, makes or causes to be taken, misappropriates, uses to his benefit or that of a third person, or disposes of for any similar act, in whole or in the part, a thing or a sum of money which is the property of another and which has been delivered to him in trust or for a specific purpose breaches trust, this crime is the usual provision that persons in charge of the activity of taxation are commit<sup>198</sup>

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<sup>194</sup> The Preamble of federal corruption crime proclamation No.881/2015, 21<sup>st</sup> year, No 36, 3<sup>rd</sup> April 2015 Addis Ababa, Ethiopia.

<sup>195</sup> Ibid Art 9

<sup>196</sup> Ibid Art 10

<sup>197</sup> Ibid Art 11

<sup>198</sup> Ibid Art 31

## UNIT FIVE

### 5. THE PRACTICE OF TAX AUDITING IN SOUTHWESTERN REGIONAL STATE KAFFA ZONE, BONGA CITY ADMINISTRATION

#### 5.1 Introduction

As per the international standard of auditing tax auditors are required to comply with relevant ethical requirements relating to audit engagements. Again the auditors should conduct the practice of audit under International Standards on Auditing. If the plan and performance of the audit is with an attitude of professional skepticism recognizing that circumstances may exist which cause the financial statements to be materially misstated<sup>199</sup>

The federal and regional tax administration obliged tax officers shall be honest and fair in the exercise of any power, or performance of any duty or function, under tax law, whereas taxpayers have the right to acquire fair service from the office of revenue authority and get treated each courtesy and respect<sup>200</sup> Moreover the code of conducts employees of the tax authority required to respect and apply laws, regulations, and cases based on objective facts and being impartial to all taxpayers and individuals seeking service<sup>201</sup>

It has been suggested that tax is the pillar of the economy of a country like Ethiopia whose source income is primarily on taxation, it is crucial and required to non-compromise in protecting the rights of taxpayers.

For this thesis is, the research area is Southwestern regional state, Kaffa Zone particularly Bonga city administration, Kaffa zone located in the southwestern area of Ethiopia, According to Kaffa zone revenue authority, in Kaffa zone there are around 13115 taxpayers from all categories among them around category “A” taxpayers are 572 and 646 taxpayers are under the category “B” in Bonga city administration there are around 5673 taxpayer among 379 Category “A”

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<sup>199</sup> International standard on auditing 200: objective and general principle governing an audit of financial statement June 15, 2006

<sup>200</sup> Art 6(2) of federal tax administration Proclamation No. 983/2016, 22<sup>nd</sup> year, No. 13 Addis Ababa, August 20, 2016. And 6(2) of tax administration proclamation 166/2017 of SNNPR state, 25<sup>th</sup> year No.2 Hawassa, Feb, 16, 2017

<sup>201</sup> Art 40(1)(b) of 56/2003 SNNPR state income tax proclamation No. 56/2003, year 8<sup>th</sup> No.5 Hawassa 1<sup>st</sup> march 2003 in conjunction with Article 97(6) of SNNPR state income tax proclamation No. 165/2009 previous regulations and directives previous proclamations will have effect under the existing proclamation as long as it does not contradict with the existing income tax proclamation or unless expressly repealed by new regulations and directives

taxpayers and category “B” taxpayers a 162 and the remaining are under the category “C”. There are around ten tax auditors in the city administration which concludes the auditing activities as they are entitled by the tax laws. The governing law in Kaffa Zone Bonga city administration with tax administration is the laws of SNNPR state that including, Income Tax Proclamation no. 165/2009, Tax administration proclamation No.166/2009 and Tax regulation proclamation No. 165/2010 of SNNPR State, several directives. The civil service proclamation, federal criminal codes are among them. As the revenue authority of Bonga city administration, they use three types of tax auditing system, which includes comprehensive audit, desk audit, and spot auditing, according to comprehensive audit as its name implies it all-encompassing audit conducted by the auditor, and the taxpayers are required to provide the books and accounts that lasted not less than ten years, whereas spot or issue audit is a yearly income of taxpayers to be audit and it is the usual form of auditing as the tax auditors say, finally the desk audit shall be conducted whenever there a need to further investigation on the taxpayers' proper compliance<sup>202</sup>.

It is hardly controversial to state that it is a challenge for states to fully implement the protection of taxpayers from the illegal tax auditors and related ill-mannered tax officials. However, in light of the research conducted, this thesis fully agrees with the argument that tax auditors and officials in the revenue authority need to practice their professional and ethical standards ‘in a manner that recognizes, the right of taxpayers.

Thus, the previous chapters have shown several laws that are particular to the tax system and other related professional and ethical standards which dictate how the tax officials to act. Accordingly, this chapter aims to assess the extent of practical realization of proper implementation of ethical and professional standards to realize the implementation of the right of taxpayers in Bonga city administration and measures taken, their adequacy, and challenges against the full realization of the rights of taxpayers.

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<sup>202</sup> Interview with Mr. Bizuayehu Girma the head of kaffa zone revenue authority, Nov 10, 2021.

## **5.2 The practice in Bonga city administration concerning the ethical and professional standards of the tax auditors and related tax officials**

### **5.2.1 The practice of tax administration and the views of taxpayers in Bonga city**

The methodology of this chapter was elaborated in chapter one of this thesis, accordingly, sampling of forty taxpayers of the city administration. The taxpayers interviewed was from the category “A” and “B” and also responsible bodies from the tax authority comprising tax auditors and higher officials in Bonga city administration tax authority and kaffa Zone high court are respectively interviewed. The taxpayers sampled are aged from 20 years to 65 old aged, from both gender <sup>203</sup> again the taxpayers included are those who lasted for 2 years and more than 15 years in the market and from elementary to bachelor degree holders are among the participant in the sampling. The majority of the taxpayers in the thesis are obtained their income from business activities primarily those taxpayers engaged in the activity of the sale of goods and rendering services. The taxpayers interviewed are experienced in the business and tax payment 27 taxpayers have been paying tax ranging from two years up to 10 whereas the remaining 11 taxpayers stayed in tax-paying from 10 up to 15 years and the remaining 2 stayed in taxation for more than 15 years<sup>204</sup> For the purpose of this thesis tax higher officials and auditors are parts of the interview from around ten tax auditors in the city administration some senior tax auditors<sup>205</sup> are subjected to the interview

Complaint that ranging from mistreatment, and disrespect by the auditors and correlated workers and officials of the tax administration. Again uncalculated and unilaterally altering taxpayers category from one category to another higher category without consideration to the income and cost of the taxpayers. There is bias on lawful taxpayers based on various illegal standards and principles and internal chain with the tax administration and the judicial system in the city administration are crucial points the researcher acquired from the taxpayers in the city administration.

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<sup>203</sup>The tax payers interviewed was from the category “A” and “B” aged from 20 years to 65 old aged. The tax payers are 15 from category A and the remaining 25 from category “B”

<sup>204</sup>30 tax payers are under the educational status that range from primary school to certificate and 5 Diploma, 4 tax payers are holder of first degree and the remaining one is holding master’s degree.

<sup>205</sup> Three tax payers one has the experience of six years and the other two have three and two years of experience and among three two are degree holder the other one is diploma holding.

All chapters before examined have emphasized the importance of addressing the problems of fair equitable payment of tax by the taxpayers, through professional and ethical standards provided by the international and domestic laws. Accordingly, this section examines the practical implementation of every underlying determinant of the rights of taxpayers in the city administration.

Based on the interview from concerned bodies several findings showed that there are several inadequacies in the tax system of Bonga city administration, Complains by taxpayers that ranging from mistreatment, and disrespect by the auditors and correlated workers (lack of good ethics) and officials and uncalculated and unilaterally altering tax payers category from one to other higher category without consideration to the income and cost of the taxpayers, corruption, discriminations and professional incompetence of the auditors are some findings the tax.

An interview with one of the taxpayers called Abiyot, who conduct the business of photography says that the auditors and related officials in the tax administration usually has the habit of considering the taxpayers as deceiving or taxpayer is all about deceptions in doing so I have experienced several mistreatments and disrespect from the auditors in the tax administration<sup>206</sup> this is similar to other taxpayers that which are mistreated and disrespected whenever they have dissatisfaction and complain about the decision of the tax authority in the Bonga city administration<sup>207</sup>

Several taxpayers are subjected to abuse owing to the conspiracy of the competing traders (new traders with the competitive trading activity of previously existing business) unfortunately some employees in the tax administration are party to conspiring with some traders to influence the others. As the interview with Samson who is in the business of printing different two-dimensional products said he was the first to bring the printing machine<sup>208</sup> in this city administration for more than two years he was the sole provider of printing service in the city administration, recently many competing traders brought similar machine engaged in the service of printing hereafter several influences on his business unfortunately which let him learned several employees of the tax administration conspired to tackle my business by alleging that he

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<sup>206</sup> Interview with Abyot a business man in Bonga, Ethiopia November 2021

<sup>207</sup> Interview with tax payer Abuye a trader in Bonga, Ethiopia November 2021

<sup>208</sup> The printing machine used to prepare different two dimensional products like billboard , banners, paint on shirt similar products.

stayed more in the business and required to pay more and several auditors and even some officials appear before my business premise and mistreat and insult the employees moreover they insisting other government institutions to abstain from getting any printing service from my printing service, being in a court proceeding in this regard”<sup>209</sup>

The other problem taxpayers incurred is the groundless transition from one category to another upper category, that there is a doubt about their professional competence to conduct such activities. A photographer called Yitagesu says *“I started the business almost three years and have been under category “C” but now for no good reason they turn me into category “B”, due to the Covid 19 and countrywide inflation and other related challenges I didn’t make any advancement in my photo studio and I didn’t believe there is a possible way to convert me in another category”* Furthermore he says, he has reported the complaint about their prejudicial decision for the tax administration for three times, no one yet tried to respond anything”<sup>210</sup> The procedures to claim the grievance needs to consider very crucially unless tax authorities end up being absolute.

Another taxpayer called Adugna who conduct, writing, photocopy and printing machines years ago started internet service with few computers, he was under the category “C” taxpayer they now transformed his category to “B”, what he asserting is *“the mere existence of internet service doesn’t mean the activity is profitable, for your surprise within a week there are not more than three or five customers are getting the internet service. Now I’m under category “B” and you may not see me in the market anymore because I can’t afford the coming taxation”*<sup>211</sup> this is a condition that a lot of taxpayers are being exploited by an arbitrary decision of the auditors and bodies in the tax administration and ending up leaving the market I have interviewed similar taxpayers, the especially unjustified transition of taxpayers category.

Aniley is a trader who used to be a trader who was in the business of selling accessories of buildings in Bonga City administration, he paid unfairly decided amount of taxation due to terror of the ineffective justice system and cost of time, energy, and payment for the lawyer and now he

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<sup>209</sup> Interview with Samson a business man in Bonga, Ethiopia November, 2021

<sup>210</sup> Interview with Yitagesu a Business man in Bonga, Ethiopia November, 2021

<sup>211</sup> Interview with Adugna conducting business in Bonga, Ethiopia November, 2021

conducting on the verge of departing the market he said.<sup>212</sup> Even though his ground to retreat the justice system is due to lack of enough awareness, I questioned almost all of the taxpayers if there is anything from the tax authority in Bonga city administration giving way of awareness on to as the decision of the tax authority can be averted, majority the taxpayers believes the decision as final and even if they try to appeal they consider the court as an institution serving for the sole interest of the government.

Mr. Asmare a trader conducting Hotel business Bonga who stayed for nine years in the business, for the question the researcher asked; what do you experience in your stay in the business of a hotel? He says *“I always doubt about the competence of the auditors in the tax administration, usually there is lack of transparency in the practice of auditing and rush to decide the tax amount several times they overstated the amount of taxation and many times I appealed and averted their decisions, the cost of time, money, and energy is very tiring, I always doubt about those young auditors capability in their profession because I have experienced such exaggerated tax amount to be paid, more than third times”*<sup>213</sup> several taxpayers with similar experience are interviewed, even if they come up fulfilling their legal requirements<sup>214</sup> the tax administration frequently neglect their tax declarations and follow the exaggerated calculation entailing them into unwanted cost resources that could be used for another investment<sup>215</sup>

### **5.2.2 Practice in Bonga City Tax administration and the views of professionals and officials of the tax administration**

As specified under the first chapter, a qualitative method of research shall be employed through interviews with tax authorities and employees in the tax administration the researcher interviewed with the higher Head of tax Bonga City administration and auditors.

Senior tax auditor Habtamu specified his positive along with the negative views of the tax administration; the tax administration. A good thing about the tax administration “compared to other governmental institutions this tax administration has better performance of the duties and through years’ amount of revenue the tax administration achieve is rising progressively, he also

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<sup>212</sup> Interview with Aniley a trader in Bonga, Ethiopia November, 2021

<sup>213</sup> Interview with Mr. Asmare in bussines man in Bonga, Ethiopia 2021

<sup>214</sup> Like keeping book and account for category “B” and keeping statement of transaction for tax payers under category “A”

<sup>215</sup> Interview Alemayehu, Tarekegn and Sultan business persons in Bonga, Ethiopia November, 2021

says the employees in the tax administration relatively are committed” whereas there are several negative sides of the tax administration, regarding the ethical and disciplinary standards he said there is a concerned body called the disciplinary office that deals with the ethical issues of the tax administration, but there is a practical gap fulfilling their duties again *“lack of devising well-organized tax dates primarily about VAR, TOT reports of the taxpayers, it usually challenges us to determine the amount. Again as an institution, the tax administration fails to provide basic training concerning the newly enacted laws”*<sup>216</sup>

The other senior tax auditor called Eshetu <sup>217</sup> says even though there are several good deeds the tax administration apparently has several weaknesses to generating competent and ethically mannered tax employees, as Eshetu says “there is a grave challenge to providing professional training and awareness concerning ethical standards that the employees comprising the tax auditors are likely to conduct”<sup>218</sup> The tax authority of Bonga, city administration, lacks a commitment submit tax employees that including the tax auditors who found in crime illegal acts, this is primarily for the reputation of the tax authority he says again putting the data of taxpayers in a well-organized manner has been a challenge.<sup>219</sup> the tax auditor called Temesgen, working in Bonga city tax administration considers insufficiency of the monthly salary of the employees compared with the weight of work in the tax administration even *“there are part-time works we are doing when it is the session tax declaration and payment period which we stay at work extraordinarily without any payment of per dime”*<sup>220</sup>

Finally the head of the tax administration Mr. Admasu stated his tax administration working primarily the tax payers to be registered on VAT and TOT and door to door checking whether the tax payers are complying with required commandments whereas based on the tax laws of the regional government, the tax administration takes legal measures on tax payers who violates the their duties, Additionally regarding the disciplinary ethical and professionals in the tax administration “there is a disciplinary standard directive that the employees in the tax

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<sup>216</sup> Interview with Habtamu a tax auditor in Bonga city tax administration, Ethiopia November, 2021

<sup>217</sup> A senior tax auditor in Kaffa Zone tax administration who used to be an employee as tax auditor in Bonga city Tax administration

<sup>218</sup> Interview with Eshetu a tax auditor in Kaffa Zone tax administration, Bonga, Ethiopia November 2021

<sup>219</sup> Ibid

<sup>220</sup> Interview with Temesgen a tax auditor Bonga, Ethiopia November, 2021



administration expected to understand and practice”<sup>221</sup> though this doesn’t seem the practical fact of the city administrations tax authority; as several employees in the tax administration stress that “the emphasis in this tax administration is working the regular task of the tax administration and there is lack of preparing the tax payers as competent professionals and disciplined employees”<sup>222</sup> As Mr. Admasu says the employees in the tax administration usually lacks to be punctual to arrive before their work place and incompetency to submit their reports particularly they untimely submit their vouchers while collecting the income from the tax payers<sup>223</sup>, but he wanted to say nothing for questions related to rumors of corruption, discriminations on tax payers and related issue in the tax administration.

### **5.2.3 Bonga city tax administration and the outlook of Kaffa Zone High court**

Kaffa zone high court is a judicial body situated in Bonga city administration serious tax-related breaches. For a longer period of years, the court entertained numerous tax-related cases and the researcher conducted an interview the senior judges in the high court of Kaffa zone, he reflected on the tax system of Bonga city tax administration and what kind of cases are usually entertained and what are the conspicuous challenges the tax system.

The high court usually adjudicates cases from two perspectives one from the perspective of taxpayers; deceiving the tax and improper usage of income machines are common cases whereas the other is the perspective of tax administration, primarily breach of trust is the usual, lots of tax auditors and related employees of the tax administration accused and convicted with the high court. Per a year more than thirty cases that related to breach of trust from all over Zone of Kaffa but cases from Bonga city tax administration are the dominant ones<sup>224</sup>

The other judge in kaffa Zone High court mentioned as a ground for the preliminary challenges related to the tax crimes and crimes related to auditors in the tax administrations are predominantly, lack of well-organized control of the practice professionals in the tax administration and their practice, the other is the intent to unlawfully enrich by the professionals, lack of effective tax corruption combating anticorruption instructions, he again stress that most of the tax laws are unclear, ambiguous and subjected to continuous amendment without even

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<sup>221</sup> Interview with Mr Admasu the head of Bonga city tax administration, Bonga, Ethiopia November, 2021

<sup>222</sup> Interview with tax auditors, Eshetu, habtamu, dessale , Bonga , Ethiopia November 2021

<sup>223</sup> Interview with Mr Admasu the head of Bonga city tax administration, Bonga, Ethiopia November, 2021

<sup>224</sup> Interview with Fikadu a Judge in Kaffa zone high court, Bonga Ethiopia December, 2021

being practiced and again the justice system “*nonexistence of the tax appeal commission at zonal level intensely affecting the justice system of the taxation*”<sup>225</sup> Regarding Bonga city tax administration, through years several cases approaches before the high court in the form of appeal and institutionally the tax administration ordinarily practiced lack of properly organizing the data of tax payers, unwillingness to cooperate with judicial bodies whenever there is suspicion about corruptions and breach of trust accusations “*the tax administration is very much concerned about their reputation*”<sup>226</sup> all above mentioned grounds and others tended that there is serious problem in the tax system of the city administration and there need a substantial rectification in the tax administration.

#### **5.2.4 The Anti-corruption commission of Bonga city Administration and the tax authority of Bonga city administration**

The Anticorruption commissions are legally obliged whenever there is suspect or information on preparation for the commission of corruption to undertake rapid corruption prevention activity whereas where it has suspicious about the commission of corruption and to report for a relevant organ to investigate<sup>227</sup>

The anti-corruption commission in the city administration has been working on crimes of corruption based on the reports in the Bonga City administration. Regarding tax-related corruptions in Bonga city administration, the usual reports are related with the first one is bribe and nepotism are the primary reports that; Bribe is corruption crime the proclamation articulated and it is an act by any public servant or employee directly or indirectly, seeks, receives or exacts a promise of an advantage for him or another, to act or refrain from acting, in violation of the duties proper to his<sup>228</sup> to bribe any public servant who accepts undue advantage, for the performance of an act proper to his office, solicits or obtains an advantage or exacts a promise before or after the performance of such an act, shall be punishable “the tax administration usually suspected with a bribe that some employees do a favor for those pays and discriminate those taxpayers who fairly pay their tax. Again the common reports are related to nepotism employees

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<sup>225</sup> Interview Assfaw judge in Kaffa Zone High court, Bonga Ethiopia December 2021

<sup>226</sup> Interview Mr Abreham public prosecutor in kaffa zone high court Bonga, Ethiopia 2021

<sup>227</sup> Art 7(4) Ethics and anti-corruption commission establishment proclamation of SNNPR state No. 142/2012, 18<sup>th</sup> year No, 1Hawassa Feb, 28/2012 and the federal

<sup>228</sup> Ibid Art 10

in the tax administration favor for their ethnics and usually, those taxpayers from another side of Ethiopia are treated less favorably

The head of the anti-corruption commission stipulated that people usually only report the act of corruption and the usual fear to keep the proceeding by the taxpayers and the tax administration has the tendency of hiding the corrupt deeds of its employees and very less commitment by the tax administration to work in cooperation with the anticorruption commission<sup>229</sup> those activities adversely affect the combat of corruption-related crimes in Bonga city tax administration.

### **5.3 Challenges against the realization of virtuous tax auditing system in Bonga City Tax administration**

The interpretation of the right to a fair, equitable, and unbiased taxation system are the determinants, that taxpayers are entitled by the constitutions along with interrelated tax laws, that would mean State has obligations in which to ensure and fulfill those indispensable rights of the taxpayers. Interview with the taxpayers under category “A” and “B” in Bonga town revealed that there is a total or partial violation of those rights.

Thus, it's important to figure out challenges against the realization of the mentioned above taxpayers' rights in the study area. Accordingly, based on the overall analysis of the thesis and the information obtained from participants (taxpayers, tax auditors, high officials of tax administration, and judges of courts) and key informants the following challenges against realizing the rights of taxpayers.

#### **1. Challenges associated with the Law**

The professional and Ethical standards of employees in the tax authority are not properly stipulated in many tax proclamations. Even the tax administration doesn't specify which activities the taxpayer is expected to conduct and which is not due to the vacuums in the federal and regional tax laws, it ultimately created a way of violating their professional ethics and responsibility either deliberately or in good faith.

Regarding the taxpayers, the federal, as well as the regional laws of tax in Ethiopia, are not properly articulated in a way that layperson could understand. Again taxpayers are supposed to be thoughtful in which methods tax auditing system is conducted. The majority of tax payers'

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<sup>229</sup> Ibid

state whenever there is a dissatisfaction with the decision made by the tax authority as the decision is not convenient to the *“I usually claim the grievance that “the decision is not fairly considered the income and cost of my business and I want the tax body to review the decision”*<sup>230</sup> and there is lack of strong law that enforce a transparent and responsible activity of the tax employees in the manner understandable to the taxpayers.

## **2. Institutional encounter in the tax administration**

Intuitively Bonga city tax administration usually lacks a commitment to provide capacity-building pieces of training for professionals, training regarding the ethical standard. There is no organized data of the taxpayers, abstention from granting basic awareness for the taxpayers are some institutional challenges. A senior auditor called Eshetu<sup>231</sup> who served five years in Bonga city tax authority says *“the tax administration lacks a commitment to provide capacity building training on the profession of auditing, training regarding ethical standards.”*<sup>232</sup> Capacity Building training and schooling the ethical standards to the tax employees (including tax auditors) in the tax administration has a crucial role in facilitating the reduction of violation in the practice of their duties and influencing them to be well-mannered and ethical workers, ultimately securing the fulfillment of the right of taxpayers. The other auditor called Kochito who is serving in the tax administration says *“In Bonga city tax administration the nonexistence of well-organized data of taxpayers is a crucial challenge the tax administration failed to ensure”*<sup>233</sup> to decide the amount of future taxation it is indispensable to have well-organized information about the taxpayers, among the challenges the taxpayers stipulated is the unfair transition of categories of the taxpayers. Doubt by the taxpayers about the impartiality of the members formed to resolve the grievance of taxpayers in the city administration. Mr. Admasu the judge in the high court of Kaffa Zone *“the taxpayers usually allege that as they don’t have confidence in whatever the decision by the committee formed by the tax authority of the tax administration and I know many cases that subjected demotion by the high court, I believe that there are better experts and relatively impartiality in higher judicial structure than the lower*

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<sup>230</sup> Interview with Yitagesu business man in Bonga, Ethiopia November, 2021

<sup>231</sup> A tax auditor in Kaffa Zone Tax authority, who served five years in Bonga city tax authority( from(October 2008- January 2013 E.C)

<sup>232</sup> Interview with Eshetu a senior tax auditor in Bonga city tax authority, Ethiopia November, 2021

<sup>233</sup> Interview with Kochito a tax auditor in Bonga city administration tax authority, Ethiopia November, 2021

one”<sup>234</sup> As an institution, the tax administration is known to be less committed to coordinate with another justice institutions like that of Bonga city anti-corruption commission.

#### **4. Discrimination**

To some extent, discrimination is a challenge in the tax administration in which the researcher identified. Tax payers usually don't be treated equally in the tax in Bonga city administration, the interview with a tax payer who is in the business of Digital printing media is a good example a man Called Samson *“I am the first to bring the printing machine in this city administration for more than two years I was the sole provider of printing service in the city administration, recently many competing traders brought similar machine engaged in the service of printing hereafter several influences in my business unfortunately I learned several employees of the tax administration conspired to tackle my business by alleging you stayed more in the business and required to pay more, several auditors and even some officials appear before my business premise and mistreat and insult the employees moreover they insisting other government institutions to abstain from getting any printing service from my printing service, am in court proceeding in this regard”*<sup>235</sup> Similarly a tax payers subjected to mistreatment based on their political position, particularly regarding the formation of the new regional state Southwest, Taye investing coffee production around in Bonga says *“I was oppressed, primarily based on Facebook rumors that said he was among the investors who doesn't wanted the formation of new regional state and funding for the achievement of his plotting practice, this reached to the Bonga City tax administration influenced through unfair increment of taxation”*<sup>236</sup> Even if he take part in such conspiracy act there are various legal provisions that he will be adjudicated before courts despite this lawful remedy he was subjected to unfair discrimination in the tax administration.

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<sup>234</sup> Interview with Admasu a judge in Kaffa zone high court, Bonga, Ethiopia November, 2021

<sup>235</sup> Interview with Samson a business man in Bonga, Ethiopia November, 2021

<sup>236</sup> Interview with Taye an investor in Bonga, Ethiopia. November 2021

### **3. Challenge related to the implementation of legal remedies whenever there is a professional or ethical violation in the tax administration.**

As per the Kaffa Zone high court, several cases related to taxation are held up in the air due to distortion of evidence “Usually criminals are professionals primarily under the provision of Breach of professional duty and Corruption crimes<sup>237</sup> in many cases shreds of evidence are subjected to alteration as if they are no longer valuable or Many professionals bargain in a manner free from elucidating them to legal liability”<sup>238</sup>

The other challenge of commitment from the side of the tax administration in exposing the employees violating laws and regulations senior auditor Eshetu says “officials in the tax administration of Bonga city are usually reluctant to disclose evidence that may dishonor the reputation of the tax administration”<sup>239</sup> this also a challenge if fight crime and criminals under governmental structure are not fortified institutionally it becomes a barrier to safeguard the justice system.

### **5. Non-existence of Tax appeal Commission**

Tax appeal commission is composed of members “individuals who are assigned from justice bureau, finance and economic development bureau, individuals from trade and industry bureau and finally individuals Council of Trade and Sectorial associations shall serve as Member”<sup>240</sup> from the above provisions we understand that that tax appeal commission is a qualified institution that included competent professionals that would adjudicate a given tax appeal from a different perspective. Based on the tax administration proclamation of the SNNPR state, “A dissatisfied taxpayer with the decision of the tax authority can file the application of dissatisfaction within 21 days beginning from the day the taxpayer get the notice, the dissatisfaction of the taxpayer may be based on the amount of the tax calculated by the tax authority”<sup>241</sup> Due to the non-existence tax appeal commission the justice system in the tax administration known to be escorted with continuous complains by the taxpayers and tighten up the normal activities of the higher courts working instead of tax appeal commission that

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<sup>237</sup>Art 69 and art 407 of FDRE criminal code, proclamation No. 414/2004, 9th of May, 2005 Addis Ababa

<sup>238</sup> Interview with Admasu a Judge in Kaffa Zone high court, Bonga, Ethiopia November 2021

<sup>239</sup> Interview with Eshetu a senior tax auditor in Bonga city tax authority, Ethiopia November 2021

<sup>240</sup> Ibid Art 11(1,2)

<sup>241</sup> Ibid Art 54(1,2) tax administration proclamation 166/2017 of SNNPR state, 25th year No.2 Hawassa, Feb, 16, 2017

relatively composed competent professionals again taxpayers are wide-opened to exhausting, time money and energy consuming justice system to plea grievance of the tax decisions.

## **6. Lack of awareness**

The majority of traders are known to be less concerned about their academic standing, As the researcher has been mentioning, the majority of the taxpayers are not progressive in their educational status due to various factors, this brought being unaccustomed to their constitutional and tax-related rights and created a vacuum for dubious and exploitative professional tax auditing. Among the taxpayers, the thirty taxpayers are under the educational status that range from primary school to certificate and five are diploma, four taxpayers are the holder of the first degree and the remaining one is holding second degree”<sup>242</sup>

## **Conclusion**

Taxpayers are usually subjected to enormous injustices that emerge from the silly mistreatment to challenges that force them to leave the market. Taxpayers are customarily subjected to the unethical and illegal practices of the tax authorities, including the unjustified transition of category, discrimination among the same taxpayers, exaggerated tax amount decisions. Very Exhausting, time costing and unreliable justice system of tax administration and other related challenges confronted the taxpayers. Several grounds are for the existing encounters that consist of the nonexistence of simple and unsophisticated ethical as well as professional rules. Challenge related to the tax authority; less commitment the tax authority to provide professional and ethical training for the tax auditors and correlated employees, the problem of properly organizing the data of taxpayers, again lack of courage to disclose relevant evidence whenever there is a suspicion of tax crimes. Lack of awareness of taxpayers about their determinant rights is among the constraints in the taxation system of Bonga city administration.

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<sup>242</sup> A data from the interview related to category A and B tax payers in Bonga, Ethiopia November 2021

## UNIT SIX

### 6. CONCLUSION AND RECOMMENDATION

#### 6.1 CONCLUSION

As mentioned in the previous chapters the role of taxation in the economy has an indispensable role in the economy of a country. Countries that base their economy must form resilient legislation concerning taxation and a well-mannered and competent tax system, to achieve a fair taxation system and overall economic development. In previous chapters, we have touched up some international instruments dealing with auditors practicing in the public dome. Accordingly, the International Federation of Auditors (IFA) and the International Standard of Auditing (ISA) stipulate the professional and ethical standards of the tax auditor in the public arena. The federal and regional tax laws Ethiopian Federal and regional laws stipulated standards concerning the lawful tax system. The constitution of FDRE and the Southwestern regional state impliedly stresses that the practice of tax auditing must follow the principles of equity, legality, and fairness. Again several subsidiary tax laws at the level of the Federal and regional state are enacted targeting to achieve an amicable tax system in the country.

FDRE constitution art 41(1) Every Ethiopian has the right to engage freely in economic activity and peruse a livelihood of his choice anywhere the national territory. Again the constitution of the new regional state under Art similar article 41(1) whosoever person in the regional state has the right to conduct whatever economic activity he needs to engage, moreover the constitution of the new regional state Art 43(1, 3) stated peoples of the regional state are entitled to the right of forming a better life and sustainable development and the right to get all the developmental facilities from the government.

Taxpayers in the regional state have legally vested right to exercise their right to engage in whatever economic activities, as long as it does not contradict the law and morality of Ethiopia and the government is mandated to facilitate all the possible ways to realize the above mentioned constitutional rights.

Despite the above-mentioned facts, the tax system of Ethiopia has several challenges that are proved by a variety of researches. Among the difficulties, tax-related problems are commonly known deterrents from exercising economic rights. The efficient and effective exercise of tax



administration plays a crucial role in realizing the economic rights of the citizens. Mal administration, injustice, incompetence, and unethical conduct of some professionals in the tax system are seriously crumbling the system of taxation. Such circumstances have a tendency of troubling the non-belligerent economic activity of the taxpayers and eventually delinquency on the overall economic development of the country.

Tax audit among the practice in the tax system that professionals appointed by the government officials to decide on amount in which taxpayers are entitled to pay the taxation. The process includes the taxpayers under category “A” and “B” to declare their yearly income and costs and the auditor to give the final decisions on that base. The research finds out that the tax audit system in Kaffa Zone, Bonga City Administration is faced up with more than a few challenges. The taxpayers in the city administration are subjected to encounters that start from mere mistreatments to unjustified unilateral tax decisions which ultimately force them to leave the market. Particularly there is an unjustified transition from one category to another category, the activities in the tax system are not transparent and taxpayers are subjected to discriminatory acts ultimately many taxpayers ended up being subjected to unjust deeds of the tax administration and leaving the market. Again for the taxpayers who are dissatisfied with the decisions of the Bonga city tax administration, there is no tax appeal commission that is competent for the adjudication of tax-related grievances.

Bonga city tax administrations there are challenges related to the competence of the tax auditors and members that looks grievance of the taxpayers in the tax administrations, this can be featured by the number of too many reports of grievance and many cases are subject to appeal before the higher court and majority cases are averted the decisions of the tax administration.

Institutionally the tax administration looks to have less commitment to realize a competent tax system that the system of organizing the data of the taxpayers is very poor. Again it lacks coordination with the anti-corruption commission of the city administration, as professionals in the tax administration are usually suspected with bribes and nepotism reports, but the tax administration is known to tend to cover illegal deeds of their employees.

Ethiopian laws are very ambiguous and tricky in stipulating the ethical and professional requirements for the tax officials and employees, tax auditors as supposed to have a clear documented standard for their specific activities.

## **6.2 Recommendations**

In light of the aforementioned conclusions the following recommendations are set out:

1. Laws of tax are usually are ambiguous, lack clarity, and subject to frequent amendments without being put on the ground, the new regional state has to enact laws of tax which will not be subjected to vagueness, clear and easily comprehensible and that may ease the complexity of laws which are tough for laypersons like taxpayers.

2 As per the international framework, there are single documented, unambiguous ethical standards like Ethics Guideline of International Federation of Auditors /Accountants (IFAC) and International Standard of Auditing (ISA), the government of Ethiopia and the regional state are required to enact the professional and ethical standard that professional auditors in the tax administration shall be governed.

3. The tax auditors in the city administration lack to conduct their auditing activities in the manner compiled with principles of accuracy, efficiency, fairness, transparency, consistency to ensure the essential values of tax auditing, this is primarily due to slackness of the tax administration of Bonga city administration for that reason the tax administration must look their tax-related needs critically and examine, address the internal problems to realize the justice system of the tax.

4. The intensified political and ethnic-based discrimination in the tax in Bonga city tax administration needs to be investigated and those officials who engage in conspiring discriminatory acts should stand before justice. The tax administration, courts, and anticorruption commission should play a crucial role in this regard.

5. The finding of this thesis believed that the government required setting up circumstances to ensure justice regarding the tax system in Bonga city administration, predominantly forming the tax appeal commission is crucial and that the government must give due regard to forming tax

appeal commission, tax issues must be adjudicated by the professionals who have better skill and understanding of taxation and the tax system.

6. The tax administration of Bonga city has to build tax auditors which are fit academically, professionally decent, and those who treat the customers of the tax administration fairly and those abstain from corruption and unjust acts.

7. The government must provide the platform for the bodies in the tax administration that of sustainable capacity building, creation of awareness and bring up the tax auditors to the modern technological advancements and skills.

8. The taxpayers in Bonga town who are denied justice have to be encouraged because their capacity is used as an efficient response against unjust treatments. Government has to work on building as an input to fight unjust and fraudulent undertakings in the tax administration.

9. The anti-corruption commission of Bonga city administration needs to be committed to investigating intensively especially tax-related corruption reports and encourage whosoever tax reporting corruption. Again the commission expected to work in coordination with financial government institutions predominantly with tax authorities to combat the intensified corruption.

10. Media, professional groups, research organizations should play a crucial role in resolving the problems in the tax system, through giving the pieces of training and awareness to rebuild the deteriorating economy.

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## ANNEXES

### *Annex I*

#### Questionnaire for Data Collection

Interview	No. Name:
Date:	Location:

#### Information before the interview

Introduce yourself and explain why you are in Bonga town, Ethiopia.

Explain why you want to ask him/her some questions.

Explain what the answers will be used for.

Explain that he/she will be anonymous and that he/she can do not have to say anything he/she does not want to. Explain that we can stop the interview when he/she wants to. Ask again if it is okay to ask some questions.

1. Sex

Female

Male

2. Age

20-30

31-45

45- 65

3. Your level of Education

Grade 1-8

Grade 9-12

Diploma

First degree

Second degree

3. In which category is your business included?

Category “A”

Category “B”

4. How long have you stayed as a taxpayer?

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5. What business you are engaged with?

Hotel business

Electronics and Digital media business

Sale of Goods (including, finished and accessory products)

Other\_\_\_\_\_

**The tax system of the city administration in line with fulfillment duties by tax payers:**

6. Are you fulfilling your legal duties for taxation (like keeping books and account, VAT invoices, statement of the transaction)?

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7. How do the tax administration communities in Bonga city treat you? (Regarding ethics and decency?)

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8. How do you consider the auditing activities (In line with your tax declaration)?

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**Fairness, equitability of the tax decision Ethics of the employees in the tax administration**

9. As a taxpayer, what do you think the auditing system does it conducted based on willingness to conduct the audit considering law and on the declaration made by the taxpayers and no arbitrary unilateral decision?

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10. Do you notice any exaggerated breach of law while conducting the tax audit in the tax administration?

Yes

No (continue with question 11)

10.1 Did you file an appeal? If yes, how do you see the tax administration's commitment to undelaying justice? And how do you see the fairness of the decision?

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10.2 What do you think is the effect of the non-existence of the tax appeal commission in the City administration?

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11. Auditors in the city administration are they free from any claim of any incentive to conduct the required service to the taxpayers?

Yes

No (continue with question 12)

11.1 What kind of an incentive is usually the claim to conduct?

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11.2 Do you think there is a platform prepared by the tax administration to combat such acts?

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11.3 What do you know about the anti-corruption commission? Have you reported for the commission? If not, why?

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12. How do you see the ethical treatment of employees in the tax administration including the tax auditors (including treating respectfully and in a disciplined manner?)

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13. Do you get any information/awareness about your duties and right as a taxpayer and the responsibilities of the tax administration and the right to of appealing? If anyone giving you the awareness

- Yes                       the tax administration      others\_\_\_\_\_
- No                          from the mass media

## ***Annex II***

### **Interview with the auditors in Bonga city administration tax authority**

1. While appointing you as an auditor does the tax administration gives awareness on the subject of the professional and ethical standards required by auditors?
2. Do you think that you have enough professional manual that helps to conduct tax auditing by way required by law?
3. Do you get enough opportunity for training regarding the new laws and regulations of taxation?

4. Did you put any effort into all the possible measures that the tax administrations to prepare training on awareness creation of professional as well as ethical standards of the auditors?
5. Do you think that the salary and per dime you earn in the tax administration is fitting with your duties in the tax administration?
6. How do you see the awareness of taxpayers about the accomplishment of their duty mainly regarding the keeping of books and accounts and the periods of tax declaration and other technical requirements?
7. What is your view regarding the independence and fairness of the appellate body provided by the tax administration?
8. How do you see the city tax administration tax authority in your carrier, the strong and weak sideways?

### ***ANNEX III***

#### **Interview with the higher officer of Bonga City tax administration**

1. As a City administration tax authority what measures do you conduct to fulfill legal as well as the fair tax system, particularly regarding the conduct of tax audit?
2. How does the commitment of the city administration look like concerning training its employees particularly the auditors, about the professional and ethical standards?
3. What measures the tax administration takes to give awareness to the taxpayers in Bonga city administration?
4. What are the usual faults committed by the employees primarily by the tax auditors of the tax administration, what Administrative and legal measures the tax administration takes?
5. Whenever there is a grievance by the taxpayers regarding the decisions of the tax administration what are the platforms prepared by the tax administration to overview the decisions?
6. How do you see the impartially and independence of the tax-appealing bodies of the tax administration?

7. What measures do you take to combat offenses related to corruption and malpractice in the tax administration? Particularly regarding tax auditors engaging in such practice?

8. How is the cooperation of the tax administration with the anti-corruption commission? Are committed to coordinating to expose those tax employees of the tax administration?

#### ***ANNEX IV***

### **Interview with A judge and president of Kaffa Zone high court**

1. How many cases do you entertain in high courts per year that have a direct relationship with tax cases in high courts?

2. Among the cases related to tax, how do you see the case of the Bonga City tax administration; particularly the cases regarding the breach/violation of the law by the tax auditors?

3. From all experiences you acquired through the years, what do you think are, the very causes that force employees in the tax system to violate laws particularly breaching of trust?

4. What do you think are the apparent causes for violations by the employees and officials in the tax administration of Bonga?

5. What are the usual grievances appealed by the taxpayers and what do you think the root cause is?

6. How do you see the coordination of the tax administration with the high court in combating the crime and criminals in the tax system?

#### **ANNEX V**

### **Interview with the officer of anti-corruption commission in the city administration**

1. What kind of cases was reported for the anti-corruption regarding violations related to taxation?

2. In the Bonga city administration what kind of grievance was filed before the anti-corruption commission?

3. How do you see the commitment of the taxpayers in the city administration regarding the report of the corrupt acts committed in the tax administration?
4. Regarding reports of corruption against the officers of the tax administration and employees, what are the usually filed grounds?
5. What do you see as the coordination of the tax administration regarding exposing the corrupt members of the tax administration and cooperating through disclosing documents for the anti-corruption commission?