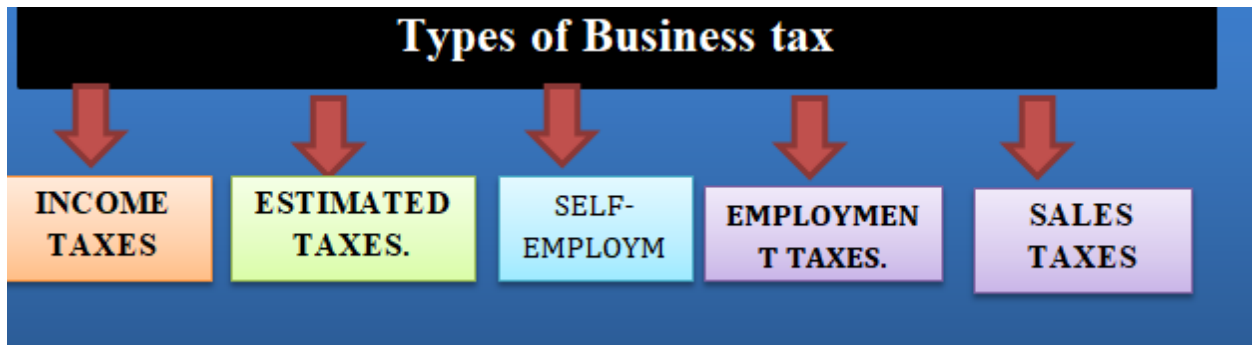


ACCOUNTING AND FINANCE

LEVEL – IV

BASED ON MARCH, 2022 CURRICULUM V – II



Module Title: Processing Business Tax Requirements

Module code: LSA ACF4 M05 1123

Nominal duration: 70 Hours

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Acronym

CKD	Completely Knocked Down
CURNN	Client Update Return Not Necessary
DSPs	Digital Service Producers
NLA	Non Lodgment Advice
SKD	Semi knocked Down
PR	Private Ruling
OBLMGT	Obligation Management
VAT	Value Added Tax

Introduction to the Module

Accounting and finance filed; “Process Business Tax Requirements”. in the work place helps to maintain Accounting records; establish and maintain a process for managing business tax returns; Explain the process of tax returns and lodgments in business tax requirements.

This module is designed to meet the industry requirement under the Accounting and Finance occupational standard, particularly for the unit of competency process of Business Tax Requirements.

This module covers the units:

- Records for taxation purposes
- Business tax returns
- Tax returns and lodgments

At the end of this Unit Students will be able to:

- Maintain accounting records for taxation purposes
- Establish and maintain a process for managing business tax returns
- Elaborate the Process tax returns and lodgments

Module instruction

For effective use this modules trainees are expected to follow the following module instructions:

1. read the information written in each unit
2. accomplish the self-checks at the end of each unit
3. read the identified reference book for examples and exercises

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UNIT ONE: RECORDS FOR TAXATION PURPOSES

This unit is developed to provide you the necessary information regarding the following content coverage and topics:

- . Accounting system for Tax Purpose
- Managing Business Tax Returns
- Taxation requirements

Upon completion of this unit, you will be able to:

- Maintain accounting records for taxation purposes
- Explain how to manage business tax returns
- Explain taxation requirements

1.1. Accounting system for Tax Purpose

Tax accounting is a structure of accounting methods focused on taxes rather than the appearance of public financial statements. In short, tax accounting is the means of accounting for tax purposes.

Tax accounting is governed by the Internal Revenue Code, which dictates the specific rules that companies and individuals must follow when preparing their tax returns. Tax accounting applies to everyone—individuals, businesses, corporations, and other entities. Even those who are exempt from paying taxes must participate in tax accounting. The purpose of tax accounting is to be able to track funds (funds coming in as well as funds going out) associated with individuals and entities. Tax accounting is the subsector of accounting that deals with the preparations of tax returns and tax payments. Tax accounting is used by individuals, businesses, corporations and other entities. Tax accounting for an individual focus on income, qualifying deductions, donations, and any investment gains or losses. For a business, tax accounting is more complex, with greater scrutiny regarding how funds are spent and what is or isn't taxable.

1.1.1 Tax Accounting Principles vs. Financial Accounting (GAAP)

In the United States, there are two sets of principles that are used when it comes to accounting. The first is tax accounting principles and the second is financial accounting, or generally accepted accounting principles (GAAP).

Under GAAP, companies must follow a common set of accounting principles, standards, and procedures when they compile their financial statements by accounting for any and all financial transactions. Balance sheet items can be accounted for differently when preparing financial statements and tax payables. For example, companies can prepare their financial statements implementing the first-in-first-out (FIFO) method to record their inventory for financial purposes, yet they can implement the last-in-first-out (LIFO) approach for tax purposes. The latter procedure reduces the current year's taxes payable.

While accounting encompasses all financial transactions to some degree, tax accounting focuses solely on those transactions that affect an entity's tax burden, and how those items relate to proper tax calculation and tax

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document preparation. Tax accounting is regulated by the Internal Revenue Service The IRS also requires the use of specific documents and forms to properly submit tax information as required by law.

1.1.2 Types of Tax Accounting

- A. Tax Accounting for Individuals
- B. Tax Accounting for Businesses
- C. Tax Accounting for Tax-Exempt Organizations

Tax Accounting for Individuals

An individual taxpayer, tax accounting focuses solely on items such as income, qualifying deductions, investment gains or losses, and other transactions that affect the individual's tax burden. This limits the amount of information that is necessary for an individual to manage an annual tax return, and while a tax accountant can be used by an individual, it is not a legal requirement.

Tax Accounting for Businesses

From a business perspective, more information must be analyzed as part of the tax accounting process. While the company's earnings, or incoming funds, must be tracked just as they are for the individual, there is an additional level of complexity regarding any outgoing funds directed towards certain business obligations. This can include funds directed towards specific business expenses as well as funds directed towards shareholders.

Tax Accounting for Tax-Exempt Organizations

Even in instances where an organization is tax-exempt, tax accounting is necessary. This is due to the fact that most organizations must file returns. They must provide information regarding any incoming funds, such as grants or donations, as well as how the funds are used during the organization's operation. This helps ensure that the organization adheres to all laws and regulations governing the proper operation of a tax-exempt entity

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1.2. Manage Business Tax Returns

1.2.1. Accounting for Business income tax

This is the tax imposed on the taxable business income/Net profit/ realized from entrepreneurial activity. Taxable business income would be determined per tax period on the basis of the profit and income statement, which shall be drawn in compliance with the generally accepted accounting standards. Before discussing in detail let us discuss some common terminologies that are used in the business income tax.

You need good records to prepare accurate financial statements. These include income (profit and loss) statements and balance sheets. These statements can help you in dealing with your bank or creditors and help you manage your business. taxes appear in some form in all three of the major financial statements: the balance sheet, the income statement, and the cash flow statement. Deferred income tax liabilities can be included in the long-term liabilities section of the balance sheet. Deferred tax liability is a liability that is due in the future

The three financial statements are:

- A. The income statement
- B. The balance sheet
- C. The cash flow statement.

Each of the financial statements provides important financial information for both internal and external stakeholders of a company. The income statement illustrates the profitability of a company under accrual accounting rules. The balance sheet shows a company's assets, liabilities, and shareholders' equity at a particular point in time. The cash flow statement shows cash movements from operating, investing, and financing activities. These three core statements are intricately linked to each other and this guide will explain how they all fit together. By following the steps below, you'll be able to connect the three statements on your own.

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1.2.1 TAX RATE

This is the tax imposed on the taxable business income/net profit/ realized from entrepreneurial activity. Taxable business income would be determined per tax period on the basis of the profit and loss account or income statement, which shall be drawn in compliance with the generally accepted accounting standards. Corporate businesses (bodies) are required to pay 30% flat rate of business income tax. For unincorporated or individual businesses, the BUSINESS INCOME TAX RANGES from 10% - 35%. Unincorporated or individual businesses are taxed in accordance with the following schedule below:

Table.1 Business Profit Tax (Schedule C)

Taxable business income (per year)		Tax rate (%)	Deduction (in birr) *
Over birr	To birr		
0	7,200	Exempt threshold	720
7,201	19,800	10	720
19,801	38,400	15	1,710
38,401	63,000	20	3,630
63,001	93,600	25	6,780
93,601	130,800	30	11,460
130,801		35	18,000

According to Proclamation 979/2016, Unincorporated or individual business realized annual business income (net profit) is liable to pay tax on that income at the rate specified in schedule "C" above. Employment income tax (Schedule A) is based on monthly personal income whereas business income (Schedule C) and rental income (Schedule B) that is discussed in the following chapter are on annual basis. Thus, the tax bracket of schedule B and schedule C is computed as twelve times tax bracket of schedule A. Deduction of each tax bracket for schedule B and schedule C can be also computed on the same way as it was computed for schedule

practice is legal. Failing to report your true income is illegal (tax evasion), whereas claiming a credit for child-care expenses is legal (tax avoidance).

For example, let's imagine that Josh thinks he has cracked the code to save money in the Ethiopian states. Josh plans not to disclose the income that he earns from a side job he has. This way, he can keep his entire earnings from this second job without having to pay taxes to the government. What Josh doesn't know is that this is illegal!

Tax evasion is the individual or business decision to avoid or underpay the taxes imposed on them.

Individual Tax Compliance

Individual tax compliance revolves around reporting accurate yearly income. In the United States, individuals file their taxes and are required to file them appropriately, given how much income they earn. If individuals fail to report all of their income to avoid paying taxes, then this would be tax evasion.² While individuals are responsible for filing their taxes accurately, they can also pay for a service to assist them in this process; after all, the penalty for not complying is quite large.

Business Tax Compliance

Business tax compliance is similar to individual tax compliance in that it revolves around reporting accurate yearly income. As you can imagine, keeping track of income at the business level is no easy task! Businesses will need to pay the proper state and federal taxes; businesses will have to keep track of any charitable donations they made; businesses need to have an employee identification number; etc.³ Failing to comply with tax laws can result in serious consequences for businesses. Therefore, businesses will usually have a tax accounting service to assist them with tax compliance.

Importance of Tax Compliance

What is the importance of tax compliance? The importance of tax compliance is that by paying their taxes, individuals and businesses are funding the government's tax revenue. Government tax revenue is important for a

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variety of reasons, from balancing the budget to providing goods and services to its citizens. Without a consistent stream of tax revenue, the government would not be able to accomplish these goals. Let's take a deeper look at how tax revenue is used to balance the budget and pay for goods and services.

Balanced Budget

For a government to properly balance its budget, it will need to account for its revenue and spending. Let's look at the equation for the budget balance for further clarification:

$$\text{Savings} = \text{Tax Revenue} - \text{Government Spending}$$

What does the equation above tell us? In order for the government to balance its budget, it needs to offset any high government spending with increased tax revenues. One way the government can do this is to simply increase the tax rate for all citizens and businesses. By enforcing tax compliance, the government **can** increase the tax rate and increase its tax revenue to balance its budget. However, what if individuals and businesses choose not to pay taxes?

If this occurred, the government would not be able to balance its budget. Prolonged deficits can be problematic and even result in a country defaulting on its debt. It is for this reason that tax compliance is important when it comes to balancing the budget.

3.1 Business tax returns and lodgments

1.3.1. Invoice requirement

An invoice is an itemized commercial document that records the products or services delivered to the customer, the total amount due, and the preferred payment method. The seller can send either paper or electronic invoices to the customer.

Your invoice format must include:

- Your business name and contact details.

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- Your customer's name and contact details.
- The label 'Invoice'
- A unique invoice number.
- The invoice date and date of supply.
- A description of the goods or services and their prices.
- VAT (if applicable)
- Subtotals and totals.

1.3.2. Goods and service tax requirements

Taxes applicable to imported goods in Ethiopia include the import duty, withholding tax at a 3% fixed rate, excise tax if applicable, value-added tax at a fixed rate of 15%, and surtax at a fixed rate of 10%, except for goods exempted under applicable laws.

1.3.3. fringe benefits tax

Please note that the aggregate tax liability on fringe benefits shall not exceed 10% of the salary income of the employee. FBT is a tax on benefits you provide to your employees. It applies to things like:

- work vehicles available for personal use
- subsidies on gym memberships or insurance
- Discounted goods and services.
- FBT doesn't apply to things already taxed for the employee, like:
- salary and wages
- cash bonuses
- employee allowances

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1.3.4. *luxury car tax*

In addition to customs duty, car importers in Ethiopia pay five different forms of tax:

- VAT of 15%;
- excise tax of up to 100% (depending on engine size);
- 10% surtax;
- withholding tax of 3%; and
- income tax.

The only tax that remains is the customs tax, which has dropped to 15% for fully assembled vehicles, and 5% for semi-assembled, while CKD (completely knocked-down) vehicles, that is, those that are being assembled in Ethiopia are not taxed at all

Ethiopia issues Excise Tax (Amendment) Proclamation, 2023

- *Ethiopia has amended its Excise Tax Proclamation no. 1186, published in 2020, with a 2023 edition.*
- *The changes were effective on 27 April 2023, the date of ratification.*
- *The amendment provides new tax rates for excisable goods and reduces the number of goods exempt from excise tax.*

Executive summary

The Federal Democratic Republic of Ethiopia (FDRE) House of Peoples Representative has amended Excise Tax Proclamation number 1186/2020 and issued Excise Tax (Amendment) Proclamation No. 1287/2023.

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The Excise Tax (Amendment) Proclamation is intended to lower the excise tax rate imposed on imported motor vehicles, among other items. It also seeks to eliminate certain special tax and duty privileges that were granted to some persons and organizations. Further, it imposes excise tax on telecommunication services.

Detailed discussion

The Amendment to the Proclamation clarifies the distinction between new and used vehicles and provides different rates for excisable goods and services.

New definitions

The Amendment has now defined the following items:

- Ethyl alcohol — means alcohol of purity of 80% or more
- New vehicle — means a vehicle that has not been used since its manufacturing year and includes those imported in semi-knocked down (SKD) or completely knocked down (CKD) form to be assembled locally
- Used vehicle — means a vehicle that is not covered under the definition of new vehicle

Changes to the First Schedule of excisable goods

The Amendment has added new items, reduced the excise rate for some items and excluded one item from the First Schedule.

Some of the main items are mentioned as follows

Newly added item

Tariff code	Description	Previous rate	New rate

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	Telecommunication service of mobile and wireless telephone (internet, voice, and SMS)	0%	5%
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Reduction in excise tax rate

Tariff code	Description	Previous rate	New rate
15.01 to 15.16	Edible animal or vegetable fats and oils and their cleave products containing 40g or more saturated fat per 100g, or unable to determine level of saturated fat from label and partially and wholly hydrogenated, with content of 40g or more saturated fat per 100g, or more than 0.5g of trans fat per 100g, or unable to determine level of saturated fat form label	30% 40%	30%
17.01	Any type of sugar (in solid or liquid form) excluding molasses, maple sugar and maple syrup	20%	10%
1704.1000	Chewing gum	20%	10%
1704.90 to 1806.90	Edible chocolates and sweets	20%	10%
2207.10 and 2208.9090	Ethyl alcohol	60%	10%
2501.0010	Salt	25%	10%
Chapter 27	Fuel — super benzene, regular benzene, petrol,	30%	15%

	gasoline and other motor spirits, jet fuel		
Chapter 50 — 63 excluding 57	Textile fabrics, knitted or woven of natural silk, rayon, nylon, wool, partly or wholly made from cotton, which is grey, white, dyed or printed, in pieces of any length or width (except mosquito net and Abugedi) and including blankets, bedsheets, counterpanes, towels, counterpanes, towels, table clothes and similar articles manufactured by industries.	8%	5%
Chapter 57	Carpets	30%	15%

Exclusion from excise tax

Tariff code	Description	Previous rate	New rate
8521.1000 — 8528.7300	Video recording or reproducing, television broadcasting receivers, apparatus, photo or video camera	10%	None

Reduction of exempt excisable items

The Amendment has revised the list of excisable items that are exempt from excise tax, including:

Exempt excisable goods

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- Excisable goods for the consumption of passengers or crew of aircraft while aircraft is in international traffic
- Excisable goods by a diplomatic or consular missions in Ethiopia to the extent provided for under the Privileges and Immunities Regulations
- Imported consignments for emergency relief in response to an emergency call issued by the Government
- All goods imported or purchased locally for official use by the Ethiopian Defense force and Federal and State Police Commissions as provided in a Directive
- Excisable goods except vehicles imported by a passenger subject to limitation provided for in the appropriate law

Exempt excisable services

- Excisable services supplied in Ethiopia to a diplomat or consul and their family forming part of the diplomat or consul's household in Ethiopia to the extent provided for under the Privileges and Immunities Regulations

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Self – check – I

Part-I. Choose the Best Answer from the Given Alternatives

1. Statement 1: Other percentage taxes are indirect taxes that can be passed on by one person required to pay to another person who shall bear the burden of paying the tax. Statement 2: Transactions that are subject to the other percentage taxes are no longer subject to the value- added tax but maybe subject to excise tax.
 - A. Only statement 1 is correct
 - B. Only statement 2 is correct
 - C. Both statements are correct
 - D. Both statements are incorrect
2. Statement 1: All VAT-exempt taxpayers shall be subject to other percentage taxes. Statement 2: A taxpayer who is subject to percentage tax on his gross receipt will also be subject to income tax on his net income.
 - A. Only statement 1 is correct
 - B. Only statement 2 is correct
 - C. Both statements are correct
 - D. Both statements are incorrect
3. Which statements are wrong?
 - A. Percentage taxes are basically on sales of services.
 - B. Percentage taxes are not allowed by law to be shifted to the customers or clients.
 - C. An isolated transaction not in the course of business will not result in a liability for a percentage tax.
 - D. None of the above.
4. A seller of agricultural food products is VAT-exempt. His annual gross sales in 2020 amounted to P3, 000,000. To what business tax is he liable?
 - A. 3% tax on VAT-exempt persons under Sec. 116 of the Tax Code
 - B. 12% VAT
 - C. 3% common carrier's tax under Sec. 117 of the Tax Code
 - D. None of the above.

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5. Ana has the following data for 2019 taxable year

Gross sales P2,850,000

Collections P1,420,000

If Ms. Ana is a seller of goods, her business tax for the year should be:

- A. P42,600 OPT
 - B. P85,500 OPT
 - C. P170,400 VAT
 - D. P342,000 VAT
6. Using Ms. Ana's data for 2019 taxable year and assuming further that the taxable year is 2020, the correct amount of Percentage Tax should be:
- A. nil
 - B. P14,000
 - C. P28,500
 - D. P57,000
7. Arianne is an operator of 10 buses with routes from Manila to Subic and is likewise a transportation contractor with 3 freight trucks. For the taxable year 2021, she reported gross receipts from her bus operations of P36,000,000. Her gross receipts, however, from her freight of goods or cargoes amounted to only P800, 000 for the year.

Assuming Arianne is a non-VAT registered, how much is her total business tax due?

- A. P1,088,000
 - B. P1,104,000
 - C. P1,176,000
 - D. P4,416,000
8. Assuming Arianne is VAT registered, how much is her total business tax due?

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- A. P1,088,000
- B. P1,104,000
- C. P1,176,000
- D. P4,416,000

Part_ II. Matching

Match Column A terms with Column B Definitions

Column A	Column B
____1. Deferred tax liability	E. Due currently
____2. Incorporated Business Organizations	F. Pay 30% income from profit
____3. Employment Income Tax	G. Pay tax liability calculated using schedule C
____4. Unincorporated business Organizations	H. Ranges from 10%-30%
	I. Schedule A
	J. Schedule B
	K. Due in the Future

Part-III. Short Answer

1. Write the five type of taxes paid by luxury car tax

2. Write at least four applicable list of Fringe benefit tax

3. Explain what Invoice means

4. Write the mechanism how the government balance its budget

5. Elaborate what Business tax Compliance means.

UNIT TWO: MANAGING BUSINESS TAX RETURNS

This unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Accounting System to Manage Lodgments
- Records to comply with Lodgments

This unit will assist you to attain the learning outcomes stated in the cover page. specifically, upon completion of this unit, you will be able to:

- Establish accounting system to Manage Taxation Lodgments
- Maintain sufficient and current records to comply with lodgments
- Meet Lodgment Schedule and its requirements

2.1. Accounting system To Manage Taxation Lodgments

An accounting system is a system that is employed in a company to organize financial information. It can be either manual or computerized. The main reason why you should be using an accounting system is to keep track of expenses, income, and other activities

Accounting system helps businesses to keep track and manage their financial transactions. That includes sales, purchases, assets and liabilities. Business accounting system is particularly helpful when you need to generate reports. As a business owner you probably already know that proper data reports impact greatly the process of decision making. In the past all data were gathered manually. Luckily today we are living in a computerized age. And that allows us to store the financial records easily. Now you can enter all the data, change them and interpret simply by logging into your accounting system on your computer or mobile phone. The past, loads of manual calculations, would be involved to balance out the ledgers

An accounting system allows a business to keep track of all types of financial transactions, including purchases (expenses), sales (invoices and income), liabilities (funding, accounts payable), etc.

1.3.5. Deductible and non-deductible expenses in calculating taxable income

Allowable deductions (Deductible expenses) In accordance with income tax proclamation 979/2016 and regulation Article 8 the following expenses shall be deductible for gross income in calculating taxable income.

- The direct cost of producing the income such as the direct cost of manufacturing,
 - purchasing, importations, selling and such other similar costs;
 - General and administrative expenses connected with the business activity;
 - Premiums payable on insurance directly connected with the business activity;
 - Expenses incurred in connection with the promotion of the business inside and outside the country, subject to the limits set by the directive issued by the minister of Revenue
- Commissions paid for services rendered to the business provided. If the tax authority has reason to consider that the total amount of salaries and other personal emoluments payable to the manager or managers of a private limited company is exaggerate it may reduce the

said amount for taxation purposes to the limit which, in view of operations of the company, appears justifiable, either by disallowing the payments made, or in any other way which may be just and appropriate.

- Sums paid as salary, wages or other emoluments to the children of the proprietor or member of the partnership shall only be allowed as deduction if such employees have qualification required by the post.
- Deductible interest - payable on loan of interest tax is paid on the rate of interest specified in proclamation 286/2002 shall be allowed as deductible if it is paid; - To lending institutions recognized by the national bank of Ethiopia, - To foreign banks permitted to lend to enterprises in Ethiopia; - Interest paid to foreign banks may only be deductible upon fulfilling; - Interest in excess of the rate used between the National Bank of Ethiopia and the commercial banks increased by two (2) percentage points.
- The lending bank shall, prior to the granting of any loan to pay such person, file a declaration in writing with the tax authority wherever it informs said authority concerning all loans granted to any person liable to pay income tax in Ethiopia
- The borrower shall withhold 10% from gross interest payable to the lender and transfer it to the tax authority within two months of the end of the fiscal year.
- Conditions for deducting gifts and donations Gifts and donations shall be allowed as deductions on the following conditions:
 - If the recipient of the donation is registered as welfare organization and where it is certified by the registering authority that the organization has record of outstanding achievement and its utilization of resources and accounting system operates with transparency and accountability;
 - If the contribution is made in response to emergency call carried by government to defend the sovereignty and integrity of the country, to prevent man made or natural catastrophe, epidemic or for any other similar cause;
 - Donation made to non-commercial education or health facilities
 - Grant and donation allowed as deduction where the amount of the donation or grant does not exceed 10% of taxable income of the taxpayers. Here, we can see a loophole because taxable income of the taxpayer is vague (it doesn't clearly show whether it is after or before the donation) Depreciation allowance Depreciation

allowance shall be granted only to taxpayers who keep satisfactory records showing.

- The date and cost of acquisition of the asset;
- The total amount deducted for depreciation since the date of acquisition
- Reinvestment of profit of a resident share company or registered partnership may only be allowed as deduction is an amount not exceeding 5% of the taxable income of each accounting year
- If the taxpayer transfers the share or capital contribution in respect of which deduction was allowed, the amount deducted shall be part of the taxable income of the accounting year in which the transfer was affected and shall be taxed as such.
- Purchase of shares and capital contribution made between related persons shall not be allowed as deduction.
- Deductible bad debts Bad debt is considered as deductible for tax purpose if the following conditions are fulfilled.
 - i. An amount corresponding to this debt was previously included in the income.
 - ii. The debt is written off in the book of the taxpayer and
 - iii. Any legal action to collect the debt has been taken but the debt is not recoverable.
- Special Reserves for finance institution in the determination of taxable business income of finance institutions, a deduction shall be allowed for special (technical) reserves in accordance with the directives issued by the national bank of Ethiopia. The business income, however, shall be increased by the amount drawn from such reserves.
- Trading stock for the purpose of ascertaining the income of a person for a tax period from a business, there shall be deduction of the cost of trading stock of the business disposed of by that person during that period.

2.1.2 Non-deductible expenses (non-allowable deductions)

The following are non-deductible expense in taxable income computation.

- A.** The cost of acquisition, improvement, renewal and reconstruction of business assets that are depreciated pursuant to Proclamation 286/2002, Article 23 of the proclamation;
- B.** An increase of the share of capital of a company or the basic capital of a registered partnership;
- C.** Voluntary pension or provident fund contributions over and above 15% of the monthly salary of the employee;
- D.** Declared dividends and paid out profit shares;
- E.** Interest in excess of rate used between the national Bank of Ethiopia and the commercial banks increased by two (2) percentage points;
- F.** Damages covered by insurance policy;
- G.** Punitive damages and penalties;
- H.** The creation or increase of Reserves, provisions and other special - purpose funds unless otherwise allowed by this proclamation;
- I.** Income tax paid on schedule C income and recoverable Value Added Tax;
- J.** Representation expenses over and above 10% of the salary of the employee;
"Representation allowance" shall mean hospitality expenses incurred in receiving guests coming from outside of the enterprise in connection with the promotion and enhancement of the business.
 - i. Personal consumption expenses;
 - ii. Expenditures exceeding the limits set forth by the proclamation or regulations issued here under;
- K.** Entertainment expenses, "Entertainment" means the provision of food, beverages, tobacco, accommodation, amusement, recreation or hospitality of any kind to any person whether directly or indirectly.
- L.** Donation or gift:
 - A.** If the recipient of the donation is not registered as welfare organization and/or organization hasn't record utilization of resources and accounting system operates with transparency and accountability;

- B.** If the contribution is made in response to emergency call carried by government and such donation or grant is exceeding 10% of taxable income of the taxpayers.
- M.** Sum paid as salary, wages or other personal emolument to the proprietor or partner of the enterprises;
- N.** Expenditure for maintenance or other private purpose for persons mentioned above;
- O.** Losses not connected with or not arising out of the activities of the enterprise;

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

- a. Awards for adopted or suggested innovations and cost saving measures, and
- b. Public awards for outstanding performance in any field.
- c. Income specifically exempted from income tax by the law in force in Ethiopia, by international treaty or by an agreement made or approved by the Minister.
- d. The revenue obtained by:
 - i. The Federal, regional and local Governments of Ethiopia;
 - ii. The National Bank of Ethiopia. From activities that are incidental to their operations shall be exempt from tax on Schedule C income.

2.2. Records to Comply with Lodgments

Every entity must keep and maintain accounting records that support the existence, completeness, and accuracy of its financial reporting. Accounting records should include enough detail to support the recorded transactions, events, or circumstances.

Just as individuals need to report their earnings for tax return, so does your business, even if there is no tax to pay.

The tax returns you need to lodge and when you need to lodge will depend on your business structure.

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Business structure	Declare	Due date
Sole trader (can be known as an individual in business or working for yourself)	Your business income in your individual tax return.	31 October unless you lodge through a registered tax agent*
Partnership	Your share of the partnership income in your individual tax return. The partnership itself will also need to lodge a partnership return.	Both returns are due by 31 October unless you lodge through a registered tax agent*
Trust	Any trust distribution you receive in your individual tax return. The trust will also need to lodge a trust return.	Both returns are due by 31 October unless you lodge through a registered tax agent*.
Company	Any salary or wages you receive, including any other payments such as director's fees or income from dividends, in your individual tax return. The company will also have to lodge a company tax return.	<p>If you don't lodge through a registered tax agent</p> <ul style="list-style-type: none"> Individual tax returns are due by 31 October. Company tax returns are generally due by 28 February each year.

2.3. Lodgment Schedule

The lodgment program helps you manage your workload by allowing progressive lodgment of your clients' obligations over the 12-month period.

You can access the lodgment program from website. Check out the due dates by month for a snapshot of what's coming up. The lodgment due date for tax returns for taxable large and medium entities is set in different times. This includes the associated schedules and reports. This date will be updated in the systems soon. There is no change to the payment due date.

Tips to prepare for tax time

To prepare for tax time, it is recommending that:

- Update your client list to add new clients or remove those you no longer represent.
- check your clients' lodgment program due dates in *Online services for agents*
- Lodge prior year tax returns to receive 2023 due dates. It can take up to 3 weeks for due dates to update in our systems after you lodge prior year returns, so there's no need to request a deferral in the meantime.
- Advise us when a return is not required or if further returns are not necessary, so we can update our records.

Participation deduction

If the taxpayer transfers the share or capital contribution in respect of which deduction was allowed, the amount deducted shall be part of the taxable income of the accounting year in \ which the transfer was affected

and shall be taxed. Purchase of shares and capital contributions made between related persons shall not be Allowed as deductions.

Loss carry forward

Depreciation shall be transferred when the Tax Authority accepts the described book account.

If the determination of taxable business income results in a loss in a tax period, that loss may be set of against taxable income in the next three periods, earlier losses being set off before later losses.

If, during a tax period, the direct or indirect ownership of the share capital or the voting rights of a body changes more than twenty-five percent (25%), by value or by

Number, the loss is set off against taxable income is on that period and the previous period.

A net operating loss may be carried forward and deducted only for two periods of three years.

Depreciation

As time passes, all plant assets with the exception of land lose their capacity to yield services. Accordingly, the cost of such assets should be transferred to the related expenses accounts in an orderly manner during their expected useful life. This periodic cost expiration is called depreciation. For Financial Accounting purpose in determining the amount of depreciable cost that is to be recognized as periodic depreciation expenses, three factors need to be considered: the plant asset's

- A. Initial cost,
- B. Residual value, and
- C. Useful life.

A calendar month is ordinarily the smallest unit of time used to calculate depreciation expense and firms may recognize partial year depreciation. Firms may also use the four methods of depreciation: straight-line units of production, declining balance, and sum of the year's digits. For Tax Purpose in Ethiopia, pooling method is used for computer and ICT related equipment's, straight-line method for buildings and intangibles. **Residual value** is not taken into consideration in determining the depreciation expense rather the tax authority stated annual percentage to be used for determination of depreciation expense for each type of plant asset. There is no any article, which state on how to treat depreciation for partial year (That is, when a plant asset is placed in service at the partial year).

Fine art, antiques, jewelry, trading stock and other business assets not subject to wear and tear and obsolescence shall not be depreciating.

Depreciation for Income Tax

The acquisition or construction cost, and the cost of improvement, renewal and reconstruction, of buildings and constructions shall be depreciated individually on a straight-line basis at five percent (5%).

The acquisition or construction cost, and the cost of improvement, renewal and reconstruction, of intangible assets shall be amortized individually on a straight- line basis at then percent (10%).

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The following two categories of business assets shall be depreciated according to pooling system at the following rates:

- a. Computers, information systems, and software products and data storage equipment: twenty-five (25%)
- b. All other business assets: twenty percent (20%)

In each category of plant asset, the rate of depreciation specified is applied to the depreciation base of the category. The depreciation base shall be the book value of the category as recorded in the Opening balance sheet of the tax period:

Increased by the cost of assets acquired or created and the cost of improvement, renewal and reconstruction of assets in the category during the tax period.

Decreased by the sales price of assets disposed of and the compensation received for the loss of assets due to natural calamities or other involuntary conversion during the tax period.

If the depreciation base is a negative amount, that amount shall be added to taxable profit and the depreciation base shall become zero.

If the depreciation base does not exceed Birr 1,000, the entire depreciation base shall be a deductible business expense. If a revaluation of business assets taken place, no depreciation shall be allowed for the amount of the revaluation. In determination of taxable business income, a deduction is permitted in respect of each category of business assets for the maintenance and repairing expenses of business assets belonging to that category for the actual amount of the expenses, but not in excess of twenty percent (20%) of the depreciation base of the category at the end of the year. Any actual expenses exceeding this twenty percent (20%) shall increase the depreciation base of that category.

Depreciation base used for pooling system is as follows:

Example #1

The following information is obtained from Almaz Private Limited Company.

The book value of a pool of computer in the opening balance sheet of the tax period as of Hamle 1,1997 was birr 150,000

During the year 1998:

Almaz bought data storage equipment for birr 75,000, software products for birr 50,000.

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The existing computer was upgraded and renewed for birr 12,000.

Almaz has also received birr 15,000 as compensation from Haron computer, supplier, since some of the storage equipment is non-functional.

Almaz sold two old computers and received birr 8,500

Required: Determine,

Base of computer pooling system to compute depreciation expense.

A. Depreciation expense for the year ended Sene 30, 1998.

B. Record the journal entry for depreciation expense?

The depreciation base shall be the book value of the category as recoded in the opening balance sheet of the tax period:

Increased by the cost of improvement renewal and reconstruction of assets in the category during the tax period.

Decreased by the sales price of assets disposed of and the compensation received for the loss of assets due to natural calamities or other involuntary conversion during the tax period.

Thus, depreciation base is computed as follows:

Beginning book value:		Br. 150,000	
Add: Additions during the period:			
Storage equipment:		75,000	
Software products:		50,000	
Upgrading cost:		12,000	137,000
Subtotal			287,000
Less: Compensation:	15,000		
Cash proceeds from selling	8,500		(23,500)
Depreciation base for taxation:	-		263,500

Computers and its accessories depreciated according to a pooling system at 25% tax rate.

Therefore, depreciation expense for the year 1998 would be $25\% \times 263,500 = \text{birr } 65,875$

Journal entry to record depreciation expense for the year is:

Depreciation expense	65,875
Accumulated depreciation	65,875

Example #2

The following information is obtained from Chena Private Limited Company.

1. The book value of a pool of computer in the opening balance sheet of the tax period as of Hamle 1, 1997 was birr 5,000.

During the year 1998:

- The existing computer was upgraded and renewed for birr 3,000.
- Chena sold two old computers and received birr 7,100

Required: Determine,

1. Base of computer pooling system to compute depreciation expense.
2. Depreciation expense for the year ended Sene 30, 1998.
3. Record the journal entry for depreciation expense.

Solution

Beginning book value:	Br. 5,000
Add: Upgrading cost:	3,000
Subtotal	8,000
Less: Cash proceeds from selling	7,100
Depreciation base for taxation:	900

Article 23(9) stated that if the depreciation base does not exceed Birr 1,000, the entire depreciation base should be a deductible business expense. Thus, the whole amount of 900 Birr is depreciation expense of the year. Depreciation Expense 900

Example #3

Ato Gashaw Yazachew, tax expert in FIRA, reviewed FAST Private limited company's books of account and found the following information:

Income before tax of birr 15,000 as of the year ended Sene 30,1998;

The book value of a pool of computer in the opening balance sheet of the tax period as of Hamle 1,1997 was birr 25,000.

During the year 1998:

FAST bought data storage equipment for birr 5,000, software products for birr 3,000.

FAST has also received birr 29,000 as compensation for Haron computer, supplier, since some of the storage equipment are non-functional.

FAST sold two old computers and received birr 4,500

Required: Determine,

1. Base of computer pooling system to compute depreciation expense.
2. The correct taxable income for the year ended Sene 30, 1998.

Solution

Beginning book value: Br. 25,000

Add: Additions during the period

Storage equipment: 5,000

Software products: 3,000 8,000

Subtotal 33,000

Less: Compensation: 29,000

Cash proceeds from selling 4,500 33,500

Depreciation base for taxation: (500)

Income tax Proclamation 286/2002, Article 23(8) stated that if the depreciation base is a negative amount, that amount shall be added to taxable profit and the depreciation base shall become zero. Thus, the depreciation base is zero. The taxable amount would be birr 15,500 (i.e. $15,000 + 500$).

Example # 4

The following information is obtained from Alpha Private Limited Company.

The book value of a machinery in the opening balance sheet of the tax period as of Hamle 1, 1997 was birr 90,000.

On Tikmet 15, 1998 Alpha sold an old machine and received birr 2,000.

On Ginbot 21, 1998 the existing machinery maintained and repaired for birr 30,000

Required: Determine,

Depreciation base of the machinery.

How much of the maintenance and repairing expense is reported as an expense for the period?

Depreciation expense for the year ended Sene 30, 1998.

Record the journal entry for depreciation expense.

Solution

Beginning book value: Br. 90,000

Less: Cash proceeds from selling 2,000

Subtotal: 88,000

Alpha has incurred birr 30,000 for Maintenance and repairing. However, Article 23(11) stated that in determination of taxable business income as deductions is permitted in respect of each category of business assets for the maintenance and repairing expenses of business assets belonging to that category for the actual amount of the expenses, but not in excess of twenty percent of the depreciation base of the category at the end of the year. Any actual expenses exceeding this twenty percent shall increase the depreciation base of that category. Thus, 20% of 88,000 which is birr 17,600 has to be recorded as repairing and maintenance expense; and the

remaining birr 12,400 has to be added back of depreciation base. In other words, the total 30,000 birr has to be split into two and shall record 17,600 birr as an expense and the remaining 12,400 birr as an asset. Hence, depreciation base of the machinery is:

Beginning book value:	Br. 90,000
Less: Cash proceeds from selling	2,000
Sub Total:	88,000
Add: Excess from maintenance and repairing cost	12,400
Depreciation base for taxation:	100,400

The machinery is depreciated at 20% tax rate, thus, Deprecation expense for the year would be birr 20,080 (i.e. 20% x 100,400)

3.2 SELF – CHECK – II

Part-I. Choose

Choose the |Best Answer from the Given Alternatives

1. Which is subject to transfer tax?
 - a) Sale
 - b) Barter
 - c) Complex transfers
 - d) Sale and Complex Transfers
2. Who is subject to transfer tax? C
 - a) Transferor
 - b) Transferee
 - c) Both transferor and transferee
 - d) None of the choices is correct
3. Which is taxable on all transfers regardless of location? D
 - a) Resident citizen
 - b) Resident alien
 - c) Non-resident citizen
 - d) All of the choices are correct
4. Estate tax is _____. A
 - a) A property tax because it is imposed on the property transmitted by the decedent to his heirs
 - b) An indirect tax because the burden of paying the tax is shifted on the executor or any of the heirs of the decedent
 - c) An excise tax because it is imposed on the privilege exercised by the decedent to transfer ownership over the estate
 - d) A poll tax because it is also imposed on residents of the Philippines whether Filipino citizen or not
5. Statement 1: Decedent is the person whose property is transmitted through succession, whether or not he left a will.
Statement 2: Heir is the person called to the succession, either by the provision of a will or by operation of law. C
 - a) Only statement 1 is correct
 - b) Only statement 2 is correct
 - c) Both statements are correct
 - d) Both statements are incorrect
6. Statement 1: Notarial will is a will that is entirely written, dated and signed by the testator. Statement 2: Compulsory heirs will inherit the properties of the decedent with or without a will. B
 - a) Only statement 1 is correct
 - c) Both statements are correct

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- b) Only statement 2 is correct

- d) Both statements are incorrect

- c) Statement 1: Estate tax is an excise tax because the object of which is the shifting of economic benefits and enjoyment of property from living to the dead.

8. Statement 2: Upon effectivity of the TRAIN Law, estate tax is a proportional tax. It is no longer based on a graduated tax rate but to a fixed rate of 6% based on the net income of the decedent. C

- d) Only statement 1 is correct

- c) Both statements are correct

- e) Only statement 2 is correct

- d) Both statements are incorrect

9. Statement 1: The taxpayer in estate tax is the estate as a juridical entity.

Statement 2: Estate tax accrues from the moment of death of the decedent. B

- f) Only statement 1 is correct

- c) Both statements are correct

- g) Only statement 2 is correct

- d) Both statements are incorrect

10. Statement 1: In a revocable transfer, the decedent was motivated by the thought of death to transfer the property.

Statement 2: In a transfer in contemplation of death, the decedent reserves for himself the power to alter, amend, revoke or even terminate such transfer. D

- h) Only statement 1 is correct

- c) Both statements are correct

- i) Only statement 2 is correct

- d) Both statements are incorrect

Part-II. True-False Part

Write True if the Statement is true and false if the statement is not true.

- _____1. Awards of a given firm are taxable incomes.

- _____2. If the recipient of the donation is not registered as welfare organization.

- _____3. Voluntary pension or provident fund contributions over and above 15% of the monthly salary of the employee is not taxable.

- _____4. Residual value is taken into consideration in determining the depreciation expense for tax purpose.

Part-III: Short Answer

Give Short Answer for the following questions

1. Write the three elements to calculate Depreciation

i. _____

ii. _____

iii. _____

2. Elaborate how depreciation is calculated for tax purpose

3. How Loss Carried forward is treated in taxation? Explain

UNIT THREE: TAX RETURNS AND LODGEMENTS

This unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Required Returns and lodgments
- Processing accounting data
- Review Returns and lodgments

This unit will assist you to attain the learning outcomes stated in the cover page. specifically, upon completion of this Unit, you will be able to:

- Identify required returns and lodgments
- Process Accounting data
- Review returns and lodgments

3.3 Required Returns and lodgments

Lodgment Management is a sub-domain of Obligation Management (OBLMGT). This page contains information and art effects for Digital Service Providers (DSPs) who have or are interested in developing web services that enable a business or their intermediary to manage their lodgment obligations to the ATO (Australian Tax Office). The services described below are only deployed on the SBR ebMS3 platform.

For ease of use, services have been organized into the following business processes:

- **Lodgment obligations** – Allows users to notify the ATO that an income tax return is not necessary for a given year or into the future.
- **Seek a ruling** – Allows users to submit a request for a Private Ruling on a tax matter.
- **Lodgment progress and outcome** – Allows users to view the progress of return(s)/lodgment(s), with a separate service allowing access to the outcome details for issued individual assessments and supporting validation of the ATO processing against what was lodged.

The ATO provides a number of common art effects and reference documents to support DSPs (such as the ATO Service Registry and the ATO Service Support Versioning Strategy). These can be found [here](#).

Lodgment obligations

Service Name: Lodgment Not Necessary (LDGNN)

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Service Version	0002.2021				
Service Actions	Submit – Allows for the submission of a Non Lodgment Advice (NLA) for Income Tax Returns or Taxable Payment Annual Reports where a return or report is not necessary for a given year or into the future.				
Name	Version number	Status	Size	Published date	
ATO LDGNN.0002 2021 Package v1.0 Contents (DOCX)External link	1.0	Final	208KB	23	September 2021
ATO LDGNN.0002 2021 Package v1.0 (ZIP)	1.0	Final	669KB	23	September 2021

Service Name: Client Update Return Not Necessary (CURNN)

Service Version	0002.2016				
Service Actions	Lodge (submit) – Allows an intermediary to notify the ATO if a client is no longer required to lodge a tax return for specified year/s (return not necessary – RNN) or from a specified year (further return not necessary – FRNN).				
Name	Version number	Status	Size	Published date	
ATO CURNN.0002 2016 Package v1.7 Contents (DOCX)	1.7	Final	220KB	1	September 2022

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Seek a ruling

Service Name: Private Ruling (PR)

Service Version	0001.2015				
Service Actions	Submit — Allows for submission of a Private Ruling (PR) application behalf of a client or a group of clients along with up to six unstructured attachments (each up to 10MB in size) to support the application.				
Name	Version number	Status	Size	Published date	
ATO PR.0001 2015 Business Implementation Guide (DOCX)	1.1	Final	251KB	16	November 2017
ATO PR.0001 2015 Package v1.4 Contents (DOCX)	1.4	Final	244KB	20	September 2018
ATO PR.0001 2015 Package v1.4 (ZIP)	1.4	Final	315KB	20	September 2018

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Lodgment progress and outcome

Service Name: Lodgment Progress (LDGPROG)

Service Version	0001.2017				
Service Action	List – Provides details of the progress of an income tax return(s)/lodgment(s).				
Name	Version number	Status	Size	Published date	
ATO LDGPROG 0001.2017 Business Implementation Guide (DOCX)	1.2	Final	257KB	19	March 2020

Name	Version number	Status	Size	Published date
ATO LDGPROG.0001 2017 Package v.1.1 Contents (DOCX)	1.1	Final	196KB	21 May 2020
ATO LDGPROG.0001 2017 Package v1.1 (ZIP)	1.1	Final	1.1MB	21 May 2020

Service Name: Lodgment (LDG)

Service Version	0005.2023			
Service Actions	List – Provide tax agents, business intermediaries and business a list of the client's expected and received lodgments. The information returned includes, but is not limited to: Financial Year, Lodgment Status, Period Status, Form types, Lodgment due dates, Payment Due Dates and Lodgment Received Dates.			
Name	Version number	Status	Size	Published date
ATO LDG 2023 Package v1.0 Contents (DOCX)	1.0	Final	203KB	13 April 2023
ATO LDG 2023 Package v1.0 (ZIP)	1.0	Final	2.0MB	13 April 2023
ATO LDGMENT Business Implementation Guide (ZIP)	1.0	Final	150KB	1 June 2023

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Name	Version Number	Status	Size	Published date
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Name	Version Number	Status	Size	Published date
ATO LDG 2019 Package v1.7 Contents.docx	1.7	Final	202KB	14 September 2023
ATO LDG 2019 Package v1.7.zip	1.7	Final	1.5MB	14 September 2023

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Service Name: Assessment (ASMT)

Service Version	0003.2018				
Service Actions	<p>List – Returns a list of issued individual assessments for the nominated client, account and/or periods.</p> <p>Get – For a specific assessment, this interaction will return the assessment details that determined the assessment outcome, and details of fields that have been adjusted. In addition to the 2016 and 2017 financial year, assessment outcome details for the 2018 and 2019 financial years (including early lodgers for the 2020 financial year) are returned.</p>				
Name		Version number	Status	Size	Published dated
ATO ASMT.0003 2018 Business Implementation Guide (DOCX)		1.1	Final	243KB	26 March 2020
ATO ASMT.0003 2018 Package v1.7 Contents (DOCX)		1.7	Final	214KB	13 April 2023
ATO ASMT.0003 2018 Package v1.7 (ZIP)		1.7	Final	937KB	13 April 2023

Name	Version number	Status	Size	Published date
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Name	Version number	Status	Size	Published date
SBR ebMS3 Web Services Implementation-Guide (DOCX)	1.7	Final	1.96MB	14 December 2017
SBR ebMS3 SDK Developer Guide (DOCX)	1.4	Final	1.87MB	13 August 2020

3.4 Processing accounting data

Processing accounting data involves calculations, classification, summarization, and consolidation. In manual accounting systems, this processing occurs through the established manual methods and the recording, posting, and closing steps in the journals and ledger.

Six stages of data processing

- Data collection. Collecting data is the first step in data processing. ...
 - Data preparation. Once the data is collected, it then enters the data preparation stage.
 - Data input. ...
 - Processing. ...
 - Data output/interpretation. ...
 - Data storage. ...
 - Become a data processing master.
- HOPE Share Company prepared income statement for the year ending Sene 30, 1998 for financial accounting purpose. In preparing such statement the company followed General Accepted Accounting Principles (GAAP). The company used accrual basis of accounting and LIFO method of inventory costing.

Hope Share Company

Income statement

For the year ending sene 30, 1998

Net sales	Br.450, 000
Less: cost of sales	150, 000
Gross profit	300,000
Operating expenses:	
Salaries and employee's benefits	83,000
Representative expenses	2,500
Donation	25,000
Promotion expenses	15,000
Amortization expenses	6,000
Stock obsolescence expense	4,500
Court fines (penalties)	2,500
Depreciation expense – building	10,000
Depreciation expense – machinery	8,500
Total operating expenses	157,000
Earnings before interest and income	143,000
Interest expense	93,000
Earning before tax	50,000
Income tax (30 %)	15,000
Net income	35,000

Additional information

Ato Solomon, tax expert in tax authority, reviews Hope's share company books and has the following information:

Donation includes birr 20,000 given as a gift to the emergency called by the government to protect epidemic diseases; and birr 3000 given for political parties; birr 2,000 given for Ato Abebe, who has been guest in television talk show.

- The cost of goods sold would have been birr 110,000 if the weighted average methods of inventory costing method is used.
- Amortization expense includes; 2,000 birr for amortization of patent; and birr 4,000 for good will.
- Salaries and employee's benefits include an employer 20% provident fund contribution to all its permanent employees. The total basic salary of permanent employees for the given tax year is birr 60,000.
- The company is paid birr 500 for each day to the chief accountant, Ato Bekele as a representation fee while he attends meeting 5 days held in Hilton Addis. His basic salary is birr 3,500.
- The company had a bad debt expense of birr 2,000, which is written off to the debtor and legal action to collect the debt has been taken but the debt is not recoverable. The company did not consider it in determination of income by considering it as un-deductibles.
- The company incurred a loss of birr 5,000 in the year ended 1997.
- Promotion expense includes: birr 5,000 for television advertisement, birr 2,500 for billboard advertisement and birr 7,500 for personal entertainment expense. The company is paying its bank loan that obtained from commercial bank of Ethiopia at an average of 7.5% annual interest rate. The unpaid outstanding bank loan at the beginning of the period was birr 600,000. The company has also paid interest expense for Ato melaku Belay, one of shareholders, at 12% annual interest on loan of birr 400,000.

- Depreciation expense for buildings and machinery is calculated in harmony with Ethiopian tax provisions.
- The total amount of share capital is birr 2,000,000.

Required:

Prepare an income tax return (income statement for tax purpose) in accordance with the provisions of income tax proclamation 286/2002.

Solution

There are two methods to prepare an income tax return or income statement for tax purpose. First method: the first method is that only make an adjustment for the income statement that is provided in the question by adding or subtracting the allowable revenue and expenses respectively. This means that start from the sales add if there is any income taxed under this schedule and subtract the allowable or deductible portion of cost of goods sold and operating Expense. This can be illustrated as follows.

Hope Share Company

Income statement

For the year ending sene 30, 1998

Net sale	Br. 450,000
Less: Cost of goods sold	110,000
Gross profit	340,000
Operating expenses:	
Salaries & employee's benefits	80,000
Representative expense	1,750
Donation	20,000
Promotion expense	7,500

Amortization expense	2,000	
Stock obsolescence expense	0	
Court fines (Penalties)	0	
Bad debt expense	2,000	
Depreciation expense - building	10,000	
Depreciation expense - Machinery	8,500	
Total operating expense		131,750
Earnings before interest and tax:		208,250
Interest expense:	83,000	
Earning before tax:		125,250
Loss carry forward (1997)	5,000	
Taxable income		120,250

Ways of Computation of deductible expenses:

D Cost of goods sold:

The inventory costing method which is allowed for tax purpose is weighted average method. Thus, the amount of cost of goods sold birr 110,000, which is calculated based on such weighted average method has to be used. Salaries and employees benefit: Pension contribution, provident fund and all forms of retirement benefits contributed by employers in an amount that does not exceed 15% (fifteen percent) of the monthly salary of the employee is deductible. Thus, the extra 5% employer provident fund is not deductible.

$$\begin{aligned}
 \text{Salaries and employees benefit} &= 83,000 - 5\% \times 60,000 \\
 &= 83,000 - 3,000 \\
 &= 80,000
 \end{aligned}$$

Representative expense:

A representation expense over and above 10% of the salary of the employee is not deductible. Therefore, deductible representative expense = $10\% \times 3,500 = \text{Birr } 350$. The excess birr 150 (i.e. $500 - 350$), which is paid to Ato Bekele is not deductible. Thus, the representative expense that is allowed as deductible is birr 1,750 (i.e. $\text{Birr } 350 \times 5 \text{ days}$).

Interest expense:

Interest expense paid for the bank in the tax year = Unpaid balance of the loan x tax rate

$$= 7.5\% \times 600,000$$

$$= 45,000$$

And Interest expense paid for Ato melaku belay is at 12% yet Proclamation 286, Article 21 stated that interest paid to other creditors including shareholders can be considered as deductible only 2% in excess of rate used between the National Bank of Ethiopia and the commercial. Thus, the deductible interest expense is only 9.5% (i.e. $7.5\% + 2\%$) of unpaid balance. Deductible Interest expense paid to Ato melaku belay is: $9.5\% \times 400,000 = \text{Birr } 38,000$.

Deductible expenses that are allowed by tax authority are computed as follows:

Once again it is important to check whether such deductible interest expense paid to the shareholder is not exceeding the allowed amount under Article 21(3). Proclamation 286, Article 21(3) stated that Interest paid to shareholders on loans and advances shall not be deductible to the extent that the loan or advances in respect of which the interest paid exceeds on average during the tax period four times the amount of the share capital. The total deductible interest expense would be the sum of interest expense paid to Commercial Bank of Ethiopia and deductible interest expense paid to the shareholder (Ato melaku belay), which is birr 83,000

Donation:

Donation which is given for political parties and Ato Abebe is not deductible. However, the donation which is made for the emergency called by the government to protect epidemic diseases may be deductible if the donation is not exceeding 10% of taxable income and the

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taxable income become birr 120,250. The donation given for government is 16.63% (i.e. 20,000/120,250), however, tax authority allowed donation as deductible only 10%.

Second method: the second method is that by starting from the income before tax adjust for non-allowable and allowable portion of income and expenses as appropriate.

The following Steps can be used to illustrate the second method.

Preparation of financial statement

Income or loss per accounts before tax -----xx

Adjustments

Add:

(1) Expense included in the income statement but not deductible for tax purpose -----xx

(2) Income or profit taxable under schedule C but not incorporated in the account -----xx

Deduct

. Income included in the statement but not taxable under schedule C -----0-

4. Expense that was not included in the accounts but deductible for tax purpose

- Bad debt expense ----- 2,000

Income before tax ----- 125,000

Less: loss carried forward ----- 5,000

Income adjusted for tax purpose (taxable income) ----- 120,250

Note: both methods yield the same result and for the second method the explanation that is given for each account under method one can be used.

. Foreign tax credit

- If during the tax period a resident derives foreign source income, the Income Tax payable by that resident in respect of that income shall be reduced by the amount of foreign tax payable

on such income. The amount of foreign tax payable shall be substantiated by appropriate evidence such as a tax assessment, a withholding certificate or any other similar document accepted by the Tax Authority.

- However, the reduction of the Income Tax provided in (1) shall not exceed the tax payable in Ethiopia that would otherwise be payable on the foreign source income.
- In the case of a taxpayer subject to Income Tax on Schedule C income, any reduction of tax prescribed in (1) shall be limited to the tax that would otherwise be payable in Ethiopia computed as if Article 28 (loss carry forward) of Proclamation 286/2002 applied separately to each foreign country in respect of profit and losses derived from sources therein.
- The reduction of tax prescribed shall be calculated separately in respect of each foreign country from which income or profit is derived

3.2. Review Returns and Lodgments

Example 1

Dr. Mesafint Abera, a resident in Black lion hospital who specialized in Bio chemistry, teaches medical students for 12 lecture hours in Kenya and Botswana and derives the following income in the month of Tikmet 1998. His monthly basic salary in Black lion Hospital is birr 3,500.

Country	Gross income	Tax paid in abroad
Kenya	15,000 shilling	3,000 shilling
Botswana	21,000 Pula	8,000 Pula

He has also brought appropriate withholding certificate accepted by the Tax Authority for tax paid in abroad. The average exchange rates during the period were as follows:

1Birr = 8 Kenya shilling and 1 Birr = Botswana 0.7 Pula

Required: How much tax is expected from him on income brought from abroad?

Solution

The reduction of tax prescribed shall be calculated separately in respect of each foreign country from which income or profit is derived.

Country Gross income Tax paid in abroad

Kenya 15,000 shilling 3,000 shilling
= 1875 birr = 375 birr

Proclamation 286, Article 70 stated that a tax payer who derives income from different sources subject to the same schedule shall be assessed on the aggregate of such income. Hence, total gross income for the month is calculated his basic salary birr 3,500 plus gross Income obtained from Kenya birr 1875. The total gross income is birr 5,375. Total Income tax = (Gross taxable income) x Tax rate - deduction

$$= (5,375 \times 25\%) - 565$$

$$= 778.75$$

Income tax on his basic salary = (Basic salary) x Tax rate - deduction

$$= (3,500 \times 20\%) - 302.5$$

$$= 397.5$$

Income tax payable to Ethiopia Tax Authority on such foreign source (Kenya) income is

Calculated as follows:

Total income tax:	Birr 1,218.75
Less: tax paid on his basic salary	397.5
Income tax payable from foreign income	578.75
Less: tax paid in abroad;	375.00
Tax from foreign income	203.75

Country Monthly gross income Tax paid in abroad

Botswana 21,000 Pula 8,000 Pula

$$= 30,000 \text{ birr} = 11,428.57 \text{ Birr}$$

Total gross income for the month is calculated his basic salary birr 3,500 plus gross income obtained from Botswana Birr 30,000. The total gross income is birr 33,500.

Total Income tax = (gross taxable income) x tax rate - deduction

$$= (33,500 \times 35\%) - 662.50$$

$$= 11,062.50$$

Income tax on his basic salary = (Basic salary) x Tax rate - deduction

$$= (3,500 \times 25\%) - 235$$

$$= 640$$

Income tax payable to Ethiopia Tax Authority on such foreign source (Botswana) income is

Calculated as follows:

Total income tax;	Birr 11,062.50
Less: Tax paid on his basic salary	640.00
Income tax payable from foreign income	10,422.50
Less: Tax paid in abroad:	10,422.50

Tax from foreign income

The Income tax paid by resident in abroad shall be reduced by the amount of foreign tax Payable on such income. However, the reduction of the Income Tax provided shall not exceed the tax payable in Ethiopia that would otherwise be payable on the foreign source income.

Example #2

AAA enterprise, unincorporated business, a resident in Ethiopia derives the following income from the following countries in the current year.

Country	Annual Gross income	Tax paid in abroad
Sudan	655,000 Dinar	30,000 Dinar
Yemeni	30,000 Rial	8,000 Rial
Djibouti	500,000 Franc	25,000 Franc

The firm has also brought appropriate withholding certificate accepted by the Tax Authority for tax paid in abroad. The average exchange rates during the period were as follows: 1 Birr = 20 Djibouti franc = 24 Sudanese dinar = 22 Yemeni rial. In addition to income from abroad the firm reported taxable income of birr 100,000 **for operation with in the country.**

Required: How much tax is expected from the enterprise on income brought abroad?

Solution

Country	Annual Gross income	Tax paid in abroad
Sudan	655,000 Dinar	30,000 Dina
	= 27,291.67 birr	1,250 birr

Total gross income for the year is calculated the firm's annual profit birr 100,000 plus gross Income obtained from Sudan birr 27,291.67. The total gross income is birr 127,291.67.

$$\begin{aligned} \text{Total Income tax} &= (\text{Gross taxable income}) \times \text{Tax rate} - \text{deduction} \\ &= (101,363.64 \times 35\%) - 7,950 \\ &= 27,527.27 \end{aligned}$$

$$\begin{aligned} \text{Income tax on domestic income} &= (\text{taxable business income}) \times \text{tax rate} - \text{deduction} \\ &= (100,000 \times 35\%) - 7,950 \\ &= 27,050 \end{aligned}$$

Income tax payable to Ethiopia Tax Authority on such foreign source (Sudan) income is

Calculated as follows:

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Total income tax: Birr 27,527.27

Less: Tax paid on domestic income 27,050.00

Income tax payable from foreign income 477.27

Less: tax paid in abroad: 363.64

Tax from foreign income 113.63

Country gross income Tax paid in abroad

Djibouti 500,000 Franc 25,000 franc

= 25,000 birr = 1,250 birr

Total gross income for the year is calculated the firm's annual profit birr 100,000 plus gross income obtained from Djibouti birr 25,000. The total gross income is birr 125,000

Total Income tax = (Gross taxable income) x Tax rate - deduction

== 27,527.27

Income tax on domestic income = (taxable business income) x Tax rate - deduction

= (100,000 x 35%) - 7,950

= 35,800

Income tax payable to Ethiopia Tax Authority on such foreign source (Sudan) income is

Calculated as follows:

Total income tax: Birr 35,800.00

Less: Tax paid on domestic income 27,050.00

Income tax payable from foreign income 8,750.00

Less; tax paid in abroad: 1,250.00

Tax from foreign income 7,500.00

SELF – CHECK – III

Part-I-True –False

Write True for True Statement and False for False Statement

- _____ 1. The amount of foreign tax payable shall be substantiated by appropriate evidence.
- _____ 2. Provident fund contributed by employer above 15% of basic salary is non-taxable.
- _____ 3. Cost of Goods sold is non-deductible to determine taxable income.
- _____ 4. Collection of data is the second step in data processing.
- _____ 5. Data is processed only manually.

Operation Sheet

Title: To Calculate Business Tax Return

Resources Needed

- Paper
- Pen
- Calculator

Steps:

1. Identify Tax Period Sales
2. Differentiate deductible and non –deductible Expenses and Costs
3. Compute Gross Profit
4. Compute Total Deductibles
5. Differentiate the type of business firm
6. To Calculate Taxable Income
7. To Calculate Business Tax Return

Given Data

ABC Share Company prepared income statement for the year ending Sene 30, 2012 for financial accounting purpose. In preparing such statement the company followed General Accepted Accounting Principles (GAAP). The company used accrual basis of accounting and LIFO method of inventory costing.

Net sales	Br.850, 000
Less: cost of sales	250, 000
Salaries and employee's benefits	53,000

Representative expenses	4000
Donation	25,000
Promotion expenses	15,000
Amortization expenses	6,000
Stock obsolescence expense	4,500
Court fines	6000
Depreciation expense – building	16000
Interest expense	14000

Additional information

Ato Kasa , tax expert in tax authority, reviews ABC’s share company books and has the following information:

- ✓ Donation includes birr 20,000 given as a gift to the emergency called by the government to protect epidemic diseases; and birr 3000 given for political parties;
- ✓ The cost of goods sold would have been birr 80,000 if the FIFO methods of inventory costing method is used.
- ✓ Amortization expense includes; 2,000 birr for amortization of patent; and birr 4,000 for good will.
- ✓ Salaries and employee’s benefits include an employer 20% provident fund contribution to all it permanent employees. The total basic salary of permanent employees for the given tax year is birr 40,000.
- ✓ The company had a bad debt expense of birr 2,000, which is written off to the debtor and legal action to collect the debt has been taken but the debt is not recoverable. The company did not consider it in determination of income by considering it as un-deductibles.

Lap -Test Task-1-Calculate Gross Profit
 Task-2 Calculate Total Deductibles
 Task-3 Calculate Taxable Income
 Task-3 Calculate ABC Company Business Tax Return

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Developers' profile

No	Name	Qualification	Educational background	Region	College	Mobile number	E-mail
1	Kassa Terefe Gelaw	MA	Accounting & Finance	A.A.	Kirkos Manufacturing College	0993298301	kssterefe@gmail.com
2	Remedan Abdurehman	MBA	Accounting & Finance	A. A.	GENERAL WINGET PTC	0933233939	Rame.abdu10@gmail.com
3	Sewumehon Anteneh	MSC	Accounting & Finance	A. A	Kirkos Manufacturing College	0948032126	sewumehonanteneh@gmail.com
4	Aynabeba Zewdie	MA	Accounting & Finance	Oromya	Sebeta Polytechnic College	0911724881	Aynabebazewdie81@gmail.com
5	Ejigu Terefe	MA	Accounting & Finance	Oromya	Burayu PTC	0913440478	kenaketejigu@gmail.com