

# The Structure of Tax and Rationale of Recent Business Income Assessment in Oromia

By Teshome A.(PhD), OPEDC<sup>1</sup>

July 24, 2017

## 1. Introduction

The quality and strength of the government usually evaluated based on its ability in mobilizing sufficient revenue that needed to economic development. One of the dominants sources of the government revenues is tax that would be paid by households and business people or organizations. A tax is a compulsory<sup>2</sup> or forced payment made to a governmental unit. The major objectives of tax are to raise revenue for economic development, to foster economic growth, to attain income equality/wealth redistribution, to achieve price stability and full employment and other social development: home ownership, charitable activities, and environmental preservation.

Those countries with broad tax base and efficient tax system have been realizing fast and sustainable social development. Tax matter for economic development in both developed and developing countries. Transparent and credible tax system promotes state building by encouraging governments to be more accountable to their citizens.

Recent report reveals that the share of internal revenue from total budget has been decreasing during the last decade. In the same way the region only manages 58 percent of its GTP-II<sup>3</sup> internal revenue plan. Such kind of poor internal revenue mobilization was strongly hampering the socio-economic development. It needs bold political commitment to bring broad based and efficient tax system. Understanding this chronic problem, the regional State has undertaken the daily business income assessment to enhance regional resources mobilization.

---

<sup>1</sup> OPEDC-Oromia Planning and Economic Development Commission, the author can be reached by e-mail address:a.teshom@gmail.com

<sup>2</sup> If we purchase certain goods, the state may require the seller to collect a sales tax. If we fail to pay or remit these taxes to the government, we may be subject to civil, or even criminal, penalties. If we own real estate, the local government places an assessed value on that property and sends us a bill for property taxes.

<sup>3</sup> The region was planned to increase internal regional revenue to Birr 19.9 Billion in 2009. But the actual revenue the region managed to mobilize was in this year was only Birr 10.4 Billion.

Those individuals who want to hold our people to their traditional and backward thinking went to divert the purpose of recent daily income assessment for their cheap political popularity. The major purposes of this brief article are to discuss the tax structure of the region and the rationale for daily income assessment conducted in 2009EC. The article consists of five sections. The second section presents the concepts of tax assessment and compliance. The third section discusses the trends and structure of the tax revenue in Oromia. The fourth section presents the rationale for daily income assessment in the region. The last section is summary.

## **2. Concepts of tax assessment**

Tax assessment refers to valuing the income or value of the individual for the purpose of tax payment. The tax authority conducts annual tax assessment to improve the efficiency and fairness of tax in the given country or region. Taxes must be paid as you earn or receive income during the year, either through withholding or estimated tax payments. Therefore everyone must pay taxes on the income they receive during the year, whether it is from a job, self-employment, or other sources. The ability to pay principle is the common methods that used to achieve fair taxation<sup>4</sup> in the given economy. It is important to conduct tax assessment to get detail information about the ability to pay by individual or organization.

Policy makers are more concerned about tax assessment due to two reasons: its revenue implications and equity concerns. The absence of continuous tax assessment was the major reason for government inability to identify properly the ability of the tax payer. Therefore the well organized and systematic tax assessment and the higher number of tax compliances is not only important for the purpose of revenue mobilization but also helpful for fair and efficient tax collection.

## **3. Trends and structures of tax in Oromia**

Trends of tax revenue indicate the change of tax revenue during the study period. In 2002EC the total revenue of the region was Birr 1.6 Billion. The tax revenue in this year was around Birr 942 Million. In 2004 EC the total internal revenue and tax revenue were increased to Birr 3.6 Billion and Birr 1.5 Billion respectively. The tax revenue has increased by 34 percent which is less the

---

<sup>4</sup> Fair taxation which is regarded as generally and universally equitable

57 improvement to the total regional revenue. In 2006 the total regional tax revenue has reached 7.1 Billion which shows 49 percent annual growths. The tax revenue was increased by 22 percent in 2006 EC. In the same way in 2009 EC the total revenue and tax revenue in the region were increased to Birr 10.42 Billion and Birr 8 Billion respectively. The annual growth rate of internal tax revenue was increased by only 11 percent between 2006 EC and 2009 EC

In 2009 EC both the regional total revenue and tax revenue were decreased by 0.2 percent and 1 percent respectively. The trends analysis revealed that the tax revenue was increased and the rate of the annual growth rate of tax revenue was decreasing. The regional output and private business has been increasing during the last few years but the growth rate of internal revenue was decreasing. The higher decline in fiscal capacity influences the regional tax-GDP ratio. The ratio of tax revenue to GDP in the region was less than 2 percent which is the least as compared to the national ratio of revenue-GDP which is 14 in 2008EC. The current trend of tax revenue for sure erode the future spending capacity of the region unless visible measure taken by the government

The Structure of tax can be seen by the composition of tax which include direct and indirect taxes. In 2009 the regional government direct and indirect tax revenue collection were Birr 6.7 Billion and Birr 2.5 Billion respectively. The direct tax was taken 73 percent of the total tax revenue and Indirect tax covers only 27 percent of the total regional tax revenue. The direct tax has shown 0.2 percent growths when the indirect tax decreased by 2.1 percent between 2008 and 2009. In 2009 the government has managed to collect 91percent and 76 percent of the planned direct and indirect tax respectively. The structure of the regional tax revenue was dominated by direct tax with declining share of the indirect tax. In the same was the planned tax collection performance of indirect tax was lower than the direct tax in the region.

The major types of the direct tax included employment income, house rental income, royalty income and agricultural income and profit income taxes. The employees and house rental income taxes were taken 67 percent and 27 percent of the total direct tax respectively. Both employment and house rent income tax covers 94 percent of the total direct tax. The government has failed to collect the most of the planned direct tax revenue in 2009, except the government employment income tax.

VAT, excise and turn over tax are the major components of indirect tax in the region. In the region VAT take the higher share of the indirect tax which is 69 percent of the total indirect tax.

In 2009 the region has managed to collect only Birr 1.7 Billion which is 80 percent of the planned VAT collection.

The tax revenue in the region has been dominated by the employee income tax that does not include the wide range of the tax payers. Most of the employee income tax came from the government which takes 61 percent of the employee income tax. The higher share of the income tax would affect the revenue mobilization capacity of the region and at the same time reduce the saving capacity of household which may increase the inequality in the region. The government workers pay tax while the other private workers and business people do not pay the tax. This proves the existence of an unfair tax system in the region which will increase horizontal inequality. Such kind of poor tax structure does not only reduce regional tax revenue, it reduced tax efficiency and effectiveness to bring the desired level economic development.

#### **4. The rationale of daily income assessment in Oromia**

The preceding section explains the trends and structures tax in Oromia. The study indicates that Oromia tax system characterized as poor tax structure that affects the tax revenue collection and its fairness. Tax should be fair and efficient to achieve fast and sustainable economic development. Realizing this situation, Oromia national regional state has implemented legal, institutional and tax management reform. One of the actions taken by the regional government was to conduct daily business income assessment. The major rationales of this business income assessment were to update business transaction data or information, to improve the regional tax structure and to increase tax compliances.

The most important fundamental reason for the implementation of daily income assessment was the absence of recent data on the number of sale tax payer in the region. The last tax assessment was conducted in the region in 2003EC that mean before six years. During the last six years nobody knows the change in the level financial transaction and the number of business people in the region. In the rapidly changing business activities tax assessment is not the option. It is completely illegal and illogical to collect tax without tax assessment for the last six years. The government conducted the daily income assessment for 319,491 out of 383,238 business people in the region. This daily income assessment enables the region to get 75 thousand new tax payers. This outcome would enhance tax fairness, reduce tax evasion and broaden the regional tax base.

The second rationale for daily business income assessment was to change the existing poor tax structure which is dominated by emplacement income tax and category C tax payers. As mentioned above employment income tax takes 45 percent of the total regional revenue and 73 percent of regional tax revenue. In the same way category A and B tax payers take only 4 and 5 percent of the total number of sale tax payers. The report released from regional tax authority indicates that the number and share of category A and B tax payers has been increased to 8.2 percent and 9.4 percent respectively. After daily income assessment, the number of category A and B taxes payers were increased by 11 and 10 thousand respectively. Now the share of these two categories tax payers has increased from 9 percent before daily income assessment to 17.6 percent after assessment. The share of category C tax payer decreased from 91 percent to 82.4 percent. This will not only improve the structure of tax in the region, it also enhances tax fairness.

The third rationale of conducting daily income assessment was to increase tax compliance. Tax compliance<sup>5</sup> is defined as taxpayers' ability and willingness to comply with tax laws which are determined by ethics, legal environment and other situational factors at a particular time and place. Similarly, tax compliance is also defined by several tax authorities as the ability and willingness of taxpayers to comply with tax laws, declare the correct income in each year and pays the right amount of taxes on time.

The lower number of tax compliances in the region became the major reason for higher tax evasion and low growth rate of tax revenue. According to the survey conducted by Oromia Revenue Authority (2016) on 4,701 business people, only 514 business people were using receipts for their business transaction. That means only 11 percent of the tax payer respect the regional tax law in terms of issuing sale receipts. The numbers of business people that do not use any sale receipt were 3,548. It is 75 percent of surveyed business people are avoiding tax.

Further the tax audit conducted on 12,928 business people in 2009 collected additional Birr 1.6 Billion. The higher tax non compliances indicate the unfair and inefficient tax system in the

---

<sup>5</sup> Tax compliance refers to as the reporting of all incomes and payment of all taxes by fulfilling the provisions of laws, regulations and court judgments. Another definition of tax compliance is a person's act of filing their tax returns, declaring all taxable income accurately, and disbursing all payable taxes within the stipulated period without having to wait for follow-up actions from the authority

region which can be managed and controlled by continuous income assessments. The recently conducted daily income assessment would increase tax compliance in the region.

## **5. Summary**

The structure and trends of tax in the given state determine the economic development. The increasing trends of tax revenue and the appropriate tax structure will be the sources of stable development finance. During the last ten years Oromia regional state tax revenue growth rate was declined as compared to the spending need of the region. In the same way the regional tax revenue characterized as narrow tax base which dominated by limited number of government employment income tax. The poor tax structures and low performances of tax revenue collection in the region highly affected the internal finances capacity and resources utilization. Tax avoiding and evasion became the common practices in the region. The shortage of development finances due to poor tax collection of the region enforce the government to postponed various development project.

Changing the tax structure and increase tax revenue collection is the only option to bring fast and broad based economic development. The regional government has taken various measures to improve tax revenue collection capacity and attain fair tax system. The daily income assessment is one of the measures that were taken the regional government to realize fiscal consolidation. The region cannot afford to collect the same tax revenue from limited number of tax payers which erode the region fiscal capacity for the last few years.

The regional government must continue to apply fiscal consolidation to provide stable public good and services. Tax compliances must be improved to maintain higher internal tax revenue. A number of factors determine the number of tax compliance. The wider perspective of tax compliance requires a degree of honesty, adequate tax knowledge and capability to use this knowledge, timeliness, accuracy, and adequate records in order to complete the tax returns and associated tax documentation. Therefore the government should focus more on internal tax revenue by improving tax recording system and collection efficiency and it effectiveness on mobilizing the required revenue to manage development spending.

### ***Realizing Economic Revolution in Oromia Through Fiscal Consolidation***