

Taxing Crime: The Application of Ethiopian Income Tax Laws to Incomes from Illegal Activities

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Abstract

In this article, the author argues that incomes from illegal sources are subject to the payment of income taxes in Ethiopia. The author has made an analysis of the definition of income provided in the income tax law and concludes that the definition of income in the Income Tax Proclamation is broad enough to include incomes from many sources including income from illegal sources. According to the law, in order to categorize an activity as an income, the presence of the economic benefit is the sole element that has to be considered. Even though incomes from illegal sources are in principle subject to the payment of the tax either according to schedule C or, alternatively, schedule D, various factors, specially, problems relating to the structure of the income tax, absence of suitable declaration forms, etc. may create difficulty in taxing the income. Therefore, in order to enable taxpayers to carry out their responsibility without incriminating themselves, the tax authority has to make amendments to its declaration form and other necessary formalities.

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Introduction¹

Al Capone, the world's best known gangster and public enemy number one, was quoted saying [t]he income tax law is a lot of bunk. The government can't collect legal taxes from illegal money'² after his sentence for tax evasion in relation to incomes that he generated from illegal liquor trade.

An income tax is one of the main sources for Federal and Regional Governments' revenues. As its name implies, an income tax is a tax on incomes, not on transactions. In this short article, the writer will try to identify the standing of the Ethiopian income tax laws in relation to incomes generated from illegal activities. If illegal activities are to be taxed, then the writer will identify the applicable schedules in order to tax the incomes. Furthermore, an identification of the rules governing deductions in relation to costs incurred in order to generate the illegal income shall also be made. The writer will also discuss some relevant issues such confiscation of benefits from crimes and the relationship between taxation and the prohibition of double jeopardy.

I. Taxing crime in Ethiopia

In some countries, courts permit taxation of incomes from illegal activities, this issue is a well-established tax principle in countries like USA, Canada, UK, Australia, New Zealand and Ireland.³

¹ This article exclusively deals with the Federal Income laws; nonetheless the discussion also applies to income tax laws by regional governments as well. The definition of income in regional tax laws is also the same.

² Alphonso ('Al') Capone, the notorious American crime boss, had escaped prosecution for his criminal activities but was convicted of tax evasion and received a custodial sentence. See *Capone v United States*, 56 F 2d 927 (1932).

³David Lusty, (2003),"Taxing the untouchables who profit from organized crime", Journal of Financial Crime,Vol. 10 Iss: 3 pp. 209, In USA, there are many court decisions supporting the fact that income from illegal activity should be tax. See *James v United*

Some scholars argue that taxing income from illegal sources will make government a silent partner in the illegal activities; therefore, the income must be free from tax and the criminal must be punished according to the criminal laws of the country.⁴ On the contrary, it is frequently argued that a dollar of profit from unlawful activity will buy just as much as a dollar of lawful profit; hence, the criminal should be subject to the same income tax principles applicable to those incomes considered lawful.⁵

In order to give a fair treatment of the issue, it is better to start first by explaining some important concepts. Accordingly, first we shall define income and then define taxable income as provided in the income tax laws and we shall finally identify the standing of Ethiopian income tax laws with respect to taxing income from illegal activities.

A. Definition of Income

Defining income is one of the trickiest problems in taxation of income. Broader definition of income will give tax administration an opportunity to

States (366 U.S. 213 (1961)). See also Bittker "Taxing Income from Unlawful Activities" (1974-1975) 25 Case W. Res. L. Rev. 130 at 136.), Commissioner of Internal Revenue v Glenshaw Glass Co. (348 U.S. 426 (1955)), United States v Mueller (74 F.3d 1152), Webb v IRS, USA (15 F.3d 203 (1st Cir. 1994)), Blohm v Commissioner of Internal Revenue (994 F.2d 1542 (11th Cir. 1993)), In UK, as can be seen from the following cases, the courts tend to argue that incomes from illegal activity are taxable *CIR v Delagoa Bay Cigarette Co Ltd* 1918 TPD 391 at 394; *Commissioner of Taxes v G* 1981 (4) SA 167 (ZA) 168C-169H; *CIR v Insolvent Estate Botha t/a 'Trio Kulture'* 1990 (2) SA 548 (A) 556-557; ITC 1545, 54 SATC 464 (C) 474-5; ITC 1624, 59 SATC (T) 373 at 377-8; *Minister of Finance v Smith* 1927 AC 193 at 197-8; *Mann v Nash (Inspector of Taxes)* 1932 1 KB 752 at 757-8; *Partridge v Mallandaine* (1886) 18 QBD 276.

⁴Warneke D & Warden D 'Fraudulent Transactions – Are the Receipts Taxable?' (2003) 17 *Tax Planning* 28, Bittker, Boris I., "Taxing Income from Unlawful Activities" (1974). *Faculty Scholarship Series*. Paper 2289. available at http://digitalcommons.law.yale.edu/fss_papers/2289 accessed on July 11, 2011

⁵ Stein M 'Tax on the Fruits of Fraud – A Tale of Two Cases' (1998) 12 *Tax Planning* 116, Ranjiana Gupta, 'Taxation of Illegal Activities in New Zealand and Australia' 3 *Journal of the Australasian Tax Teachers Association* (2008) 108, Celeste M Black, *Taxing Crime: The Application of Income Tax To Illegal Activities* (2005) 20 AUSTRALIAN TAX FORUM 440

collect revenues from as many revenue sources as possible while narrower definition of it is a negative to the public treasury as it curtails the taxation powers of the treasury to restricted fewer items recognized by the law as income. One of the issues relating to defining income is the identification of what an income itself is, for instance, a person with a 2000 birr may use the money in order to purchase a cloth, in this case, which one is the income, the money itself or the satisfaction that the person receives from purchasing and using the purchased cloth? According to Taussig only the latter can be considered income ‘all *income consists in the utilities or satisfactions created*’.⁶ Seligman concurs with this position when he said “*We desire things at bottom because of their utility. They can impart this utility only in the shape of a succession of pleasurable sensations. These sensations are our true income.*”⁷ Therefore, at least, for these two economists, an income is not the money itself rather the satisfaction that a person derives by using the money. Nonetheless, this definition of income is impossible to put into practice as it is difficult to assess these utilities of a person from consumption of a particular thing in financial terms. For instance how much is the benefit that a person gets from wearing his new cloth or living his newly built and furnished home. In this regard Haig argued that:

‘An individual, it is true, can compare the relative worth to him of a pipe or a book or a dinner and arrange his order of consumption without the use of any formal common denominator such as money. Yet this individual would have great difficulty in telling you exactly how much satisfaction he derived from his pipe or his book. **How much more difficult would it be for a second person to measure those satisfactions for him without the aid of some common unit!** [Emphasis mine]’⁸

⁶ Taussig H, Principles of Economics (1916)134

⁷ Seligman , Principles of Economics(1914)16

⁸ Robet Haig,The Concept of Income –Economic and Legal Aspects(1921)28

Therefore, as a solution Professor Taussig proposed that . . . *for almost all purposes of economic study, it is best to content ourselves with a statement and an attempt at measurement in terms not of utility but of money income.*⁹

Consequently, the definition of income suggested by many economists is this one: *'Income is the money value of the net accretion to one's economic power between two points of time'*. It will be observed that this definition departs in only one important respect from the fundamental economic conception of income as a flow of satisfactions. *It defines income in terms of power to satisfy economic wants rather than in terms of the satisfactions themselves. It has the effect of taxing the recipient of income when he receives the power to attain satisfactions rather than when he elects to exercise that power.*¹⁰

B. Definition of Income in Ethiopia

The Ethiopia income tax proclamation defines an income as:

every sort of economic benefit including nonrecurring gains in cash or in kind from **whatever source derived and in whatever form paid** credited or received.¹¹ [Emphasis added]

As can be seen from the above definition, the Ethiopian income tax law has defined an income in terms of benefits received, not actual money. Of course, for actual taxation purposes, these economic benefits have to be changed to money income.

When it comes to the source of income, according to the law the presence of an economic benefit is the most critical factor in determination of whether a

⁹ Taussig, cited above at note 6, 135

¹⁰ Robert Haig cited above at note 8, 29

¹¹ Income tax proclamation, 286/2002, See Art. 2(10).

particular activity suffices as an income or not. The law makes it crystal clear that the source and form of payment of the economic benefit is irrelevant in the determination of whether a particular benefit can be considered an income or not. Accordingly, the source of the income can be employment, business or winning lotteries. By the same token, the payment can be effected using cash or in kind. As long as persons receive economic benefits, then the benefits will be considered incomes.

According to this definition, incomes from illegal sources such as dealing with illegal narcotic substances, corruption, theft and others will be considered incomes. In all these cases, the persons carrying out the criminal activities will get economic benefits from the acts. By doing so, they fulfill the only requirement needed in order to categorize their benefits as an income.

C. Taxable Income

The other equally important concept in imposition of tax on income is the concept of taxable income. The concept of taxable income is an important concept as it effectively defines the income tax base for a tax period. This is because in income tax, the law aims to impose duty on economic benefits generated by a person. In this regard, the taxable income is the one that most precisely reflects person's increases in economic gains during the tax period. The general income simply defines the total economic benefit generated by the person without taking into consideration the actual costs incurred by the person in order to generate that income. The taxable income, on the other hand, takes into consideration the total expenses incurred by the person in order to generate the income. Thus, it precisely reflects the net worth derived by a person for a particular tax period.

The taxable income of a person for a tax period is commonly defined as the gross income of a person for the period less the total costs incurred by the person in order to generate the income. For that reason, in order to derive the taxable income, we must subtract all the expenses incurred in order to generate the gross income. The gross income as defined above is the total of amounts derived by a person during the period that is subject to tax. Our law has defined taxable income as “the amount of income subject to tax after deduction of all expenses and other deductible items allowed under the Proclamation”.¹²

D. Exempt Income

There will be amounts that are not to be included in gross income of the person. These amounts are commonly referred to as “exempt income”. Exempt incomes are not included in the gross income of a person and thus excluded from the calculation of taxable income.¹³

Tax laws may treat an income as exempt due to various reasons. First, an amount or an entity may be exempt for social reasons. An example of amounts that may be exempt on this basis is compensation payment in case of life insurance.¹⁴

Second, an amount may be exempt as a result of international convention, agreement, or practice.¹⁵ For example, a country that is a signatory of the Vienna Convention on Diplomatic Relations is obliged to exempt from tax the official employment income and foreign-source income of a foreign

¹² See art.2(11).

¹³ Chaturvedi and pithisaria’s, Income Tax Law (1998)654.

¹⁴ See for instance article 13(f) of the Income Tax Proclamation.

¹⁵ See art.13(c) (ii) of the Income Tax Proclamation.

diplomatic officer, consular officer, administrative or technical employee of a diplomatic mission or consulate, consular employee, member of the service staff of a diplomatic mission or consulate, or a private servant of a diplomatic mission.¹⁶

Third an amount may be exempt for political or administrative reasons. For instance, collecting a tax from persons working in domestic duties as servants and guards is difficult.¹⁷

Finally, an amount may be exempt as an incentive to encourage a particular activity.¹⁸ For example, the income of a retirement fund may be exempt from tax to encourage retirement savings.

E. Deductions

The other important concept in the determination of the tax base is the issue of deductions. The general principle in case of deductions stems from the general economic principle that it is not possible to generate an income without incurring costs or all outputs require inputs of some kind and deductions are costs incurred in order to purchase these inputs. In case of deductions, a general rule followed by supplementary definition and allowance provisions is the typical approach followed by most jurisdictions. The general rule commonly allows a deduction for expenses to the extent to which they are incurred in deriving amounts included in gross income.¹⁹ Supplemental provisions allow deductions for capital allowances such as

¹⁶ The Vienna Convention on Diplomatic relation 1961, see arts.32-36.

¹⁷ This income is also exempted in Ethiopia, see art.3 of the Income Tax Regulation.

¹⁸ See article 30 of the Income Tax Proclamation, with the intention of encouraging creativity the law exempts from the payment of tax the incomes generated in the form of award.

¹⁹ See art.20 of the Income Tax Proclamation.

depreciation and amortization provisions and as a tax incentive such as charitable donations and retirement fund contributions.²⁰

F. Structure of Income Tax

Two theoretical models exist for the structure of the personal income tax. The first one is a scheduler structure. According to this structure, incomes from different sources shall be grouped into different separate schedules and taxed separately. In this approach, each income under a different schedule shall be treated separately. The tax rate, exemptions, deductions, and, at times, mode and time of payment for each schedule shall be different. Incomes are classified into different schedules mainly by using the source of income as criterion.²¹ The second one is a global structure. According to this structure, a single tax is imposed on all income irrespective of the source of the income.²²

Ethiopia follows a scheduler approach and, according to Ethiopian Income Tax proclamation, all incomes are clustered into the following schedules:²³

- **Schedule ‘A’** – Income from employment
- **Schedule ‘B’** – Income from rental of buildings
- **Schedule ‘C’** – Income from business
- **Schedule ‘D’** – Other incomes including incomes from:
 - Royalties;
 - Income paid for services rendered outside of Ethiopia;
 - Income from games of chance;

²⁰ See art.11 of the regulation and art. 21(1) and art. 13 Income Tax Proclamation.

²¹ Lee Burns and Richard Krever, Individual Income Tax(1998)2.

²² Ibid.

²³ See art.8 of the Income Tax Proclamation.

- Dividends;
- Income from casual rental of property;
- Interest income; and,
- Specified non-business capital gains.

All incomes generated from sources other than employment, rental of building and business shall be taxed based on schedule D.

II. Categories of Taxpayers

Administrative convenience requires classification of taxpayers into different groups as it is not possible to extend the same treatment to all taxpayers at the same time. In addition, principle of economy also requires the tax system to concert tax efforts on those taxpayers with high revenue potential. For this purpose, taxpayers must be classified into different categories. Taxpayers are classified into three categories according to the annual turnover they generate during a particular tax year. The Ethiopian income tax law classifies taxpayers into three categories.²⁴ Book keeping, declaration of income and other obligations differ from the taxpayer to taxpayer depending on the category they belong to.

A. Category A Taxpayers

Category “A” taxpayers are composed of two groups. The first group comprises of those taxpayers whose annual turnover for a single tax year is 500,000 or more.²⁵ In addition, any company incorporated under the laws of Ethiopia is a category “A” taxpayer irrespective of its annual turnover.²⁶ The rationale for incorporating companies under category “A” irrespective of their

²⁴ See art. 18 of the Income Tax Regulation.

²⁵ Ibid.

²⁶ See art.18 (1) (a) of the Regulation.

annual turnover seems to dwell upon the idea that given the present local and international business environment by the time companies are established they must have at least 500,000 as a starting capital.²⁷

Category “A” taxpayers are required to keep books and accounts. The books and accounts, among other details, must include the following:²⁸

- Gross profit and the manner in which it is computed;
- General and administrative expenses;
- Depreciation;
- Provisions and reserves;
- Business asset and liabilities;
- Date lost of acquisition and the current book value of the good; and,
- All purchases and sales of goods and services related to the business activity.

Keeping books and accounts is a mandatory requirement for Category “A” taxpayers.²⁹ Consequently, failure to keep books and accounts shall result in the payment of an administrative penalty.³⁰ Accordingly, if the taxpayer fails to keep books and accounts for one year, it shall pay 20% of the tax assessed as an administrative penalty.³¹ If the taxpayer fails to keep proper books and accounts for consecutive two years, the license of the taxpayer will be

²⁷ According to the Commercial Code, the minimum capital requirement for a share company is 50,000 Birr while for a private limited company it is only 15,000 Birr. Nonetheless, for some businesses there are separate minimum capital requirements for instance for banks it is 500,000,000.

²⁸ See article 19 of the Income tax Regulation.

²⁹ Id.

³⁰ Article 89 of the Income Tax Proclamation.

³¹ Id.

suspended.³² Suspension of the license will force the taxpayer to be out of the business for the period during which the licenses is suspended. This penalty may extend to the extent of revoking the license of the taxpayer depending on the gravity of the act of the taxpayer.³³ In addition to administrative penalties, failure to keep books and accounts results in determination of the tax liability of the taxpayer through estimation.³⁴ The books and accounts kept by the taxpayers will later be used as a means to determine their tax liability for the tax period.

B. Category “B” Taxpayers

Category “B” taxpayers are those taxpayers with annual turnover greater than 100,000 but less than 500,000 Ethiopian Birr.³⁵ Like category “A” taxpayers’, category “B” taxpayers are also required to keep proper books and accounts.³⁶ Nevertheless, the books and accounts to be kept by category “B” taxpayers are less complicated compared to category “A” taxpayers.³⁷ Thus, they are required to keep an account incorporating mainly profit and loss statements for the particular tax year.³⁸ Their income tax liability will be assessed based on the books and accounts kept by the taxpayers. The same administrative penalties apply if Category “B” taxpayers fail to keep books and accounts.

C. Category “C” Taxpayers

Category “C” is the third and the last category. Small businesses are the main types of businesses included in this category. All taxpayers with annual

³² See article 89(1)(a) of the Income Tax Proclamation.

³³ Id. art.89 (1) (b).

³⁴ Id. Article 69(1).

³⁵ See art.18 (2) of the Income Tax Regulation.

³⁶ Id. art.19 (2).

³⁷ Id.

³⁸ Id.

turnover income less than 100,000 Birr are grouped as category “C” taxpayers.³⁹ This category of taxpayers is not required to keep books and accounts. Their income tax liability shall be determined through a special procedure known as presumptive taxation.⁴⁰

With this in mind, we can now proceed and discuss the issue of taxing income from illegal sources in Ethiopia.

III. Modes of Taxing Income from Illegal Sources in Ethiopia

To start with, in Ethiopia, incomes from illegal sources can be taxed either as income from business or as other income. We will discuss these two possibilities in this section.

A. Income from illegal sources as a business income

As identified above, the Ethiopian tax system follows a scheduler structure. As a result, in order to levy tax on a particular item one must first identify the applicable schedule for that particular income. Regarding income from illegal activities, the activity itself has not been clearly designated in any of the schedules as an income. However, given the nature of the activity, we can consider it as business, business as defined in article 2(6) of the proclamation. The income tax proclamation has defined business as “any industrial, commercial professional or vocational activity or any other activity recognized as trade by the Commercial Code of Ethiopia and carried on by any person for profit.” According to the above definition, profit is an important element that must be satisfied in order to consider a particular

³⁹ See art.18 (3) of the Regulation.

⁴⁰ See the attached schedules at the back of the Income tax Regulation.

activity as a business or trade. In addition to profit, the activity must be of commercial professional, vocational or any other activity recognized as a business by the Commercial Code of Ethiopia.

Regarding illegal activities, for obvious reasons, every thief makes a cost benefit analysis before embarking on his activity. That means, if the costs that he is going to spend in order to carry out a particular crime are much greater than the expected returns, the person will definitely not carry out the task. Therefore, one can argue that profit is an element which is installed in every illegal activity since without a profit they would not do the act. For that matter, not only that there should be a profit, in some cases, even the profit margin has to be big enough in order to merit the particular risk associated with task. If the profit element is satisfied, then, the next issue would be identifying whether the illegal activities in general are professional commercial or vocational. Criminal activity is not recognized in the Commercial Code as trade; hence, there is no need to go there as such.

Article 2(6) while defining business, has not further defined those terms like *professional commercial activity* and *vocational activity*. This, in my opinion, is a right approach as it would be impossible to provide a clear and workable definition of profession that could be applicable to all areas. I think, that is why Cogan in his earlier writings regarding profession started his work by saying '*to define profession is to invite controversy*.'⁴¹ Therefore, it is the opinion of the author that terms like professional commercial activity or vocational activity must be construed broadly and loosely. In my opinion, for any analysis of *profession*, only four from the six

⁴¹ Charles L. Stevenson, *Ethics and Language* (1944)210; Morris L. Cogan, 'The problem of defining a profession' available at <http://www.jstor.org/stable/1029845>, accessed on 11/01/2013.

criteria laid down by Flexner should be used. Accordingly, a profession is an activity⁴² requiring intellectual operations coupled with large individual responsibilities, practical application, tendency toward self-organization, and increasingly altruistic motivation.⁴³ Hence, any person including a thief, drug dealer, serial killer etc. could be considered professional as long as their work fulfills the above criteria. Accordingly, a thief or drug dealer will be no less organized than an ordinary trader or a person engaged in import or export activity albeit that requires some kind of expertise depending on the crimes to be committed. For instance, a person hired to kill must know how to operate a gun; hence, a professional in the area. Therefore, criminal activities in this regard are commercial professional activities conducted for profit, therefore, taxable according to schedule C.

The rate to be applied would, of course, be subject to the person conducting the activity. For instance, if the criminal activity is conducted by an organization, then the income would be taxed at a flat rate of 30%, and if it is conducted by an individual, it would be taxed according to the schedule provided in article 19(2) of the Income Tax Proclamation.

1. Deductible expenses

The next important issue in taxation of income from illegal activity is the availability of deductions for their ‘businesses’. In simple terms, is it possible to deduct the cost of a bullet for a hired killer as it is the cost of running his business or income? So far, as the Ethiopian tax law is concerned, the answer is a definite YES. This is because as provided in the income tax laws taxpayers are required to pay tax only from their taxable income. Therefore, as long as their income is subject to tax, they should get

⁴² Abraham Flexner, "Is Social Work a Profession?" *School and Society*, Vol. 1 (1915) 904.

⁴³ *Id.*

the same treatment with other business persons. Hence, all costs incurred for the purpose of securing the income must be deducted. In simple terms, the burglar who purchased flash light, drilling materials and rented a car in order to transport the stolen goods will have the right to get deductions for the costs incurred since all these costs are incurred in order to generate the particular income.

B. Income from illegal sources as other income

The Ethiopian tax system follows a scheduler approach whereby income from various sources shall be treated and taxed separately. As provided in the Income Tax Proclamation, incomes other than incomes from rental of buildings, employment and business shall be taxed separately, the heading of article 8(4) says '*other income including income from*' and lists down the incomes that could be taxed according to schedule D. As can be seen from the heading, the list is enumerative not exhaustive. Therefore, it is possible to levy tax on income based on schedule D when it is not possible to levy tax according to the previous schedules in as long as the individual has received an economic benefit from his activity.

Therefore, in case of income generated from illegal sources, it is quite possible to levy tax on the income based on schedule D. Nonetheless, since schedule D has not provided the rate and modes of payment for other incomes other than those stated in the Income Tax Proclamation, it would not be possible to put it into practice.

IV. Taxation of Income Vs. Confiscation of Property

Confiscation of property is one of the punishments provided under Ethiopian laws. In this regard, for instance the new Anti-Corruption

Procedure Proclamation provides for the following: *'The court shall issue a confiscation order proportionate to the property acquired by the corruption offence, where the accused is found guilty'*⁴⁴ According to this law, the criminal shall be forced to return the property acquired from the commission of the crime and the benefits derived from those properties to the government. Similar provision also exists in the Criminal Code.⁴⁵ Confiscation rules aim at preventing criminals from being able to enjoy the fruits of their crimes by depriving them of the proceeds and benefits gained from criminal conducts.

The presence of confiscation rules makes taxation of incomes from illegal activity more complicated as confiscation takes away the income and the fruits of the crime from the criminal. There are persons who argue that government must not resort to taxing income from illegal sources when it is possible to confiscate the whole amount. In my opinion, these should not be the case. Firstly, the Criminal Code and the tax law have distinct objectives. It is not the objective of the tax law to punish the criminal for his act; this is something to be taken care of by the Criminal Code.⁴⁶ In the tax law, collecting tax from individuals getting an economic benefit is the main objective, not punishment. Hence, any comparison between the tax law and confiscation is inappropriate.

Furthermore, it is a truism that confiscation rules take away properties at the hands of the taxpayer when arrested by the law enforcement authorities. Nonetheless, it cannot go back and confiscate the incomes already consumed

⁴⁴ Revised Anti-Corruption Special Procedure and Rules of Evidence Proclamation, Proclamation No. 434/2005, art.29.

⁴⁵ Proclamation 414/2004 art.98.

⁴⁶ The Ethiopian Criminal Code in addition to punishment has also other objectives. See the preamble of the Criminal Code.

by the criminal, thus, making the punishments partial. For instance, Mr. X started to lend money to people without having a license from the National Bank of Ethiopia in 2000 Ethiopian calendar. Every year, he has been profiting 10,000 from the activity. Let us further assume that he had consumed half of the income and saved only the rest. If the law enforcement authorities apprehend him after five years, out of the total 50,000 income generated from the activity, only 25,000 Birr in the hands of the criminal can be subject to confiscation of property rule, the amount consumed by the criminal before being caught would be out of the realm of the rule. Therefore, taxing income from illegal sources by collecting taxes, fines and administrative penalties from previously consumed incomes can complement the effective implementation the Criminal Code.

V. Declaration of Income Vs. The Right Against Self-Incrimination

The income tax laws require taxpayers to declare their income during the fixed time provided in the Income Tax Proclamation.⁴⁷ During the declaration income, taxpayers are required to submit the balance sheet and profit and loss account of the business for that tax year.⁴⁸

Declaration period differs from category to category. Accordingly, category “A” taxpayers are required to declare their income within 4 months from the end of the taxpayer’s *tax year*.⁴⁹ On the other hand, category “B” taxpayers

⁴⁷ See art.66 of the Income Tax Proclamation. A person who receives his income exclusively from single employer and a Schedule D taxpayers whose tax is to be paid through a withholding method are not required to personally declare their income-see art.65 and 31-37 of the Income Tax Proclamation.

⁴⁸ Id.art.66(1) .

⁴⁹ Id.art.66(1)(a).

are required to declare their income within two months from the end of the taxpayers' tax year.⁵⁰

In order to declare their income within the given period, taxpayers must first know their tax year. Only then can they declare their income either within 4 months or within 2 months of the tax year depending on the category they belong to.

Tax year is defined in article 64(2) of the Income Tax Proclamation. Accordingly, the tax year of a person is:

- a) In case of an individual or an association of individuals, the fiscal year.
- b) In case of a body, the accounting year of the body.

Hence, as provided in article 64(2) of the Income Tax Proclamation, for an individual or an association, the tax year is the fiscal year of the Country. The fiscal year as defined in article 2(15) of the Income Tax Proclamation is the budget year of the Country. The budget year starts on *Hamale* 1 and ends on *Sene* 30. Therefore, if the taxpayer is a category "A", he shall declare his income within four months from the 30th of *Sene* and within two months of this period in case of category "B" tax payers.

In case of a body, their tax year is the accounting year of the body. The accounting year of the body will be determined through their respective memorandum of association. The memorandum of association determines the beginning and the end of the accounting year. The body will declare its income within 4 months if it is category "A" and within 2 months in case of

⁵⁰ Id.art.66(1)(b)

category “B” from the end of the accounting year determined by its memorandum of association.

In case of category “C” taxpayers, they are required to make tax payment between the 7th of July and the 6th of August every year.⁵¹ These groups of taxpayers are not required to keep books and accounts. Tax assessment in case of these group taxpayers shall be made based on presumptive taxations

According to these provisions, category “A” and “B” are required to declare their income to the tax authority using declaration forms prepared by the tax authority. In the declaration form, there are only three spaces to be filled while declaring incomes of a particular taxpayer; these are local sales, export sales and service incomes.⁵² The declaration forms leave no space for incomes from illegal sources thus making declaration of income from illegal business impossible. The appropriate remedy in this case is to provide one line for miscellaneous incomes. This way, the taxpayer can easily declare his income using the declaration forms.

Taxpayers with the duty to declare their income are also duty bound to keep books and accounts and, during declaration, the books and accounts must be presented with the declaration forms to be filled by the taxpayer. In case of incomes from illegal sources they may keep books and accounts, however forcing them to surrender these books and accounts to the tax authority shall be against the constitutional provision that provides for the right of persons’ *not be compelled to make confessions or admission which could be used in*

⁵¹ Ibid.

⁵² See Income Tax declaration form for Schedule C taxpayers especially Section 3, available at the official website of the Ethiopian Revenue and Customs Authority and can be accessed using http://www.erca.gov.et/index.jsp?id=documentation&menu_id=102&menu_ch_id=0

evidence against them'.⁵³ This would make the whole point of taxing illegal income pointless. Therefore, to make the system workable, the courts should interpret the last provision of the Constitution that provides for 'Statements obtained under coercion shall not be admitted as evidence',⁵⁴ and, in the process, make all evidence gathered from the accounts kept by the person inadmissible during criminal proceedings.

VI. Taxing Crime Vs. Double Jeopardy

Many constitutions including ours extend the double jeopardy protection rules to accused persons.⁵⁵ According to this rule, accused persons cannot be tried and punished for the same offense after conviction or acquittal. By doing so, the rule protects the accused from double trial, double conviction and multiple punishments. Accordingly, many people argue that imposing tax on crimes derived from the criminal activity will amount to double jeopardy because his punishment, if it happens, takes into account the gains obtained from his criminal act.

However, one must always keep in mind that taxation is not a penalty on a any person. Tax is a contribution expected of citizens so that government can provide the necessary goods and services to citizens. In income tax, people with ability to pay are being asked to pay their fair share of contribution to the government. When a criminal is apprehended, the criminal law punishes him for the wrongful act. On the other hand, what the income tax does is simply to collect the money the criminal should have paid to the government. In income tax law, the person is not being prosecuted for the crime but he is simply being asked to make his overdue contribution to the government. As

⁵³ Constitution of FDRE, Proc.No1/1995, article 19(5).

⁵⁴ *Id.*

⁵⁵ See art.23 of the Constitution.

the principle of prohibition of double jeopardy cannot protect a negligent driver who killed a passenger from being prosecuted under criminal law for his crime and tort law at the same time, the same should be applicable to criminal prosecution and taxing crime, these two laws aim at achieving completely different objectives. Therefore, punishment for both criminal offense and taxing crime don't violate the principle of prohibition of double jeopardy because each has an element that the other does not.

VII. Judicial Practices and Taxation of Income from Illegal Sources in Ethiopia

Recently, many court cases relating to taxation of incomes from illegal sources are appearing in Ethiopia. In two famous cases, the Federal Revenue and Customs authority brought cases against individuals caught violating the law regarding illegal money lending. According to Ethiopian law, a person needs to have the permission from the National Bank of Ethiopia in order to engage in activities reserved for financial services. One of such service is lending money. Even when persons secure permission from the National Bank of Ethiopia in order to lend money, they must do so by observing the lending rates set by the National Bank. And in all the three cases, individuals were caught violating these two requirements.

In addition to the criminal punishments against these persons, the Federal Customs and Revenue Authority requested the Federal High Court for the payment of unpaid income and Value Added Tax by persons. The Authority in its pleading argued that the defendants failed to pay income tax from their activities and had requested the court for the payment of the unpaid tax and interest on those incomes. The Court, without further investigating the issue, simply ordered the defendants for the payment of the unpaid income tax and

interest on those incomes.⁵⁶ Incidentally, it is worth noting that, before this decision, the highest court of the country passed a decision on an issue directly affecting the definition of income.⁵⁷

Conclusion

Incomes from illegal sources are taxable incomes according to Ethiopian tax laws. Income from illegal sources can be subject to schedule 'C' or 'D'. To facilitate tax payment and fair contribution of their share to the production of public goods and services by the government these groups of the taxpayers must be given an opportunity to declare their income without providing self-incriminating information to public authorities. In order to enable the person declare his income, the tax declaration forms must be modified in such a manner to include the person carry out his responsibilities by reproducing additional declaration forms or even including spaces that can be used by persons who derive their income from such 'business'.

⁵⁶ In Ethiopia, it is only the decision of the Cassation Bench that has a binding authority. Hence these decisions by the high court can only be as indicators of the path being followed by the lower courts in Ethiopia. Ayele Debelu Tax Authority Appeal Sentence, Vol.10, No. 599.

⁵⁷ In a case between Ministry of Justice and six other persons, the court decided that incomes paid to individuals in the form of compensation when reduced from their work is not subject to the payment of the tax. In its reasoning the court argued that: 'after looking at articles 2(10) and 11 of the Income Tax Proclamation, it has found no ground to consider the above payments as an *income*'. [Translation mine]. See Ministry of Justice Ethiopia v Takle Garedeaw and six others, file No.65330, Vol. 11. The court, instead of concluding in general terms, should have first analyzed the definition of income as provided in article 2(10) of the income tax proclamation. As discussed above, the definition of our income is broad enough to include any payment as an income as long as the recipients of the payments derived an economic benefit from it. In this case, the recipients have received an economic benefit from their payments. Therefore, payments made to them can be considered an income for income tax purpose. In my opinion, the court has made a serious mistake by looking at other matters than the economic benefit derived by the persons.

